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The Effect of the Economic Crisis on Local Governments in OECD Countries

The domestic financial risks of the Hungarian local government sector

SUMMARY: Stabilising the financial health of local governments, as well as restructuring their financing system gained increased attention in recent years both in Hungary and abroad. This increased attention should be emphasised on account of two reasons. Firstly, the financial-economic rippling effect of the economic crisis of 2008 has impacted all the countries, and this ripple also surfaced in the local government sector through the collapse of the fragile balance of own revenues and expenditures. Secondly, significant changes have begun in the allocation of tasks and revenues between local and central government levels, and new statutes have been created with respect to government performance, the management of public procurement, the transparency of operation and government auditing. It is a fact that in recent times, the examination of the operation of the local government system has become a central issue not just in terms of resource and task allocation, but in terms of other performance aspects as well. The State Audit Office of Hungary has been treating the supporting of Hungarian local governments through audits as a priority issue since 2011, one of the main justifications of which is that in 2010, the deficit of the local government sector raised the GDP-proportionate public debt from the planned 3.9 per cent to 4.2 per cent. This could have stimulated the increase in the number of audits and recommendations, which should be considered a significant, forward-thinking result of the recent period. The aim of this study is, on the one hand, to provide an international overview of the effect of the economic crisis on local governments and how these local governments searched for the way out, and on the other, to review the reform processes launched. One of the important findings of this study is that the reform of financial management in Hungarian local governments has significant and measurable results, at the same time, however, the risks accumulated make the sustainability of results uncertain.

KEYWORDS: state and local government borrowing, intergovernmental financial relations, federalism, financial crisis
JEL CODES: H74, H77, G01

THE EFFECT OF THE CRISIS ON THE FINANCIAL SITUATION OF LOCAL GOVERNMENTS IN OECD COUNTRIES

The impact of the economic crisis on the local government level should be examined for a number of reasons:

- in developed countries, the local level is responsible for approximately 66 per cent of public investment expenditures, as well as main welfare and public service tasks;
- the fiscal stimulus activities affecting local governments – if only indirectly – are quite significant. In the US for example, 36.3 per cent of the value of the federal fiscal stimulus package launched after 2009 was connected to the sub-national level;
- at the sub-national levels, over the past 30 years the rate of budget deficit and budget balance fluctuation was lower than in

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the case of central governments, in other words, the realisation of public finance objectives related to the budget deficit was supported well by the local level.

The crisis events of the past period fundamentally changed the situation: in the time of crisis, budget deficits were greater at the sub-national level than at the central level, and the sector moved slowly towards equilibrium (OECD, 2010), in other words, on the side of public finances, it was the sector itself that represented a barrier to recovery from the crisis. The underlying reason for this is that the system of revenues differs from that of the central government, and the tasks – and their financing through transfers – are less dependent on the crisis. The fluctuation of investments is also considerable: in both developed countries as well as Hungary, the highest values are recorded in the year prior to the elections, while the lowest in the year after the elections.

Between 1995 and 2008, the expenditures of the local government level within total government expenditures increased from 31 to 33 per cent in OECD countries, while the ratio of local revenues within total government revenues grew from 16 to 17 per cent (OECD, 2012). In the recent period, the countries have shifted towards decentralisation; at the same time though there are significant underlying differences in local taxation abilities through which external changes of the environment (demographics, demand for public services, etc.), similarly to internal changes due to the transformation of the operation of the state, create new "situations of fiscal stress" from time to time. However, the OECD also calls attention to the fact that in the short-run, resource and task decentralisation reforms can be considered a zero sum game, i.e. either the sum of the effects of the other government level or another local government on the same level will be zero.

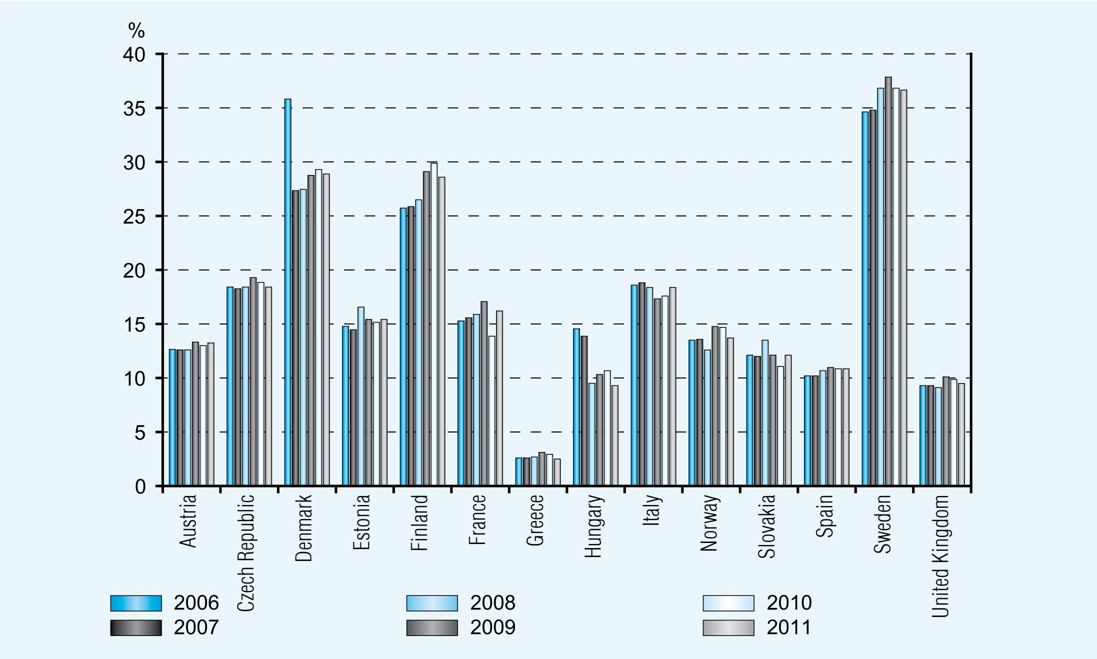
On the side of the revenue base, the economic crisis directly affected local governments, in other words, it generated a process to which all players must adapt. At the same time, in most countries the "laugh together cry together" principle was attained,[1] meaning that the change in the base of tax revenues equally affected central and local levels. Still, in a number of countries (Austria, Denmark, Finland) the ratio of local revenues within total government revenues increased, but decrease could also be observed in some cases (Hungary). Behind this seemingly positive image, however, other significant correlations may also be observed. *(See Chart 1)*

