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**Directorate for Financial, Fiscal and Enterprise Affairs  
Centre on Tax Policy and Administration**

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**Fiscal Design Across Levels of Government  
Year 2000 Surveys**

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**Country Report: Hungary**

**FINAL**

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## GENERAL INTRODUCTION TO THE SURVEY

In accordance with decisions made by the “Fiscal Decentralisation Initiative for Central and Eastern Europe” (FDI), the OECD has initiated surveys on fiscal decentralisation for the purpose of providing international comparisons on the design of fiscal systems across levels of government.

FDI is a joint initiative of the OECD, the World Bank, the Council of Europe, the Open Society Institute, UNDP, USAID and OECD Member countries to assist transition economies in Central and Eastern Europe in carrying out intergovernmental reforms. The main objectives of the Initiative are: to encourage local democracies to improve the capacity of local governments to plan and administer expenditures and raise revenues; and to support local governments in their efforts to become more responsive and accountable to their constituencies.

Thereby the survey has been written in response to a questionnaire designed by the OECD and follows the structure outlined in the questionnaire.

The survey specifically indicates the state of the following fiscal decentralisation issues:

- The design of fiscal systems.
- The profile of sub-national revenues.
- The profile of sub-national expenditures.
- The match between locally-managed expenditures and the corresponding revenues.
- The institutional arrangements for ensuring fiscal discipline and budgetary constraints.
- The design of intergovernmental fiscal relations.

The surveys in 2000 took place in six countries in Central and Eastern Europe: three OECD Member countries - the Czech Republic, Hungary and Poland - and the three Baltic states - Estonia, Latvia and Lithuania.

The survey was carried out between April 2000 and January 2001.

The survey has been prepared by the Ministry of Finance of the Republic of Hungary.

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## **1. EXECUTIVE SUMMARY**

### **1.1 Main features of local finance and intergovernmental relations**

In line with the principles of deployment of powers laid out in the Constitution the act on local governments specifies the detailed rules on the types of local governments, their mandatory responsibilities and the economic foundations of their operation.

The Hungarian system acknowledges only local governments as the base of the one-tier subnational local government system. In terms of type a local government may be a municipal government (that of a village, town, county right town, the capital city and its districts) or a county government. These, however, do not constitute a hierarchy, for the distribution and controlling functions of the former county councils have been terminated.

It should also be noted that the system established in 1990 is excessively fragmented. A total of 1,600 councils were replaced by 3,115 local governments - one for each settlement.

Over recent years the number of local governments continued to increase through separation of some formerly integrated municipalities and this process has not yet come to an end. On 1 August 2000 a total of 3,177 municipalities were operating. In the case of more than half of the total of almost 3,200 municipal governments the population is below 1,000, while in almost 300 municipalities the population is below 200.

Along with the fragmented structure of the local government system, local governments perform and exercise a very wide scope of responsibilities and powers. Local governments perform functions in almost all areas of the state responsibilities.

Despite all local governments have almost identical rights and responsibilities, in a large number of municipalities the number of inhabitants and financial resources are not sufficient for the efficient and economical performance of the services required by the population.

### **1.2 Major empirical findings**

The year 1990 was something of a milestone in the regulation of the funding sources of local governments since an entirely new regulatory system was introduced.

Former funding regulation system was a centrally controlled, so-called expenditure oriented financial regulation system which was based on the establishment of the expenditures on an individual bargaining basis. State subsidies were determined as the difference between the amount of spending and the local revenues.

In 1990 it was replaced by a so called resource oriented regulation system where the potential spending of a local government for the provision of public services is determined on the basis of the disposable resources (funds) realised by local governments. Instead of the earlier practice, the basic principle of the

new resource regulation is that the central budget contributes to the performance of the mandatory duties specified in the act on local governments and the sectoral laws for which local governments also have to involve their own revenues.

This system is aimed to incent local governments and their institutions to perform economical financial management - whilst complying with the standards specified in the sectoral laws.

In order to ensure a balanced economic growth reduction of income concentration is one of the key points of the Government's fiscal policy. The proportion of the operating revenues of the general government system had dropped from the 44.2 percent of GDP in 1996 to 41.6 percent by 1999. In line with the reduction of the share of the general government system as a whole local governmental revenues had decreased from 11.8 percent of GDP in 1996 to 11.1 percent by 1999.

**Tax revenues** represent 82-85 percent of the operating revenues of general government. These revenues has dropped over four year period from 36.8 percent to 35.5 percent of GDP.

Some 8-10 percent of tax revenues of the general government are booked among the current revenues of local governments representing 33 percent of their total revenues.

