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Considerations for the debate on the financial situation of local governments

THE ROAD LEADING TO THE CURRENT PROBLEMS

The most important thing to be emphasised is, I believe, that it was not overnight that the financial situation of local governments deteriorated significantly; their loss of position and the discrepancy between duties and funds have been standard phenomena in the past one and a half decades. From this it follows that what is needed is not merely crisis management but a reconsideration of the basis of the system. There is no question at the same time that it is impossible to establish a model operable in the long run without consolidating the current situation, which can be considered a situation of crisis. The latter produces only a pseudo solution, however, unless the measures point towards the solution of the de facto problems. The reform is impossible to implement in one step since comprehensive measures are required and, in my opinion, we are not deeply enough familiar with either the causes or the effects.

For public administration or state reforms in Hungary it holds in general that the well-sounding goals have been based on depressingly little information, analyses or model calculations and the reform concepts have especially

neglected implementability aspects. In fact, unfortunately, governing itself has been characterised by the same culture or rather lack of culture, as András Vígvári pointed out in his lecture; in many aspects you can call it blind flying: the information systems, institutional capacity or expertise required to precisely know the circumstances, potential consequences or actual effects, etc., of the government measures or interventions have been missing and, unfortunately, there has been no political demand for these, either.

While, if we are to subserviently follow trends, the philosophy and instruments of New Public Management no longer qualify as suitable for a strong or wise statehood, the truth is that Hungary has failed to adequately acquire the classic principles or instruments of Public Management and Public Policy in the first place. So as to return to the original question discussed, the almost continuous changes in the system of local government financing have been made without decision makers facing the actual problems. This has been made possible since local governments have shown respectable inventiveness in and made huge efforts for sustaining their operability; it was this 'homeostatic' quality that the government has misused for a long time. I believe that by

now, quoting *András Vígvári* once again, the family silver has really run out; reforms cannot be postponed much longer.

What is the system we want to reform actually like?

The biggest problem with the local government model introduced in 1990 was that it uniformized: it failed to address the aspects of spatiality or, to use an economic concept, those of ‘overflow’ or size-efficiency, and, in many respects, it even went against the typical international trends.

Today, the problems with *the spatial structure of Hungarian public administration* seem to be self-evidencies already.

► In the regulation of the *base level*, efficiency and professionalism have been subordinated to the requirement of closeness to citizens. The problem of the fragmented base level should not be narrowed down to the fact that even the smallest villages have an independent local government. The essence of the problem is not the former but the organisational-institutional fragmentedness in exercising local government functions: the high number of institutions providing base service; the proliferation of cities of a too small size, hardly meeting city functions; the undifferentiated system of authorities; the weakness of integrating elements; the low efficiency of financing mechanisms and the conceptual problems experienced in the field of associations. The over-fragmented local decision making system results in a public service institutional system struggling with capacity and quality problems, the victims of which are not local authorities but citizens who do not have access to high quality services.

► The management of the *medium level* according to the leftover principle (which, mistakenly, has been held for subsidiarity) has

led to excluding county local governments from power. The exclusion of counties has launched ‘compensation’ mechanisms in several directions: regional public administration has proliferated, overlapping organisational-institutional structures have been formed (in regional development, tourism, etc.); the typical lack of coordination with cities with county rights has been the source of especially extensive wasting. Furthermore, various new categories have appeared at the medium level (various districts, small regions, regions), lacking coordination, with elitism or ‘corporate regionalism’ flourishing.

The system of local government financing has occasionally tried to amend these structural problems (by fostering associations, for instance), while, at other times, it has added fire to the flames by the uncoordinated and undifferentiated allocation of development funds, by trying to adjust financing to the functions alternating between county and municipal governments and, lately, by an expressed discrimination against county governments.

It can be stated overall that in the past decades, there has been a failure to establish a constitutional guarantee for the economic independence or a predictable or stable financing of local governments. As a consequence, financial conditions have essentially been bound to annual budget acts and regulations, which have marked the extents and ratios of state subsidies on the one hand and of local revenues on the other hand. Obviously, local governments are primarily affected by the rates of state subsidies and shared revenues as far as the central budget is concerned. In this respect, too, regulation has been most importantly characterised by an ever changing nature. Year by year, there have been changes not only regarding the extents but also concerning the legal titles of state subsidies.

