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Public Debt and State Property

SUMMARY: The author analyses the possibilities of substitution between state debt management and state property. He postulates that there are possibilities for substitution over a 2–4-year time span. In the short run, debt can be decreased by spending less on the refurbishment of physical assets, but this could have a boomerang effect later. The author proposes the obligation to draw up a balance sheet for the assets of municipalities as well as for those of the central government.

The enterprises listed in the Hungarian Act on Property are categorised according to their share of the state property. A new category of key national assets is proposed. This could be a safeguard against over-ambitious privatisation. For key national assets, due renovation should be a requirement, even if they are in private ownership. The author proposes the conclusion of strategic contracts between the state and managers of national property. In the 10 new EU Member States, projects involving at least two countries should be implemented and operated in a joint effort. The ownership of assets by larger regions, and the joint management of such assets could be a model to be followed by other members of the EU.

KEYWORDS: transportation and utilities – general, privatisation, public enterprises, national budget – debt

JEL CODES: L90, L33, L32, H63

The financial problems arising from soaring public debt have highlighted the fact that excessive indebtedness leads to the devaluation of the country as a whole and causes its assets to diminish. At the level of individual entities, accountability is important, e.g. an examination of whether or not certain assets have been privatised under disadvantageous terms. Additionally, a third aspect of asset management concerns whether stakeholders have taken good care of the property entrusted to them.

PUBLIC FINANCING, WITH PROPERTY IN MIND

An analysis of the relationship between state management and public financing suggests that

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over the span of 2 to 4 years, the upkeep of property and government debt may substitute each other to a certain degree. If, owing to the repayment of debt, less is spent on the maintenance and refurbishment of assets than necessary, the level indebtedness may be reduced in the short term. However, this will take its toll later on if the specific cost of refurbishment or of replacing old capacities becomes higher. For example, in the case of the road network, repairs and slow traffic caused by potholes may lead to major losses and additional expenditures.

If state property is small in terms of real needs, this may result in life becoming relatively expensive. This may take the form of damage from floods because dikes are not strong enough, or of strategic energy assets being held by foreign entities, which charge consumers relatively high fees which may also include royalties.

The importance of financing investments is represented for instance in German regulations on public financing. The limit on deficit may be exceeded if major government investments are or have been implemented in the period concerned.

Although a vast majority of municipalities keep records on the assets which they own or manage, generally there is no statement on the assets available for individual public duties, or whether the condition of such assets allow the given duty to be discharged (Halmosi, 2010, p. 104.). It would be desirable that explicit reporting were required on the state of repair of key assets, any refurbishment backlogs, etc.

To use the example of roads again: when the wearing course (the upper 6–10 cm layer of the asphalt pavement) was last replaced, and what percentage of roads are considered more or less potholed.

Today, community financing is dominated by two components. One is the financing of wages, and the other is that of current non-personnel expenses. Compared to these, a subordinate role is given to refurbishment and investment into the replacement of assets managed or owned. In government, it is a 4–5 decade-old tradition for the state (budget, social security), or the municipality to which it allocates funds, to provide wages and the minimum required non-personnel conditions on the basis of so-called base financing. By doing so, it avoids having to argue about the grounds for minor items such as the amount of wages for individual employees, why wage appropriations were not increased, etc. However, through other channels, the owner or the government authority allocates funds for refurbishment or investment to be carried out. In the course of such allocation, they too can exercise their power and implement their ideas

directly when announcing tenders and receiving and assessing applications.

The weakness of these arrangements is that only a minimum of funds is provided systematically for refurbishment. In many cases, the completion of refurbishment that has been long overdue depends on ad-hoc factors. Institutions discharging public duties do not use depreciation that could be a kind of guarantee for the regular replacement and major refurbishment of fixed assets. In technical terms, it would be appropriate to have an automatism in place to provide a significantly greater amount of funds than today for investment into refurbishment and replacement. It is another issue that the utilisation of such funds should be adequately supervised, even under the system currently applied in this field.