As stated by the Council of Europe in its analysis of the member states, the revenues of local governments dropped in real terms between 2008–2010, as with the GDP stagnating and dropping, the sector's revenues compared to the GDP showed minimal growth or even decrease *(see Chart 2)*. In more than half of the countries, the drop in local revenues exceeded the drop in the revenues of the central government in at least one of the years between 2008 and 2010. This latter trend was especially typical of Central and Eastern European countries. With respect to many countries (for instance Romania, Serbia, Bulgaria), we can state that real revenue decrease was realised in the form of a central withdrawal of funds as it was through this that the central government wanted to expand its fiscal leeway. This phenomenon was not restricted to just smaller countries: with a year's delay, it also surfaced in larger countries (for example France, Spain, Poland). The "strengthening" of the local level by the central government through additional transfers was only observed in a few countries (France, Czech Republic, Slovenia).

In summary, therefore, the sector's macro-level situation can be properly examined by looking at both the change of revenue sharing between government levels and the change of revenue compared to GDP. There were no clear winners of the revenue sharing between

Chart 1

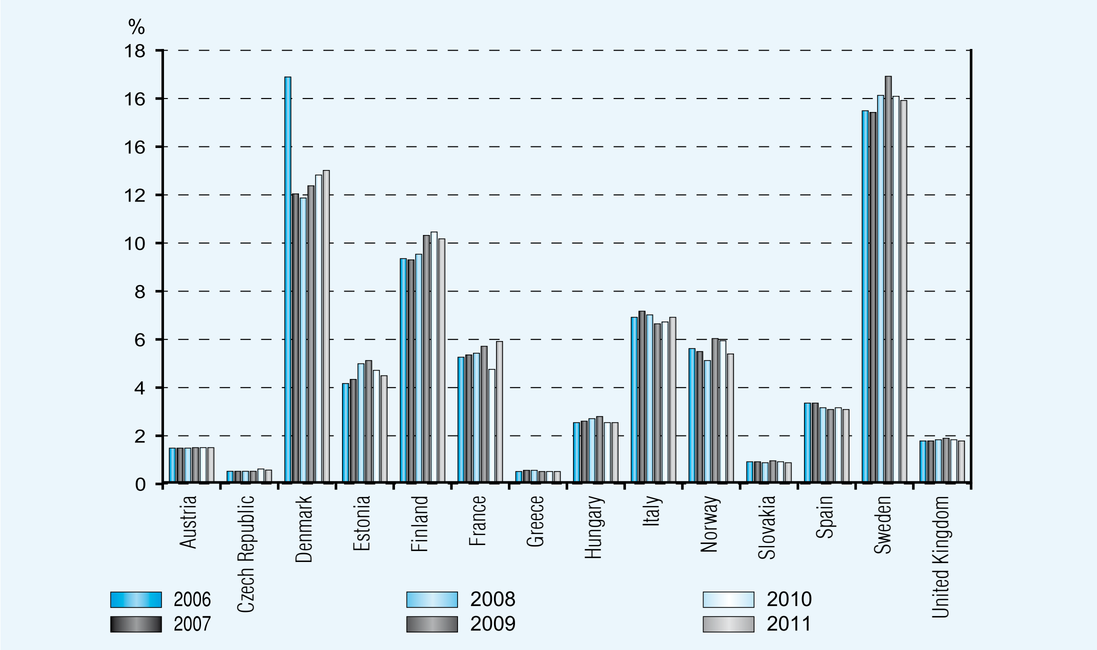
REVENUES OF THE LOCAL GOVERNMENT LEVEL AS A PERCENTAGE OF TOTAL GOVERNMENT REVENUES (2006–2011)



Source: OECD fiscal decentralisation database

Chart 2

TOTAL REVENUES OF THE LOCAL GOVERNMENT LEVEL AS A PERCENTAGE OF GDP (2006–2011)



Source: OECD fiscal decentralisation database local governments in the period after 2008 in any of the countries, the relatively better situation in some of the cases was the result of the macro-economic environment and the short and long-term goals of the central government related to the system of local governments.