The deteriorating position of local governments can be put down to the joint effects of

changes in the central redistribution of funds, the exhaustion of own reserves and the lack of rationalisation in the fields of management and public services. The main problem with the system of financing is not the extent but the unpredictability, the “structural messages” of revenue centralisation, as well as the way the system has shrunk local governments' room for financial management to the minimum. The financing model is no longer source-based; the essentially task financing model is settlement-centred and, as regards its base, it fosters the conservation of the institutional system. The central influencing and determination of local governments have reached an unhealthy extent also in the fields of operation and development; sectoral and regional aspects do not match.

A perfect evidence for the imperfections of the normative financing system or the permanent differences in local government conditions, if you like, is the overweight role of complementary subsidies meant to amend operational financing. The system originally designed for the management of temporary disturbances or start-up problems has been “organically incorporated” into the local government financing system and, for a group of local governments of a substantial number, it has become a continuous source of revenues.

THE ROAD TO REAL REFORMS

In the past one and a half decades, public administration in Hungary has developed, to a great extent, spontaneously, through occasional adjustments, being drifted along impromptu reform directions. The lack of success of public administration reforms is not a Hungarian speciality, however. What is more, the establishment of an “optimal” model is not the question of professional consideration exclusively but that of the all-time political power relations as well.

Yet, not even the above circumstance relieves the governments in office of their responsibility to devote due attention, beyond launching ambitious public political targets, to *the competence of the public administration guaranteeing the implementation*. What is more, they should also take it into consideration that the condition, structure and internal interest relations of the public administrations in office have a decisive effect not only on the implementation but already on the formulation of targets.

It is, however, not sufficient to establish a technocratic, incremental base and background in itself; a new consensus must be reached also regarding certain *political and policy base values* so that the performance of the Hungarian state/political system could significantly improve.

► The first (and most important one considering our subject) is the *consistent acceptance of decentralisation/subsidiarity* among state organisational principles. The past two decades and the preceding centuries have essentially proved that the *Hungarian state has always been centralised*, distrustful of both communities and regional players. There seems to be no other realistic perspective for Hungary, either, however, than to grant independence to regional and local governments, de facto decentralise government level competences, thereby enabling the national level to exercise its new function, connected to the global systems. It is thus not a mere structural change that is required in the power model but a paradigm change opening the way to de facto decentralisation.

► It is time we did away with the political illusions related to the local government system. *Local governing is not a goal but a means: a means to organise public services and administration*, to support the economy, to develop the infrastructure; a means for everything needed for the welfare of the population. The question is *what public administration structure best suits*

Hungarian society and economy, the public service and administration functions to perform, in the longer run.

The outlines of the structure

Without consolidating the *base level*, it is impossible to model the reform of the medium level. Let me repeat that, from the point of view of reasonable fund management, it is not small settlements that pose the real problem, let alone the size of local government bodies. If we agree that the right for local governing must not be restricted on the basis of settlement size in future, either, other solutions must be found.

In my opinion, the system of subregions strongly supported, what is more, even forced, in the past few years, is not a cure-all solution from the point of view of base-level self governing, however. For regions with typically very small settlements, the current subregion size is too large; it is by no chance thus that what are referred to as micro regions are characterised by more cooperation. (The scale of these latter is most similar to the once “joint council districts” which, in a democratic decision making framework, may be more suitable for organising the base services in the longer run as well.) On the other hand, integrating some towns or boroughs from the Great Plain into a subregion does not produce much added value. However, not only the scale but the status, too, is unfortunate, since voluntary associations can be no stable or primary bases for tasks or authorities.