Despite the reduction of the centralisation of incomes in the general government system the share of local governmental tax revenues has increased from 3 percent to 3.7 percent of GDP during the same period.

Tax revenues of local governments fall into two large categories: shared taxes and duties, and local taxes.

**Shared taxes and duties.** 40 percent of the centrally imposed and collected personal income tax is transferred to local governments, 15 percent is redistributed to the place of income generation, while 25 percent is allocated normatively taken into consideration the local tax potential. Duties are collected by local governments, a percentage of which is transferred to the central budget

**Local taxes.** In order to enable local governments to perform public services in line with the local characteristics and requirements and to provide them with means for financial management a system of local taxes was developed in 1990. The state has partially transferred its traditional right of taxation - reserved for Parliament - to local governments within the limits specified by law. Under authorisation by and in accordance with the provisions of the act on local taxes the council of elected representatives of a municipal government may issue decrees imposing local taxes.

However local governments are not under obligation to introduce and collect local taxes. The act on local taxes establishes the possibility of taxation.

The number of local governments collecting local taxes and their revenues have been steadily increasing. In 1999 a total of 2,970 local governments - 93 percent of all local governments - applied local taxes. Local taxes accounted for some 18 percent of all current revenues in 1999 - to be compared with the mere 3.5 percent in 1990. The most frequently applied locally imposed tax type is the local business tax accounting for some 84 percent of all local governmental tax revenues.

Most of the **non-tax revenues** of general government are collected in the central budget. The share of local governments of such revenues accounts for an estimated 30 percent, representing 18 percent of their total revenues.

The rules on the establishment of these non-tax revenues are specified by decrees issued by the Government and line ministries concerned. Charges and fees applied by a local government are established and announced by local governmental decrees. In some cases decrees also determine the mandatory allowances to be applied by local governments.

**Grants.** For the performance of their mandatory responsibilities local governments are entitled to grants from the central budget. The titles and the amount of grants are approved by the Parliament annually. Normative contributions represent the massive part (80 %) of these grants. Their allocation is based on indicators of concrete tasks. There are some 100 titles of allocations presently. This, however, is not a form of task-financing, because the spending of such subsidies is not subject to restrictions. A local government decides at its own discretion, how much it spends on what tasks.

A slight part (12%) of state contributions serve for specific purposes allocated under normative rules. Such subsidies are related to special operational purposes or to development projects of local governments.

Another smaller part (8%) of grants is spent also on specific purposes but allocated on individual basis. Mention should be made of an extra support for the performance of mandatory tasks of local governments. This kind of support represents some 1 percent of all grants and is provided for “local governments in disadvantaged position for reasons beyond their control” having no sufficient revenues. The budget act specifies the normative conditions under which a local government can have access to such subsidy. Its utilisation is linked, of course, to the operating expenditures, but it is not fixed to any specific target.

**Expenditure.** Under the act on local governments a local government is entitled to determine the ways and modes for the performance of their duties - depending on the requirements of the local population and its financial resources. A local government decides whether to make arrangements for the provision of a certain public service itself (through its own institution, a contractual arrangement or purchasing the service) or to co-operate with other local governments.

Under the provisions of the act on local governments the tasks of providing for certain public services may be imposed on local governments only by law.

The local governmental act also provides that where a mandatory duty is imposed on a local government the Parliament has to provide the necessary funding for the performance and exercising of such tasks and power, deciding on the amount and mode of the budgetary contribution.

The largest proportion of the current expenditure of local governments is made up by spending on the performance of education, health and social/welfare responsibilities.

In 1999 education, health and the social/welfare area accounted for 33 percent, 19 percent and 16 percent, respectively, of the total current spending of local governments. The expenditure of local governments on education, health and social/welfare functions accounted for 66- percent, 44 percent and 11 percent, respectively, of the total general government spending on the relevant areas.

### **1.3 Major problems in the fiscal design**

The most substantial problem of the Hungarian local governmental system is that an excessive degree of decentralisation has evolved in the system of scopes of duties and responsibilities.

The smallest municipalities have almost identical duties and responsibilities as does the capital city. The organisation of the performance of tasks for conurbation areas is not provided for in the system. This has not been yielding efficient solutions because there is little propensity to establish economic associations while there are no means for mandatory association in today's Hungarian legislation. International and domestic experience also shows that larger associations are not usually established on a voluntary basis.