Therefore, consideration should be given to introducing a state-level requirement to draw up a balance sheet for the property and individual assets which are managed by the central government. Certainly, such a balance sheet requires years of meticulous work from the entities concerned. This can provide a substantive contribution to the adequate assessment of the situation if it is accompanied every 3 to 4 years by reporting on the conditions of the property managed or owned. This should not be an inventory, as it is not an accountant's task, nor is it real estate appraisal. The key question with managing entrusted property is whether available capacity is sufficient for the duties at hand. Another question is what state of repair the property is in and what refurbishment work is due to be carried out on it.

In terms of the relationship between income and assets, a certain analogy can be drawn between individuals and the state. With personal income taxation, the point is made from time to time that technical aspects would justify asset declarations to be made at specific intervals such as every 3 to 5 years. From a technical perspective, information on enrichment is

required to develop a full understanding of the actual level of incomes. Similarly, at the level of the state and the field of individual duties, realistic evaluation requires knowledge of property in addition to current expenditures. That knowledge allows exploring, for example, whether spending in excess of incomes was made possible by exhausting property.

STATUTORY PROTECTION FOR KEY NATIONAL ASSETS

Since 1992, the central element of the State Property Act has been to determine which companies have 100 percent, 51 percent or 25 percent of the stake held by the state. A lower rank on that scale allows them to be privatised either in part or in full.

There are a number of known irregularities in the privatisation of utility companies and entities providing public services. Therefore, stronger safeguards against such intentions need to be incorporated into the system. One of these could be for the definition of key national assets to include a certain group of individual assets in addition to companies. Classification criteria could include strategic importance (e.g. energy, IT), an important role in the provision of public services, etc. In the energy industry, for example, possible key assets could include plants of fundamental importance, electricity grids, natural gas storage caverns and backbone, major ports and logistics centres. This group could include key elements of infrastructure networks such as international railway lines and major motorways.

With assets classified as key national assets whose physical properties are defined, it would be appropriate to require upkeep that is adequate for the condition of the assets so that they are permanently suitable for the duty concerned. It should be considered whether reporting should be required at specific intervals, such

as every 3 to 4 years, on the upkeep of property and its use for the intended purpose.

The most important rule of managing key assets could be the principle of proprietary solicitude. Where a given asset is state property, efforts should be made to maintain that position. Even if the company managing it were to become eligible for privatisation through reclassification, the asset used by it would remain state property. Additionally, it should be monitored whether the fees charged for certain services in the course of managing such publicly owned assets are unreasonably high (see, for example, the so-called management agreement between the Budapest Waterworks and a foreign counterparty resulting in expenditures worth HUF 2 billion).

Key assets could also include property not owned by the state; indeed, efforts for nationalisation should not be needed with all assets. Not only because adequate funds are currently lacking, but also because rather than property, the central element of the system would be a direct requirement for careful management of the asset concerned, and periodic reporting on such management.

It is also important to set priorities correctly. If, for example, the task is to construct a major motorway section in good quality and at low cost, then the persons in charge of the investment should be praised for refusing ideas on unnecessary valley bridge construction or tunnel boring and for constructing motorways at costs as low as those in Croatia even if the main contractor of a toll gate is in material default with a payment of HUF 10–20 million to subcontractors that carried out their work properly.

A DEMAND FOR STRATEGIC CONTRACTS

It would be expedient for the state and companies managing key national assets to enter into strategic contracts for several years. The

main provisions in such contracts could include:

- appropriate upkeep of property to ensure uninterrupted provision of the service concerned;
- implementation of major development projects considered mutually desirable for the satisfaction of real needs;
- cooperation in research and development;
- adequate university education, alignment of vocational training with needs.

Cooperation would not be concerned with daily issues of financial management, as such issues are driven by market processes.

Strategic contracts are needed in gas and electricity supply, as well as with railways and motorway managers. The parties with which to conclude such contracts would partly be determined by who manages key national assets. Such parties could include MVM, MOL, MÁV, GYSEV, Bábolna, etc., but also certain other companies for their mere size even if they do not hold key national assets. Richter, or even MAL, for its role in the economy of its region, are potential candidates. There are examples of such strategic contracts in other countries as well. In France, for instance, the state and EDF cooperate under such a contract.