The budget balance position of the local level increased drastically in 2008–2009, with deficit between 0.3–1.1 per cent of the GDP in most countries, which at the same time, started showing significant decrease as of 2010–2011. In this period, due to improving their own budgetary positions, central governments typically considered the budget deficit of the local level a secondary problem area. However, over the course of a few years, the process had changed as the quality of local public services had to be maintained, partly because serious concerns surfaced regarding the – uncontrollable – long-term indebtedness of the local level. The reason behind the decrease of budget deficits is, therefore, a number of complex government programmes, but ultimately still a simple phenomenon. *(See Chart 3)*

A significant increase in local government debt was also observed in the period under review: The debt of Austria, Denmark, Finland, Hungary, Norway, Slovakia and Spain, measured in GDP, increased by 2–3 percentage points on average, however, a varied picture may be observed in the case of the individual countries. In addition to the deterioration of the general financial situation of Latvia, Romania, Slovenia, Hungary and Slovakia, the significant increase in deficit, therefore debt as well, is also closely related to the appearance of structural support. Differences were also significant when reviewing the various years separately: local level debt increased by 9.9 and 6 per cent in 2009 and 2010 respectively in EU Member States. After the outbreak of the crisis, debts increased outstandingly in countries where the creditworthiness of local governments was previously high and borrowing was not strictly restricted. The important lesson here is that in the future, borrowing regulations should not only cover the method and rate of borrowing, but the management of insolvency as well.

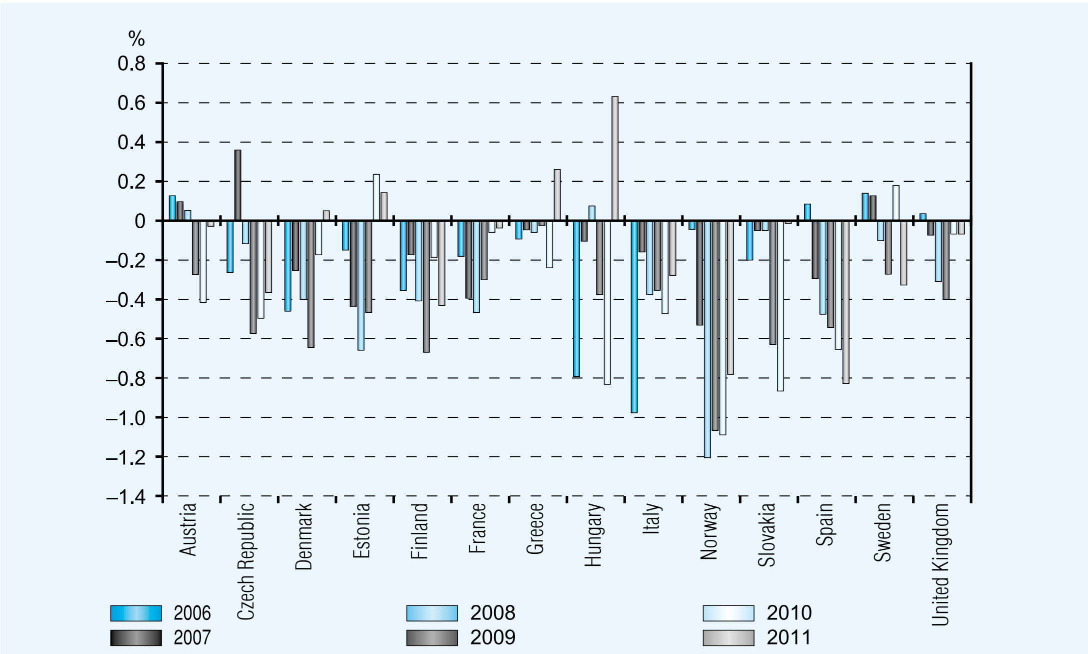
Looking at the situation from abroad, the tendencies of indebtedness of the local level are not alarming for the moment, however, in order to uncover the actual situation, the ratios of deficit and debt compared to total local government revenues must also be examined. This is where Spain stands out, as in 2008, local level debt was 170 per cent of total local revenues and more than 220 per cent in 2010. This value in Turkey was 121 and 127 per cent in 2008 and 2010 respectively, while in other EU Member States, the indicator was between 2.7 and 62 per cent. At this point, I should mention that even though local governments are very different from one another in terms of the structure of tasks and resources, in this case an outstandingly high value can be observed in the case of one particular objective indicator! *(See Chart 4)*

Following the outbreak of the crisis, positive and negative trends were established around the world. The local forms of these trends are summarised in the OECD survey which covered 41 towns[2] *(see Table 1)*.