No clear-cut arrangement has been introduced that would assign institutions performing regional tasks. county governments performing territorial functions along with the necessary financial and other operational requisites for such task performance. A persisting problem is that municipalities may

unilaterally transfer their institutions performing territorial duties to county governments which are obliged to take over and operate such institutions - and municipal governments may just as unilaterally take back such institutions. Another unsolved problem is that the ownership of assets should be transferred always along with the transfer of the relevant tasks (those who were given ownership rights in 1990 are now obliged to transfer only the right of utilisation, to the new organisation in charge of maintaining an institution).

The establishment of a regional level of governance covering several counties has gained importance from the aspect of EU accession as well. This constitutes some of the tasks to be carried out in the near future as part of the reform of the public administration system.

A more concentrated scheme of the allocation of tasks may make it possible to replace the current normative subsidy system adjusted to the fragmented regime of task performance with a regulation comprised of a substantially smaller number of elements, based primarily on global subsidies.

#### **1.4 Status of policy reform considerations**

In the spring of year 2000 the Government decided on the directions for the continued development of the institutional and financial system of general government. According to the Government decision, in order to ensure efficient and transparent utilisation of public moneys, the definition of the range and sub-systems of general government need to be reviewed, along with the general and specific regulation of the tasks of the various sub-systems. To this end, the scopes of responsibilities and powers of the state have to be reduced through the regulation of technical/professional and organisation efficiency requirements on the one hand, while on the other hand there is a need for a perceptible reduction of the number of institutions and for the simplification of their internal organisation structures.

The parties in Parliament agree that the current system of the deployment of responsibilities and powers in the local governmental system is not the most appropriate or most efficient solution, but in respect of the mode of its rearrangement one should expect heated debates. Even local governments themselves have different views on the issue.

From a professional angle the following distribution of duties seems most reasonable:

A conurbation local governmental scope of duties - existing only in respect of a few types of responsibilities in the Hungarian local governmental system - should be established. This means that keeping the number of local governments unchanged, the scopes of responsibilities of towns local governments performing the roles of district centres would be broadened, while those governments of smaller municipalities would be reduced.

The tasks that demand increased expertise and resources, including the maintenance and development of kindergartens, nursery schools, schools, the organisation of social/welfare benefits, the maintenance and improvement of roads between municipalities should be involved.

Furthermore, the mandatory - regional - roles of county governments should be clearly specified, terminating the permeability between them and municipal governments. This should result in transferring the property to the local government that maintains the given institution.

At a regional level it seems justified in a longer run to create elected local governmental bodies. The tasks of maintaining, developing of institutions serving several counties - hospitals, secondary schools etc. - and infrastructure development tasks (e.g. main roads, motorways) should be delegated to this level of local governance.

The review of the deployment of responsibilities and powers of local governments is underway. The effort is co-ordinated by the Minister of the Interior and is carried out with the involvement of the line ministries and the associations of local governments. It should be noted, however, that the amendment of the act on local government needs a two thirds majority of votes in Parliament which necessitates a broad political consensus.

In co-ordination with the review of the local governmental tasks and the rational deployment of responsibilities and powers the regulation of the resources of local governments also need to be improved, in the course of local revenues should be increased and at the same time increasing of income differences should be restricted.

## 2. THE TECHNICAL FRAMEWORK – CLASSIFICATION OF LEVELS OF GOVERNMENT AND ECONOMIC TRANSACTIONS

### 2.1 Local governmental structure: scope of responsibility and power

In line with the principles of deployment of power laid out in the Constitution, the Act on local governments specifies detailed rules on the types of local government, their mandatory responsibilities and the economic foundations of their operation.

The Hungarian system acknowledges only local governments as the base of a one-tier system. In terms of type, a local government may be a municipal government (that of a village, town, county right town, the capital city and its districts) or a county government. These, however, do not constitute a hierarchy, for the distribution and controlling functions of the former county councils have been terminated. This means that the operations of even the smallest municipal governments are directly linked to the highest level bodies of the state administration system - including ministries and other bodies with nation-wide competencies, and even with the Parliament.

It should be noted here that, although the county and regional development councils established in 1996 by the Act on regional development and zoning do have power over funds - for development - these delegated (and non-elected) bodies are not part of the sub-system of local governments. (They will soon become a fifth sub-system of general government.)

One exception to the rule is the capital city of Budapest where the Municipal Government of Budapest has been authorised, by law, to share funds from the central budget and some of the local taxes (e.g. local business tax) with the districts of Budapest.