The effectiveness of strategic contracts could be improved by the establishment of a planning system for the national economy spanning 3 to 5 years (Báger, 2010), which would initially involve indicative plans, but later on, in fields requiring long-term commitment such as most infrastructural networks and energy, even stronger powers.

REGIONAL ASSETS AND OWNERSHIP

One of the problems of the EU is that owing to its annual budget of EUR 140 billion, amounting to one percent of GDP, it fails to exert a strong influence on economic processes either

in terms of revenues, or of expenditures. That is why it is forced to establish stringent rules in an attempt to encourage Member States to engage in concerted action. Yet, there are areas which could be subject to EU action, where existing property could be operated much more efficiently and better service could be provided from less money through joint efforts. Previously, common agricultural policy was, and in part still is, such a joint task. Other examples could include the establishment and operation of major infrastructural networks.

The above apply in particular to smaller countries. As a result of free movement across borders, companies today design their operations and select establishments on the assumption of that freedom. Consequently, when constructing or modernising a section of a motorway or railway line 50–80 kilometres from the border, the needs of neighbouring countries rather than those of a single country should be taken into account as a priority. The routes for forwarding fuels supplied from external sources, such as by sea and pipelines, and the capacity of those routes should also be designed to enable the provision of supplies to several countries or districts within larger regions.

This applies in particular to neighbouring countries comprising the new Member States of EU 10. One reason is that the countries concerned, excepting Poland, are smaller in terms of territory and some have no sea access, and the transportation and energy transmission networks have not yet been created in adequate density to connect these countries. On the other hand, as attested to by the past 70 to 80 years, most cross-border connections of a sufficient extent were or are being constructed in a single relation. This could lead to dependency in terms of energy, transportation, economy, and in many ways, culture as well. Previously priorities were forced to be set towards the east, meaning exclusive relations in certain cases. Apparently, connections are first estab-

lished with the west today. By doing so, the countries concerned could, for one or even two decades, deny themselves the opportunities and safe supplies which could be provided through the establishment of intensive energy, transportation and other connections among themselves.

A solution to that could be for the countries concerned to make joint efforts for the construction of most facilities of importance to several countries, and to operate such facilities jointly. With what assets could this be an option? Primarily, core energy networks, key international railway lines, the core motorway network and major ports such as the LNG terminal could be considered. A common fleet of rolling stock could also be established to replace the current practice of time-consuming engine changes at borders. Additionally, consideration should be given to the joint ownership of major aerodromes, or at least to strategic cooperation in determining the location and content of major airport developments.

In the 10 new Member States of the EU, there is no room for 10 large aerodromes. The Budapest Airport, for example, is the large aerodrome for a region of 25–35 million inhabitants that passengers wishing to travel greater distances are recommended to reach by smaller planes, train, or car.

This could lead to the countries concerned jointly raising and allocating some of the funds required for the discharge of strategic companies. For example, a third or a half of revenues from taxes levied on fuels could be pooled to finance railway development that involves less environmental pollution on the one hand, and to join efforts to construct their motorway network on the other. In doing so, an equal role should be given to connections in west-east relations to those in the north-south relations (i.e. among one another).

In that process, care might also be taken to ensuring that eastern neighbours of the EU could only have access to EU funds if, in the zone spanning 200 to 300 km from the border, they too collect at least a half or two-thirds of the minimum excise duty applied across the EU. That serves to prevent extensive fuel smuggling.

With new projects, it is generally expedient to apply the principle of joint ownership. In many cases, however, responsible management of a particular asset could be the result of transferring into joint ownership the entire capacity concerned.

For example, it is obvious that the sections situated 30 to 40 km from the two borders along the future Warsaw–Košice–Miskolc motorway should be implemented and operated jointly. Real efficiency, also in the long term, could be achieved through joint ownership of the entire section between Miskolc and Warsaw by the region concerned, comprised of three countries in this case.