The OECD research was directed at examining the regional locations and sectoral characteristics of settlements. Nevertheless, the survey was only able to uncover that settlements with strong economic connections abroad or outside the region could hope for faster recovery from the crisis and that prospects for recovery may be improved by the varied composition of the local society in terms of age and culture, which at the same time, may prove to be a source of further conflicts in certain labour market situations. The study determines that local governments must take on an active role in stimulating the economy – for instance through strategic plan-

Chart 3

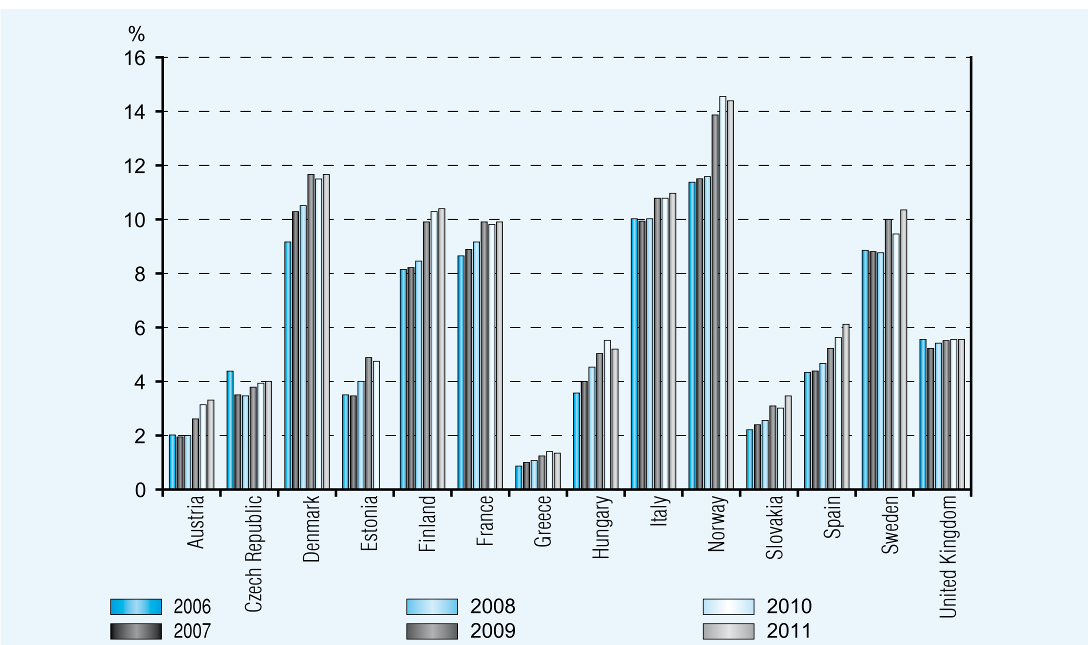
BUDGETARY POSITION OF THE LOCAL GOVERNMENT LEVEL AS A PERCENTAGE OF GDP (2006–2011)



Source: OECD fiscal decentralisation database

Chart 4

THE DEBT OF THE LOCAL GOVERNMENT LEVEL AS A PERCENTAGE OF GDP (2006–2011)



Source: OECD fiscal decentralisation database

Table 1

LOCAL TENDENCIES ESTABLISHED IN 41 LARGER CITIES IN DEVELOPED COUNTRIES AFTER THE ECONOMIC CRISIS

Positive trends	Negative trends
• employment on the labour market increased in the financial, IT, healthcare and higher education sectors, particularly among qualified employees, in the other sectors, however, stagnation or decrease was observed;	• of the 41 towns surveyed, the increase of local unemployment was not a priority problem in only 12. This was a greater problem than the increase in benefits and crime;
• the rise of tourism and trade in the towns examined stands out among the local positive economic effects,	• the decline of local economy: the problem observed could extend from tourism through the deterioration of financing opportunities to the decline in consumer confidence;
• with the exception of 11 towns, all shifted towards innovation and the generation and utilisation of green energy;	• the depreciation of the town due to the fall in real estate prices, investments, etc.
• in certain towns, new types of cooperation between the local private and public sectors were established.	• the deterioration of the outlooks of long-term strategic objectives;
	• local governance: budgetary problems, barriers, increase in internal tensions.

Source: OECD, 2009 and author's own opinion

ning, tourism promotion, encouragement of innovation –, however, this still only provides hope for recovery in the case of larger settlements, while the situation of smaller towns is determined by the results of other, more complex activities, which will remain an area to study even after the crisis.

The OECD survey also pointed out that in larger settlements and regions, the crisis arrives and ends sooner; while in the case of medium-sized and small settlements, it arrives late and is prolonged in time and as a result direct effects are significantly more difficult to determine.

THE MANAGEMENT OF THE ECONOMIC CRISIS AT THE LOCAL GOVERNMENTS OF DEVELOPED COUNTRIES

In 2011, the Council of Europe conducted a survey of the Member State measures taken by local governments in relation to the economic crisis, which, in addition to the management of the budget deficit, also collected expenditure restrictions and other incentive measures. In 8 of the 19 countries surveyed, financing pressure was alleviated with additional transfers (e.g. Denmark), in 11 countries, however, local levels were allowed a greater rate of indebtedness (e.g. Finland, Spain).

The measures taken in response to the crisis were basically heterogeneous:

- *pro-cyclical management:* decrease of expenditures, especially investments; increasing revenues (Finland, France, Slovakia, Sweden, United Kingdom, USA),
- *passive behaviour* (use of automatic stabilisers): where local autonomy is missing (for example Korea, Australia, Denmark),
- *anti-cyclical management:* decreasing taxes, increasing investments (Austria, Belgium, Canada, Germany, Norway, Spain, Switzerland).