It should also be noted that the system established in 1990 is excessively fragmented. A total of 1,600 councils (700 of which were joint councils, making a total of 2,200 municipalities) were replaced by 3,115 local governments - one for each settlement. Over recent years, the number of local governments has continued to increase through the separation of some formerly integrated municipalities, and this process has not yet come to an end. On 1 August, 2000, a total of 3,177 municipalities were in operation, broken down as follows:

**Table 2** Breakdown of local governments by type (of administrative units):

Villages	2 697
Larger villages	201
Towns	214
County right towns	22
Counties	19
Budapest (with its districts)	24

**Table 2.2** Municipalities by size in 2000

Number of inhabitants	Number of municipalities	Proportion of municipalities	Proportion of the whole population in municipalities within the population range (%)
-999	1683	53.68	7.54
1000 – 1999	659	21.02	9.11
2000 – 4999	512	16.33	14.81
5000 – 10000	140	4.47	9.47
10000 – 49999	120	3.83	22.65
50000 – 99999	12	0.38	7.50
>100000	9	0.29	28.92
<b>Total</b>	<b>3135</b>	<b>100</b>	<b>100</b>

In the case of more than half of the total of almost 3,200 municipal governments, the population is below 1,000, and in almost 300 municipalities, the population is below 200. Hungary is in the lower mid-field in Europe in terms of the total number of inhabitants per municipal government (3,250).

Along with the fragmented structure of the local government system, local governments have a very wide scope of responsibilities and powers. Although all local governments have almost identical rights and responsibilities, in a large number of municipalities, the number of inhabitants and their financial resources are not sufficient for the efficient and economical performance of the services required by the population.

In 1990, at the time of the dissolution of councils and the establishment of local governments, the responsibilities and powers were not re-engineered in a systemic manner. Thus, the majority of local governments are still performing all of the tasks that are no longer mandatory (including primarily some of the regional tasks) that evolved in a different political, economic, organisational and governing structure whose financial conditions and decision-making mechanisms were also substantially different from the current situation.

### **2.1.1 Major mandatory responsibilities of municipal governments**

The mandatory tasks of municipal governments - within the range of local public services - are specified by the Act on local governments, as follows:

- administrative (including construction administration and guardianship administration, only in towns),
- education at kindergarten,
- education and teaching at primary school,
- provision of venue for public education, library services,
- subsidising of local sports activities,
- basic health care services,
- basic social/welfare services,
- maintenance of public cemetery,
- treatment of communal waste water,
- maintenance (cleaning) of public places,
- municipal development,
- environmental protection (protection of natural features of local significance, protection of air quality),
- water supplies, sewerage, removal of precipitation, prevention/elimination of damage by water,
- maintenance of local roads,

- street lighting,
- treatment of animal carcasses,
- organisation of field guard service,
- official municipal fire brigade (only in towns),
- local tasks of civil defence,
- co-operation with national/ethnic minority governments.

Furthermore, a number of governments of small towns maintain secondary education institutions and hospitals, despite the fact that these are not mandatory tasks. Such institutions could be transferred to county governments that are in charge of maintaining such institutions but not all local governments take this opportunity.

### **2.1.2 *The responsibilities of county governments***

In 1990, a one-tier local governmental system was created in Hungary whereby county governments were not 'superior' to the municipal governments. Thus, for instance, they have no right to approve decisions made by municipal governments (in respect of their budgets) and they do not have a re-allocating role in respect of state subsidies or shared revenues, either. (The only exception under the Act on local governments, one reinforcing the rule, is the Budapest Municipal Government that is declared as a territorial government which, though it cannot exercise supervisory powers concerning the district governments, has been granted the right to allocate funds comprised of certain state subsidies and locally raised revenues. This will be discussed in Section 2.1.3.)

County governments - like municipal governments - are also comprised of directly elected representatives. Consequently, in respect of their fundamental rights, county governments have the same status as municipal governments. The difference lies in the performance of the mandatory tasks prescribed for them by the local governmental act. Consequently, there is no point in detailing the financial position of county governments.

The mandatory responsibilities of county governments include, in particular:

- Secondary school, vocational school and student hostel services; collection, safekeeping and processing of items of natural and social heritage and historical documents found or located in the territory of the given county; county library services, consultancy and services for teachers and other employees of the education and culture sector; responsibilities of physical education, organisation of sporting activities and the enforcement of rights of children and young people;
- Teaching of children under permanent health care at health institutions, teaching, education and nursing of children with disabilities who cannot be educated together with other students; specialised health care services outside the range of basic health services and special services of child and youth protection; territorial co-ordination of specialised social services and certain tasks falling in the range of specialised services;
- Co-ordination of tasks for the protection of man-made and natural environments and regional zoning tasks, identification of tourist values in the territory of the county, participation in the co-ordination of regional tasks of employment and vocational education and training and participation in the development of the regional information system.