Regional ownership could yield the following benefits:

- design and implementation of core network developments long overdue;
- reinforcement of mutual relations;
- establishment of capacities to meet real needs;
- better exploitation of Hungary's geographical position;
- real competition among companies developing infrastructural networks (e.g. in the case of constructing motorways, railways, tunnels and bridges).

In connection with its analysis of PPP projects, the NAO of the UK found (NAO, 1999, p. 31) that a vast majority of irregularities were a result of the fact that few companies possessed the technical competence required for the manage-

ment of major construction projects. As a result, priority was given to introducing the criteria of market development in tendering for national investment projects and awarding contracts. That involves facilitating the establishment of medium or large construction enterprises oriented towards national orders, which compete with one another and have completed projects of a dimension or complexity that may be used as appropriate reference allowing them to take charge of the management of medium or large national investment projects.

Regional ownership and joint management could also serve as an example to the EU as a whole. If that approach were to be taken by the EU, it could have more control over economic and financial processes, which requires the joint operation of capacities and disposal of 3 to 4 percent of the GDP. Additionally, energy security would be far greater than today, and the preference for railway transport would be more than just words.

Companies in Eastern Europe, including Hungary, have inherited capital shortage from the past. Owing to the Marshall Plan after the war, companies in Western Europe were able to recover. By contrast, on the near side of the Yalta line, planned economies prevented the corporate sector from the substantive accumulation of capital. To make their dependency complete, they were put on a very short lead in financial terms. Despite the fixed assets they may have acquired using national investment funds, there was typically an acute shortage of working capital: companies could only pay wages and purchase materials against working capital loans granted one or two days before by centrally managed banks. Capital shortage further increased in the early 1990s, causing a majority of companies to suffer significant losses in assets owing to reduced demand and to inflation rates in the aftermath of the collapse of Comecon. Companies with an appetite for capital injections were attracted by the opportunity to reduce debt through privatisation.

Table 1

ELECTRICITY, GAS, DISTRICT HEATING, 2008

	Added value			Employees		
	foreign-owned com- panies, EUR billion	Total EUR billion	Ratio %	foreign-owned com- panies, thousand people	Total thousand people	Ratio %
Some old EU Member States						
Spain	1 450	17 320	8	2,4	36,5	7
Portugal	340	3 550	10	0,3	9,8	3
Italy	1 500	18 860	8	6,6	84,2	8
Sweden	2 892	7 506	39	2,0	16,6	12
Austria	45	5 342	1	0,2	27,3	1
France	580	29 960	2	n.a	n.a	n.a
Germany	6 320	90 900	7	n.a	n.a	n.a
7 countries in total	13 127	173 438	8	11,36	174,43	7
Some new EU Member States						
Poland	969	9 402	10	9,8	150,2	7
Hungary	1,3	2,5	52	14,1	27,4	51
Estonia	n.a	n.a	n.a	4	11,4	35
3 new Member States in total	970	9 405	10	28	189	15%

Source: oecd dataset, <http://stats.oecd.org/Index.aspx?DatasetCode=HS1988&lang=en>

Table 2

INDUSTRY PRICE OF ELECTRICITY, 2010/2

(US dollar cents/kWh)

	2006	2007	2008	2009	2010
Czech Republic	94	115	151	148	144
Hungary	105	134	170	160	171
Poland	70	73	82	119	120
Slovakia	86	98	137	174	195
<i>Average of V4 countries</i>	<i>82</i>	<i>94</i>	<i>117</i>	<i>139</i>	<i>142</i>

Source: IEA Energy Prices 2010 II.

Table 3

INDUSTRY PRICE OF GAS 2010/2

(USD/10 million kcal)

	2006	2007	2008	2009	2010
Czech Republic	402	392	614	528	530
Hungary	451	584	753	611	678
Poland	294	375	532	433	454
Slovakia	379	420	622	517	535
<i>Average of V4 countries</i>	<i>364</i>	<i>420</i>	<i>605</i>	<i>502</i>	<i>525</i>

Source: IEA Energy Prices 2010 II.

