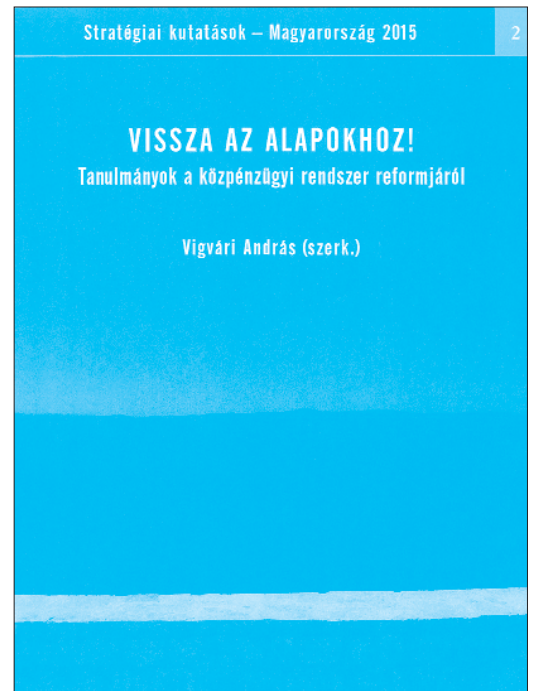


# *Back to basics!*

## *Studies on the reform of the public finance system*

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The recently published collection of studies summarises the research results of the working group studying the reform of the public sector within the framework of the Hungary 2015 project implemented pursuant to the agreement between the Prime Minister’s Office and the Hungarian Academy of Sciences.

The authors of the studies are theoretical and practical experts investigating the economic, financial and legal relations of the trends of public sector restructuring. The comprehensive selection of subjects, the examination of the arising questions from multiple perspectives, as well the openness manifested in the elaboration of alternative solutions make the book enjoyable to read on one hand, and a useful reference book for policy makers, practical experts, scientific researchers and university students on the other.

Researching the operational mechanisms of the public sector has been a neglected area of Hungarian economics. The downsizing of the

state’s role in task performance in the past two decades has favoured more the apologies accompanying the process of “denationalisation” than long-term theoretical research. However, after the foundations of the market economy were laid in Hungary, the ambiguous roles of the state, or of the public sector in the broad sense of the word, became an obstacle to further economic and social development. The book aims to make recommendations for the basic regulatory and institutional framework of the public sector of the future, based on the evaluation of national and international experiences, as well as to outline the frameworks of “the new state-foundation” to ensure global competitiveness after overcoming the current institutional discrepancies. The book provides a discussion forum for the representatives of basic and applied research projects related to the operation of the public sector, as well for processing the subject from the economic and

financial, as well as the legal and regulatory perspectives. The integrating efforts of this approach are also indicated by the following condition: Macro- and micro-level approaches have developed markedly distinct fields in economic science. There are often insurmountable walls between national economics, corporate, as well as macro and micro finances, and the representatives of these fields rarely enter into any dialogue. The macro- and micro-level approaches also appear in the public sector. The macroeconomics of the public sector deals with the operation of the large public finance supply systems, while the operation of the local governments is audited within the microeconomics of the public sector. However, the macro- and micro-level approaches cannot be divided. In fact, it is justified to apply a combined approach, which can be best illustrated with the “tree” metaphor. The root of the tree that represents the entire public sector comprises of the local governmental sector that is connected to the local economy and society by many rootlets. The leaves and fruits of the tree are public goods and services the delivery of which on a continuously regenerating basis is the most important expectation from the public sector. The flow of the vital fluids between the root and the crown of the tree (sustainable financing) is ensured by the institutional system of the public sector, i.e. the trunk and branches of the tree. The publicly owned or established network of enterprises or foundations functions in the shade and security of the crown of the tree. The virtue of this collection of studies is that while analysing the operation of the public sector it presents the subject of investigation as an organic unity, and provides a balanced presentation of problems and solutions using the macro and micro approaches side by side.

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■ The two introductory studies depict the international correlations of the operation of the public sector. *Gusztáv Báger* studies the

impact of globalisation on the transformation of the nature of the state’s role. After describing the various concepts of the welfare state he claims that the most influential task of the state for the future of Hungary is the delivery of income equalising tasks and the reinforcement of competitiveness. Therefore, he believes that the reform of task performance by the state is the token for closing the gap between Hungary and the more advanced countries, as well as for the efficient utilisation of EU funds.