In developed countries, logically central grants were increased in order for local governments to maintain or even increase certain activities. In most countries, the stimulus measures concerning local governments were for the most part connected to investment activity. In Spain, 72 per cent of the total state stimulus package was directed at facilitating local government investments, while these local governments received only 1 per cent additional funds for current operations. The increase in transfers for local government investments was 29 per cent in Germany, 27 per cent in France, 22 per cent in Portugal and 30 per cent in Norway.

According to public finance literature, the risk transfers run is that local governments will use them to actually decrease their own investments, allowing more space for additional central funds. Solutions were also created to limit local expenditure reducing effects.

- In Australia, the pre-planned investments of federal states could not be reduced. In certain cases, the stipulation of co-financing can also result in maintaining the local level of investment activity (see Canada, Germany).
- In France, the maintenance or increase of the level of investment was made a condition of the preliminary transfer of grants.
- It was established practice to accelerate the implementation of already contracted investments with additional central transfers, which allowed the sector to get additional funds. In case of tenders, the evaluation process was also accelerated.

Of course, significant reforms were also made in relation to the general operation of local governments:

- expanding borrowing, making guarantee opportunities available,
- the temporary increase in the ratio of shared revenues (e.g. Finland: ratio of corporate income tax increased from 22 to 33 per cent between 2009–2011),
- ensuring the equilibrium of the operating budget through central transfers,
- central support and funding of local priority projects.

It is a fact that measures taken in response to the crisis are wide ranging, however, there are a number of general observations we can make in connection with these measures:

- larger settlements can recover from the crisis faster and with more impressive programmes as they have advantages over other settlements in terms of international relations or access to funds and resources,
- the heterogeneity and size of the local economy and the size of the non-productive sector greatly impacts the probability of the deepening of the crisis,
- recovery is helped along greatly if there is a central aspect or guiding principle which drives the financial management of the local governments in the same direction, such as the central regulation of borrowing or the incentivisation and acceleration of investment activity.

Today, the effectiveness of government measures taken since the outbreak of the economic crisis also depends on whether the government spots the risks of the operation of local governments, whether it is able to give appropriate responses to said risks or whether the results achieved will be set back by precisely these factors. Ever since the outbreak of the economic crisis in 2008, experts have been dealing with the risks of the operation of local governments from both scientific and business aspects.

Since 2005, the OECD has been preparing so-called fiscal rule indicators[3], which provide a composite assessment of Member State regulations along the following dimensions: limiting sector size through constraining expenditure growth, assuring allocative efficiency, achieving debt and deficit sustainability and dealing with economic shocks. The fiscal rule indicators serve as tools of synthesising several rules affecting the budget of local governments, as in some cases, national rules regarding the limitation on borrowing, tax autonomy and restricting expenditures are complemented by material conditions in certain countries, the aggregate effect of which should be examined. The background of these indicators has been created based on the principles of fiscal federalism, the essence of which is illustrated in *Chart 5.*

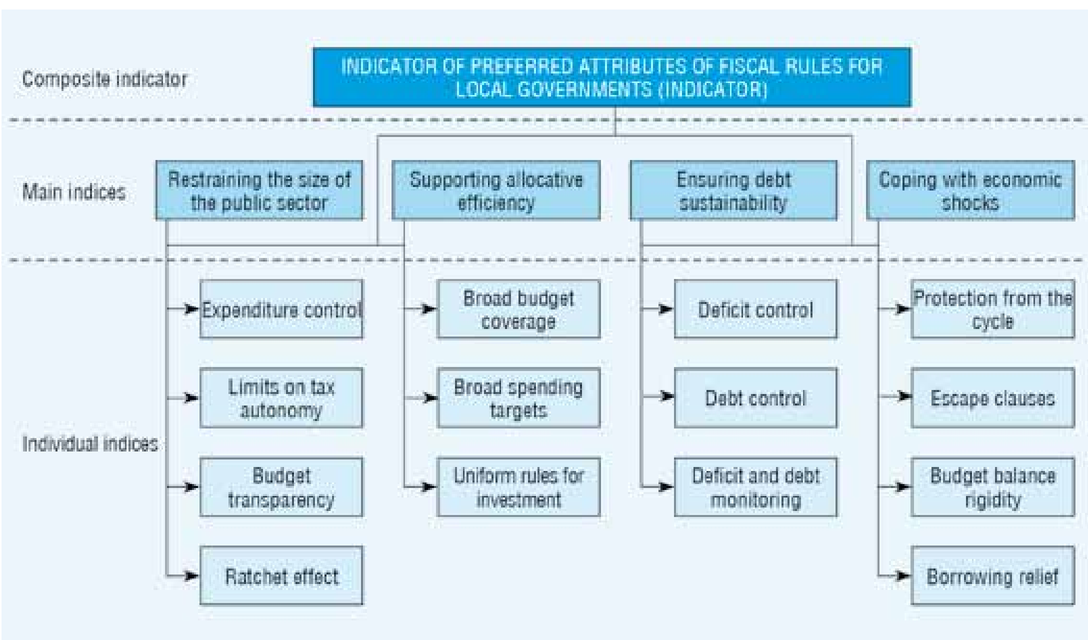
The wide-scale analysis regarding the restriction of expenditures goes beyond the framework of the present study, and includes the limits on tax autonomy, transparency, coordination problems between local and central levels, inefficient task performance as an institutional condition and the Leviathan effect, according to which politicians increase government spending just in time to improve their potential re-election chances. One of the embodiments of this is the ratchet effect, according to which during an economic crisis, local politicians react to the decrease in the tax revenue base by raising tax rates in order to increase expenditures.