Since the political change, unduly little attention has been paid, from the players of local level governing, to *cities*, even though the regulated participation of cities in the field of regional integration would have been an obvious alternative for the solution of structural problems. Legislators have used the opportuni-

ty of a differentiated assignment of authority to a limited extent only and even in operation and development financing, they have not straightforwardly supported that cities assume responsibility in district supply systems. Thus, in the consolidation of the local government level, the confirmation of the roles of cities would be equally important to the integration of small settlements in administration and public services so that, having been made interested, they should consciously assume a role in the establishment of a spatially optimal system of local and district level services, in partnership with other settlements in the neighbourhood. Fortunately, what is referred to as the system of functional city regions in the National Settlement Network Development Concept currently in formation, points towards this direction.

Another basic question of the structure is the *medium level*, which harbours huge reserves from the point of view of the operability and efficiency of the local government system. While there is a great need to analyse at the national level what spatial scale would be optimal for exercising medium-level community functions, considering the location and capacity of institutions as well as the aspects of access, etc., I believe, at the same time, that immediate measures can be taken to significantly improve the situation, which would not require any dramatic amendments in the law, either. A considerable confirmation of the position of county governments can be carried out by a simple revision of the act on authority and by the restriction of optional and overlapping responsibilities – with adjusted changes in the allocation of funds – in the budget itself. It is county governments that should be made suitable for the organisation of the majority of medium-level service functions, with a coordination authority extended to cities with county rights. Region integration functions like strategic planning, the operation

of public transport and the technical infrastructure, environment protection, employment policy, etc., should also be transferred to county governments.

STRUCTURAL REFORMS IN THEMSELVES ARE INSUFFICIENT

As András Vígvári points out in one of his works, there are two marked opinions on the scenario of a comprehensive reform, which is essentially a hen and the egg problem. According to one of them, a financial reform must be preceded by the structural and functional transformation of the local government system while, according to the other, local governments can be sent a message through the regulation of sources already.

It is a fact that, so far, the government has much more frequently “sent a message” through source regulation even about the organisation of services and development-related decision making at the local level. In spite of this, until the latest years, financing in itself has failed to force local governments to implement comprehensive, local reforms. The instability of source regulation has given no opportunity for systematic local reactions, but for retrospective corrections or patch-ups. On the other hand, it is also true that changing the financing conditions in itself is not a good enough “message” for the implementation of local service organisation reforms, for one reason because the messages of the central budget have often been manifested in curbing sources merely, leaving “crisis management” to local decision makers. Government orientations, concepts, for the long-term development of the public service spheres concerned, elaborated model patterns, professional support or a professional and social consensus about the directions of changes have almost always been missing, however. It is a serious

contradiction, let me add, that many, often absolutely ambitious professional concepts formulated in public service sectors have failed due to the shrinking of the actual room for action of local governments in financing, or have led to the unconstitutional consequence that masses of local government institutions have operated for considerable time with temporary accreditation. It is also a fact that the dissatisfaction with source regulations and the debate on the budget have mainly focused on the volume, the scarcity of sources, while comprehensive debates on the inner contents, structural amendments, coded professional messages (obviously formed by the technocratic aspects of government, mostly ministry, civil servants) have failed to take place in the majority of cases.

The solution that seems to work thus is if the transformation of the local financial system is closely related to changes in other fields; with the transformation of the public service, the taxation and development policies. It must also be appreciated that the financial difficulties of the local government sector force out a fundamental innovation also in the management practice and expertise of local governments, beyond a reform in the central distribution of funds. András Vígvári as editor chose a well-fitting title for the volume of studies on the reform of public finances: “Back to the Basics”.

Such ambitions are easy to meet when the policy of a new government is being formed. It is true that the changes in the financial situation of local governments compared to the central budget or to GDP has a clear message: local governments have undoubtedly lost position, partly due to the system of local government interest representation. There is a danger, however, that the new basics, the pressure to solve the crisis, will not support the arguments for decentralisation but confirm stronger state involvement instead.

This is why I would be careful also about the financial control of local governments. While the current situation is untenable and it can hardly be accepted that local governments get indebted “in front of the eyes of the state”, if toughening results in unjustified restrictions, on the other

hand, the ability of flexible adjustment inherent in the local government system may be lost.

Let me conclude by noting that, despite all problems and critique, we should be careful not to lose the advantages of the local government system during the consolidation.