■ *István Hetényi*’s study focuses on the tax systems and tax administration of the OECD countries and the related domestic tasks. The study, which is based on the analysis of an extremely broad statistical background, gives an insight into the different taxation levels, tax structures of countries implementing various economic policy models, the difference in the intensity of central and local taxation in the different groups of countries, as well as the relevant tendencies of change. In accordance with the conclusions contained in *Gusztáv Báger*’s study, too, the ideas pertaining to the reform of taxation are defined by objectives that somewhat contradict the requirement of competitiveness and efficient task performance by the state. The direction of the Hungarian tax reform is influenced both by the framework conditions of the contradictory target system and the manoeuvring room determined by the intentions of European integration and tax approximation. Since in the European integration area tax approximation is subordinate to the operation of the single internal market, the elimination of the tax competition hindering the freedom of competition is a slow process burdened by compromises. However, based on international comparison, the author recommends a slight rearrangement of the foci of the Hungarian tax system instead of radical changes. According to the author, this can be implemented primarily by a modest reduction of taxes through narrowing exemptions and

allowances, and by the expansion of employment. He believes that local taxation could be reformed by the transformation of the distribution of collected taxes between the local and central levels.

■ *Lászó Akar's* study also focuses on the connection between competitiveness and the tax system. He concludes that although the tax system does not directly influence competitiveness, it impacts the conditions of competition via the cost burdens on businesses, and by influencing the competitive edge of the grey and the black economy it directly deteriorates or improves the market opportunities of legally functioning businesses. The author of the study presents the ideas elaborated by the tax reform committee in 2005. Although the recent period has not contributed to the stability of the value of the recommendations, the validity of the conclusions has not diminished at all in the past period either. In line with this, the abolition of the local business tax, which is considered desirable by the business sector, too, and the reduction of public dues on employment represent the direction of tax system restructuring from the aspect of competitiveness. Restructuring shall not lead to higher corporate taxes, since the current tax rate provides an important competitive edge even in the author's opinion. The lost amount of taxes could be made up for through the introduction of real property taxation, as well as the standardisation of taxes on consumption, which can be more efficiently collected according to the experiences. The simplification of tax administration can also be regarded as a competitiveness enhancing factor, including especially the downsizing of the taxation staff of the local governments to the level required for the administration of real property taxation.

■ The legal correlations of the regulatory practice also belong to the professional foundations of the operation of the public sector. *Zsuzsanna Kassó* raises a question in the title of

her work: "Do we need a state accounting act?" Although the title makes us assume that the study processes this issue from a jurisprudential perspective, the author puts the subject of her investigation in a broader context. She presents the current system of the delivery of public tasks starting out from the constitutional foundation of the system of public finances, which serves the satisfaction of collective needs in a rational, community form. The utilisation of public funds required for the delivery of public tasks is linked to effectiveness and efficiency requirements, which can be ensured under adequate accounting, IT and audit regulation. The current budgetary system of Hungary can fulfil the tasks with significant limitations only due to the lack of a management and planning culture, the low efficiency of the institutional framework, and due to the slow proliferation of modern information technology. The author's reply to the poetic question formulated in the title – based on the current status of the capacity of the public sector – is negative for the time being. However, she finds it necessary to have an act distinguishing between the public and the private sectors, which specifies the limits of public power and the regulatory possibilities thereof. The author of the study believes that in the field of public administration the budget, financial management, accounting and audit acts shall be developed in a standard manner with the interrelated rules of law. Finally, she formulates a comprehensive recommendation, the need for "governmental action to review the legislative process and the current rules of law on the basis of political and social consensus and with the citizens' and taxpayers' interests in mind".

■ *Katalin Turcsány's* study focuses on the legislative aspects of the public finance reform. It discusses the need for the institutional reform of the public sector, and the possible directions of regulations pertaining to the public finance act and the rules of law related to

the act. In addition to stressing the need to re-codify the public finance act as a framework act, the author encourages the enactment of certain current chapters as separate acts. On top of that, she finds it justified to regulate the novel development cooperation of the public and the private sectors (public-private-partnership) in the form of an act, since it is closely related to the state decisions and the funding thereof, as well as to the planning and liability generating rules of the budget. However, in relation to the re-codification of the budget, several theoretical questions must be answered in advance: Distinguishing between public power and public service tasks is of utmost importance to determine, to what extent and under what funding conditions private economy actors can be involved in the delivery of services in addition to the state and local governmental agencies, and what guarantees and warranties must be incorporated into the system of task performance to ensure the security of supply for the citizens. Based on the definition of the basic principles of public task performance it is possible to divide the tasks between the central and local levels of public finances, which, at the same time, makes it possible to clearly define the responsibilities. According to the concepts, the primary institutional background of the provision of public tasks should be provided by the budgetary institutions, but the so called “target fund” would appear as a new type of public institution to replace public foundations. The proposal states that the public sector founded economic organisations that are loosely connected to the public sector and pursue wasteful financial management should be replaced by a new type of “public company”.