One of the most important arguments for fiscal decentralisation in public finance literature is that by creating competition with respect to public services, it improves allocation efficiency (see the theories of Tiebout and Oates). Therefore, the instrument of improving allocation efficiency is the broad spending target, which is also featured among the fiscal rule indicators. The rules related to investments are examined by the OECD due to preferential motives as every country has individual investment programmes supporting the development of small settlements.

The budget deficit and debt of the local government level should also be monitored on a continuous basis as they may impact interest rates as well as the money market perception of the entire government level, even if the debt of the local government level is considerably lower than that of the govern-

Chart 5

STRUCTURE OF THE OECD SYNTHETIC FISCAL RULE INDICATOR



Source: OECD, 2011, p. 4

ment level! Finally, we must also mention that the separation of central government responsibility from local government level debt is still unclear in certain countries, as a result of which the OECD continues to examine the interests of the local government level regarding sustainable debt policy.

The indices of resistance to economic shocks can mostly be interpreted in federal countries, where the final impact of various government levels on the local level is studied. It must also be noted that despite the economic crisis, certain countries do have built-in stabilisers and exemption conditions helping local governments, at the same time, however, we must also examine how the measures of the various government levels impact each other. With respect to the latter, the OECD study brings the example of the 2010 empirical study by *Rodden* and *Wibbels*, which showed that the introduction of higher level fiscal rules did not improve, and in fact deepened the local crisis in the US.

It is clear, therefore, that the methodology developed by the OECD is based on indicators that examine and assess the impacts of various Member State fiscal rules separately. It is, therefore, conceivable that the local government system of a given member state which received higher values for allocation efficiency at the same time gets a weaker rating for debt sustainability or perhaps resistance to economic shocks.

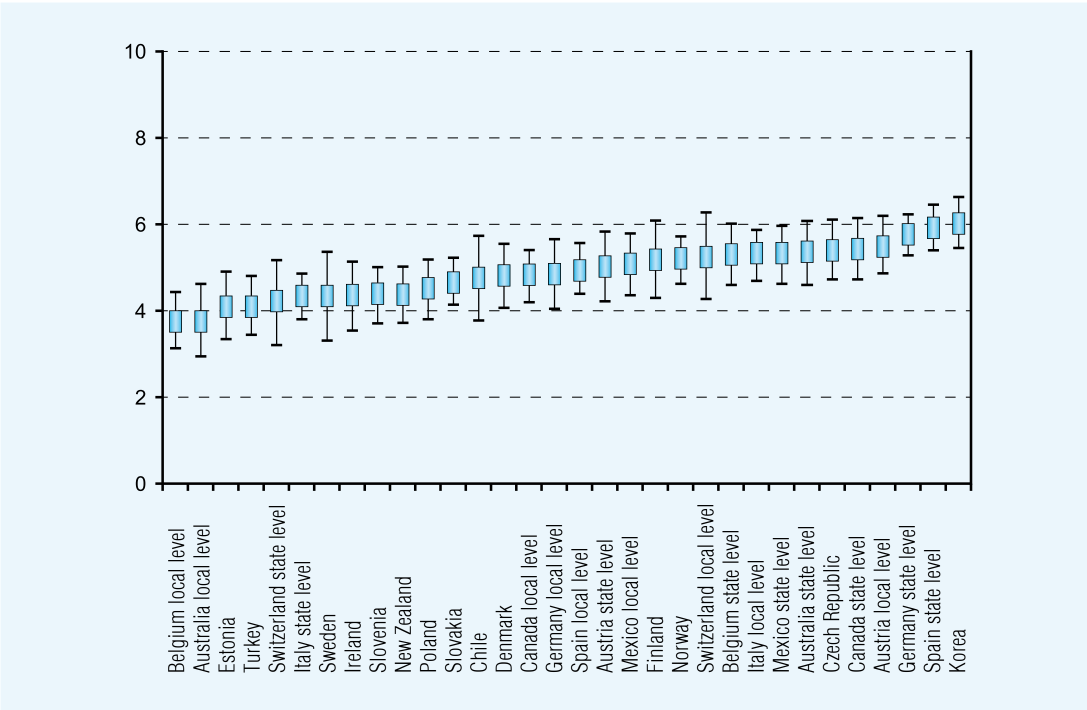
Though the OECD only prepared the composite indicator for two years, 2005 and 2011, the impact of the economic crisis on government approach is noticeable. In the period under review, none of the countries managed to efficiently control the increase of the local government level, in other words, the widening and deepening of local needs contributed to the sector increasing. Slight deterioration was observed in improving allocative efficiency at the local level in several countries (Finland, Poland, Austria), but there are also some countries that have managed to improve (Norway, Czech Republic, Spain, Germany). Examining the measures taken with respect to sustaining the budget deficit and public debt, considerable deterioration was observed in the Czech Republic and the Netherlands, however, improvement was recorded in Finland, Germany, Norway and Spain. Finally, the last composite indicator of the OECD, the indicator of the ability to cope with economic shocks showed deterioration in all countries, especially in Estonia, Poland, Slovenia and Spain, where the values calculated were close to minimal. *(See Chart 6)*