However, Hungary suffered from the sale of certain public services and strategic companies: in Hungary, the presence of foreign capital in the energy industry, for example, is much higher than the usual European rate (see Table 1). In Hungary, charges have become high because of the need for high profits. In recent years, the so-called industry price of electricity and natural gas in Hungary has been 15 to 20 percent higher than the average of the V4 countries (see Tables 2 and 3). This is a burden on the balance of payments and reduces the creditworthiness of the country, which, *inter alia*, results in higher interest premiums. Moreover, as a result, companies established in Hungary are less competitive than foreign companies.

It would probably have been cheaper for the country to borrow instead of selling off energy companies: the value of interests would have

been lower than the profits paid to foreign owners. All the more so as foreign owners took no risk, having been offered a return on assets at 8 percent in the first place, and actual profit levels were generally even higher.

CEZ is a good example of the opposite solution. The Czech coupon privatisation provided some degree of protection against a hostile buyout. The company has since gained strength and is a significant positive item among the assets of the Czech state, the total capital of CEZ Holding amounting to EUR 9 billion (CEZ Group Annual Report, 2010, p. 18.). Moreover, it provides the state with a high yield.

An initiative would be needed for the definition of key national assets in neighbouring countries, as well as of the companies managing

those assets. If this were to be done in other countries as well, consideration should be given to providing firms from neighbouring countries with opportunities in terms of holdings in strategic companies which are similar to those of national holdings. This should only apply where owners from neighbouring countries have a qualifying holding in such firms. For example, where laws require the state to hold at least 51 percent, it should be possible for neighbouring countries to hold 20 to 25 percent of the remaining 49 percent. That is because in respect of the acquisition of assets, it is not expedient to force companies from countries suffering from capital shortage with western companies. The latter are from regions which, owing to the previous Marshall Plan and 45 years of free market economy, are more capitalised, and as a result, may be expected to have plans to acquire the assets of the said countries at low cost. It has happened that the property acquired was sold to a party which, owing to significant Hungarian imports, already had a high enough share in Hungarian energy supply.

ASSETS OF URBAN REGIONS

The assets of urban regions could be defined to the analogy of key national assets.

The standard unit of regulation is currently the municipality, whether that of a village, a town, a district or a county. With municipalities, key assets are defined according to what is needed to perform such basic functions as education, office administration and healthcare. However, assets, as common sense would suggest, are not necessarily linked to such functions alone. In Budapest, for example, the relevant data on businesses owned by the municipality have not yet been incorporated into planning (White Paper, 2011). Another example: if a village situated near a larger town allots arable land for residential development

without creating a good public transport network to the town, this will significantly increase car traffic towards the town. Additionally, certain schools, doctor's offices, etc. will become overcrowded. All that could be prevented through reasonable planning. For example, building permits in conurbation zones could be made conditional on the developer's purchase of combined passes for one or two persons per residence, for 5 or 6 years, to the suburban bus service and public transport in town. That would ensure that people who start building in the area will also use the public transport later on.

A requirement for thinking in the long term would mean even more in the management of assets. For example, the size and access to areas available for property development should be among the criteria used for the valuation of the assets of a town. This could be a means of encouraging the town to offer sufficient green areas for home building by families with children even over a span of 5, 10 or 15 years. If they remain in the town, it will be possible to prevent ageing and the devaluation of the town property.

CONCLUSION

If national and local property could be redefined, it would be possible to exploit the synergies offered by coordinated development and operations in each industry (e.g. gas and electricity supply, district heating, waste collection). There is a need for sufficient funds for the adequate management and maintenance of assets. A new approach could be taken if it was recognised that in addition to current financial management, it is equally important to have a stable framework in place for financial management.

Not least, this would make it possible at times of crisis, as a means of continuous

employment, to use more energy and resources to perform overdue refurbishment work, giving work for one, two or three years to

employees of background organisations and enterprises who would otherwise be made redundant.

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