The cooperation of the public and the private sectors (PPP) raises the need for fundamentally new regulations. Since these cooperation projects usually span several years, the rules of procedure pertaining to the public sector commitments over the annual budget must

also be regulated, especially with a view to preventing the budgets of the coming years from being too committed.

■ *Izabella Bencze's* article focuses on the questions of the legal regulation of the management of state and local governmental property. After reviewing the legal-theoretical background, the author suggests directions for the necessary re-regulation. After the privatisation process is completed institutionally, a new institution should be set up for the management of assets that remain in state ownership for good. In addition to the Treasury Directorate of Legal Matters – to be set up as an institution independent from the executive branch of power, which would exercise ownership rights – the budgetary organisation fulfilling asset management tasks should be formed as a unified state treasury organisation. This proposal is aimed at ensuring that institutions managing state property stripped from unnecessary property elements should function independently from the executive power, and that ownership rights should be exercised without the involvement of politics.

■ *András Vigvári* is not only the editor, but also the author/co-author of three studies in this book. He gave the expressive title “The weakest link” to his writing on the reform of the financing system of the local governments. The study gives a detailed list of the operational problems of the local governments, and clearly explains the readers the content behind the title. The root of the problems is the gap between the delivery of legally mandated tasks and the allocated financial resources, which has been increasing for nearly two decades. Due to the unavoidable use of reserves and assets, most local governments have been completely deprived from the possibility to adjust to the requirements. The author claims that the reform of the local governmental system should be built on the predictability of resource regulation, the obligation to prepare

medium-term plans, the related responsibility system, as well as on integrated task performance by the local governments.

■ The study written in conjunction with *György Sánta* presents the organisational and institutional framework of the national economic planning system. After Hungary's accession to the EU the demand for planning and programming has considerably grown, and the requirement of institutionalisation of strategic and operative planning has been raised. According to the authors' opinion, public purpose, medium-term strategic planning would require legislative regulation, in the framework of which the process of planning and the approval of documents should be regulated. Apart from creating the institutional and personal conditions for planning, they attribute utmost importance to the harmonisation of the planning documents with the public finance budgetary plan, so that planning would not exceed the load-bearing capacity, and would be in accordance with the EU requirements pertaining to the public finance deficit, indebtedness and the rate of inflation.

■ The last study of the book, written by *András Vigvári*, describes a possible scenario leading to a public sector that promotes the competitiveness of the Hungarian economy.

Joining the mainstream of European integration has brought the historic opportunity for developing the society and economy of Hungary. Real and nominal convergence required for closing the gap is unimaginable without the comprehensive reform of the economy and finances, including that of the public sector and public finances. The reform of the large supply systems requires the reconsideration of public policies, the redistribution

of tasks between the public and private sectors, decentralisation within public task performance (allocation of tasks from the central level to the regional level) and re-centralisation (transfer of tasks from the local governmental level to the regional level). Within the transformation of the tax system, the proportions of local and central tax revenues should be significantly modified on the revenue side so that the financial independence of the regional governments could be established. The reform of the public sector must be started in the system of local governments, since the amount and risks of problems accumulated in this field so far have surpassed the critical mass. The changes require both legislative changes, and the transformation of the institutional framework and the operational rules thereof.

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In the introduction I used the image of a tree in relation to the public sector. This collection of studies unfolds the picture of a tall tree with a thick trunk. Its enormous crown hides a considerable amount of fruits, and bushy undergrowth enjoys its shade. The holes in its trunk still provide shelter for some living creatures, but the echo of the pecking of woodpeckers on its bark already warns us about the fact that the tree is drying out. The ring of axes indicates that the fellers are coming closer and closer. At the same time environmentalists are gathering around the tree and are warning about the danger of felling the tree. Whether the "fellers" or "environmentalists" prove to be stronger, and whether the old tree is replaced with a young tree with a slender trunk will turn out in the decade to come.

*János Zsugyel*