THE FINANCIAL SITUATION OF HUNGARIAN LOCAL GOVERNMENTS AFTER 2008

The situation of Hungarian local governments after 2007 began to deteriorate considerably in the financial sense. In addition to significant foreign currency indebtedness, the prolonged reform of the financial system as well as the additional tasks and developments taken on by local governments tied up capacities that seriously endangered the survival of the sector. The State Audit Office of Hungary presented and analysed the processes launched in detail, according to which processes a unique financial management approach spread throughout the sector and which will most probably have further negative effects down the line. The outstanding amount taken out in loans will shackle several settlements and not just temporarily, but also in the long-term due to long loan terms and repayments (Aczél et al., 2011). It is a fact that for local governments at the end of their load-bearing capacity, debt assumption or the assumption of the maintenance of institutions is a significant result, but the effects of these will only be temporary, i.e. further substantial reforms and long-term 'fine-tuning' will be required.

Chart 6

DEVELOPMENT OF THE SYNTHETIC FISCAL RULE INDICATOR OF OECD COUNTRIES IN 2011



Source: OECD, 2011, p. 10

The debt of local governments – for the most part denominated in foreign currency – increased dynamically after the outbreak of the economic crisis. In this respect, the bail-out of settlements came too late: the scale of the problem was pointed out in several studies by the SAO, which between 2007 and 2010 – among other things – analysed the current and accumulation activities of Budapest, the counties, towns with county rank and town local governments with the CLF method. In the period under review, the accumulated current budget surplus calculated for these settlements is HUF 599 billion[4], while the balance of the capital budget was a deficit of HUF 902 billion, and the resulting accumulated GFS balance showed a deficit of HUF 303 billion.[5] Projected to revenues, therefore, the deficit came to a total of 3.25 per cent, for which HUF 420 billion – of external funds – were available as actual funding. The true problem, however, in our opinion is that significant fluctuations-changes came about in recent years with respect to revenues, in other words, the opportunities of acquiring additional funds have either dried up or depend on external factors. The 2013 restructuring of the system of state subsidies based on fundamentally different concepts also carries veritable risks, just as the stabilisation of the system of normative financing also took several years.

An interesting phenomenon was outlined in relation to the development of non-personnel costs. The questionnaire survey (Vigvári, 2009) conducted in the summer of 2008 by the RIH-SAO pointed out that on the one hand, the rate of financial risks may vary according to settlement type, and on the other, certain atypical financial management forms were observed (e.g. delayed invoicing, formal order and performance of services), while the payment of personnel payments and bank costs, bank fees and loan repayments was in order according to feedback. In 2012, the SAO pointed out that trade payables increased very dynamically after 2007 at the settlements examined: By 2010, the value of debt increased by 24 per cent, while the value of overdue trade payables grew by 69 per cent (Domokos, 2012a). In 2010, total trade payables amounted to close to double average of monthly non-personnel expenses, while overdue debts were equivalent to 83 per cent (Domokos, 2012b).

THE MAIN FINDINGS OF THE STATE AUDIT OFFICE REGARDING THE SITUATION OF LOCAL GOVERNMENTS

After 2008, several sections of the statutes stipulating the auditing of local governments were amended in Hungary. On the one hand, more emphasis was placed on the auditing of the structure and operation of internal control systems, which was meant to review corruption-free operation and the achievement of organisational objectives, and on the other, pilot audits were conducted among local governments deemed most vulnerable to financial risks. The audits that were initially directed at towns with county rank and towns were expanded by the State Audit Office this year to cover villages as well. As of 2011, the SAO audits of business associations owned by local governments commenced something the statutes did not allow previously. Presumably, these audits will commence at larger business associations. Though these audits and the methods applied are forward-thinking, a few 'grey areas' should be mentioned.

▸The hidden debt of the local government sector resulting from wear and tear and delaying of replacements is considerable. The financing system continues to be unable to manage amortisation costs, but at the same time, the overall picture with regards to replacement, preservation and renovation investment needs for the next period is unclear. According to the State Audit Office, the development-accumulation activity may be considered a significant risk, given the uncertainty of the composition of funds for investments launched, as well as the loss of own funds and the risks arising from local business tax vulnerability. The question is whether the collateral for loans taken out is ensured or not and how local governments will be able to come up with the pre-financing required for EU tenders.

▸The situation of companies, operating under local government ownership is unknown, and in many cases there is probably interdependency towards the local government which owns the given firm. The financial situation of local governments and their business associations (off budget sector) should be presented in a uniform, standard and consolidated manner. As the situation of a Csongrád county settlement (with a population above 5,000) pointed out, the rate of debt that is considerable compared to the budget (between 100–200 per cent compared to the annual total expenditure) can be increased even further by a guarantee provided to the business association. We have already seen precedents that local governments launch investments despite the lack of ability to finance investment costs.

In my opinion – though we should also follow the directions taken by OECD countries during the management of the crisis, in other words increase the transparency of local financial management – we should strive to establish partnerships in providing public services, as well as create programmes to revive local economies, however, in light of these circumstances, the risks of the operation of the sector must also be reviewed. In order to do this, appropriate programmes are needed at both central and local level. The situation of the sector is summed up in Table 2, which also takes the findings of the relevant literature into account.

SUMMARY

The local government systems of developed countries were hit hard by the 2008 economic crisis in terms of both revenues and expendi-

Table 2

THE SWOT ANALYSIS OF THE HUNGARIAN LOCAL GOVERNMENT SYSTEM IN 2013

S = Strengths • the sector is not indebted, • the statutory reinforcement of the separation of mandatory and voluntary tasks makes financial management more stable, • the local governments 'were socialised' under strong fiscal and market pressure, a certain 'immunity' was attained, • financial management is relatively responsible and well-balanced compared to the central government, • the reasonable regulation and tightening of the conditions of additional grants (e.g. the limiting of voluntary tasks).	**O = Opportunities** • -the further development of legal regulation could become an integral process, • the EU accession created a motivation for fund-raising that is pointing in the direction of ending fragmentation, • the professional knowledge required to establish the appropriate institutions is available, • household or perhaps even corporate savings available for use to local governments may be increased with appropriate preferences, • the need to utilise local revenues will increase, which in turn could make the sector more appealing for creditors (limited opportunity), • one-off debt consolidation allows for the rationalisation of financial management, • the strengthening of the control over local borrowing is more forward-thinking, and could lead to better planned borrowing, • successful transition to accrual-based accounting could have considerable information value.
W = Weaknesses • no development of planning and control mechanisms, • the unpredictability of central fund regulation and the sharp decrease in normativity (see ÖNHIKI (subsidies for local governments with financial problems through no fault of their own)) could decrease the sector's creditworthiness, • the fragmentation of the sector does not allow for the optimisation of the costs of fund-raising (e.g. economy of scale of bond issue), • rating is practically unknown in the sector, • the accumulation of debt has commenced at companies owned by local governments, • the long-term sustainability of loan repayments is not supported by either the statutes, or management tools.	**T = Threats** • the market-based control of indebtedness holds risks down the line, • local governments are unable to manage the effects of statutory changes related to task and resource allocation, • indebtedness in foreign currency could represent a significant burden for a long time, • the insufficient level of private capital raised could result in a net contributor position against the EU's common budget, • the depletion and amortisation of assets endangers task performance, • the country's risk rating could make local government borrowing more expensive, • as a result of the subsequent financing of EU projects, liquidity needs and risk have increased.

tures, while internal structures were faced with great tensions. The states launched significant fiscal stimulus programmes that local governments were part of. All in all, deteriorating tendencies were observed in Hungary after 2008 in terms of budget deficit and indebtedness. The changes of the legal framework are attempting to handle the situation, but since the sharing of tasks between government levels is in essence being placed on a wholly new foundation, thus changing the roles related to the maintenance of institutions, the reform process itself also holds elements of risk. In Hungary, the local government sector hides great debts and risks, which should be viewed as a warning sign for the future. At the same time, it is a positive sign that settlements are seeing increasingly clearly with respect to the financial-assets risks of their operation. Liquidity plans and the liquidity positions of local governments are now discussed in representative councils. At the same time, we should also mention that for the moment, information from pilot surveys are only available regarding larger settlements or settlements with wider investment portfolios and greater debt, but the analysis of the financial situation will soon become required for all other settlements as well.

It is my view that the assumption of local government debt has great significance – not in itself, but in the broader sense – as it is part of the process during which the government is attempting to restructure the task and resource allocation system in a complex manner. Along with several other elements featured in the Act on the Local Governments of Hungary – e.g. task-based financing, striving to establish partnerships in the provision of public services, strengthening the rules of borrowing –, debt assumption is also a starting point for comprehensive change, which indicates that the system must be renewed as a whole, and not just in terms of certain elements. In view of the sector's situation, the system may arrive at its new form as a result of a learning and changing process that could take several years.

Notes

[1] During the crisis, beyond the drop in revenues, local governments also had to take loss of assets into account, while in the case of developed countries, the loss of assets or loss of value of local government investments. In general, it could be said that the drop in revenues was greater in places where local taxes were directly related to local businesses and local economic activity, compared to places where real estate was taxed.

[2] Though the survey results are insufficient to draw deeper conclusions regarding local government systems, we feel it is important to demonstrate how vulnerable smaller settlements and regions are to macro-economic processes.

[3] Fiscal rule indicators: an assessment system developed to support the work of economic policy decision makers, made up 14 individual indicators, the 4 composite indicators established on the basis of these and a "synthetic fiscal rule indicator" aggregating all the indicators.

[4] With respect to the whole of the local government sector, only annual data are available on the balance of the operating budget, according to which, while annual surplus in 2007 was HUF 172 billion, it dropped to only HUF 76 billion by 2010, which at the level of various settlements means increasingly less surplus!

[5] In the same period, the amount of current revenues was HUF 8,392 billion, while the amount of capital revenues was HUF 925 billion.

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