The law prescribed these tasks as mandatory duties for county governments. However, the law does not exclude the performance of such tasks - on a voluntary basis - by municipal governments as well (this applies typically to the operation of secondary education institutions, health and social/welfare institutions). Municipal governments - primarily those of towns - undertake such tasks because having inherited the ownership of the institutions operated by the former councils, they sometimes find it hard to

give up the right to maintaining such institutions. The law makes it possible, once every four years, for municipal governments to give up such voluntary tasks and to transfer the right of operation to county governments that are obliged, by law, to continue the operation of such institutions. This process may be reversed, if a local government so decides.

Undoubtedly, the range of the mandatory tasks of a county government does depend to some extent on decisions made by municipal governments, however, in order to provide for the safety of the financial management of county governments, in contrast to the first few years after the system change, no such rearrangement of duties may take place during the four year term between elections.

County governments also pursue their own financial management and have their own budgets. Their revenues and expenditures account for some 13 per cent of the total revenues and expenditures of local governments.

The category of 'local governments of county right towns' has evolved as a special type of local government within the system of local governance. The only major difference in comparison with other towns is that it may perform and exercise the responsibilities and powers of a county government, within the territory of the town. The council of a county right town and that of the relevant county have to set up a co-ordinating committee to harmonise co-operation in the performance of joint responsibilities.

The rules of the local governmental act stipulate that a county seat is a county right town, irrespective of the size of its population. Furthermore, on request by the local council, a town with a population of over 50,000 may be classified by Parliament as a town of county rights.

### ***2.1.3 The duties of the Municipal Government of Budapest***

The capital city is governed by separate rules. The municipal government of Budapest performs the mandatory and the voluntary tasks involving the whole of Budapest, or more than a single district, and those that are related to the special position and role of the capital city within the country as a whole.

Responsibilities concerning the whole of the capital city cover, for instance, urban development, zoning, housing management, disaster prevention, water and gas supplies, district heating, waste and rain water collection, removal and treatment, street lighting, flood protection, public sanitation, public cemeteries, public transit, tourism, environment protection, employment, secondary education, specialised health services, specialised social/welfare services, child and youth protection, and public collections. Where a given service covers more than one district - e.g. public education, education of national and ethnic minorities, performance of education and cultural tasks; public culture, sports, child and youth activities - then its co-ordination is part of the responsibilities of the Budapest government.

A district government is in charge of the operation of kindergartens, primary schools, basic health care and social/welfare services, provision for healthy drinking water supplies within its scope of responsibilities, maintenance of local public roads and the enforcement of the rights of national and ethnic minorities.

As has been outlined above, the Municipal Government of Budapest - under a special rule - does have a restricted right to re-allocate resources. Under the Act on local governments, the Budapest Municipal Government allocates the global normative contributions provided for the capital city as a whole, the relevant shared personal income tax, the vehicle tax, duties and local taxes, for itself and the various district governments.

The Municipal Government of Budapest has a 13 per cent share of the total revenues and expenditures of local governments, whilst the 23 district governments together receive 11 per cent, these figures being based on the distribution of duties and power, and the re-allocation of resources.



### **3. GOVERNMENT FINANCE STATISTICS ON SUB-NATIONAL GOVERNMENTS**

#### **3.1 Sub-national revenue**

The development of the consolidated operating revenues of general government is presented in Table 3.1. In order to ensure balanced economic growth, one of the key points of the Government's fiscal policy each year is the reduction of income concentration, aiming at improving the income position of households and the business sector, and to stimulate the inflow of foreign capital into Hungary. This endeavour is well reflected by figures as well, since the proportion of the operating revenues of the general government system dropped from the 44.2 per cent of GDP in 1996 to 41.6 per cent by 1999. In respect of their operating revenues, local governments share the fate of the entirety of the general government system. This type of local government revenue amounted to 11.8 per cent of GDP in 1996 and - in line with the reduction of the share of the general government system as a whole - it amounted to only 11.1 per cent in 1999.

##### **3.1.1 Tax revenue**

Some 82 to 85 per cent of the operating revenues of general government (see Table 3.1) come from tax type revenues (taxes, customs duties, social security contributions, state monopolies, duties on acquisition of property etc.).

The tax revenues of the state dropped over the four-year period under review, from 36.8 per cent to 35.5 per cent of GDP.

The payment obligation concerning public burdens, the group of people/entities obliged to pay, applicable rates and the mode of collection, are established by law or by local government decrees issued under authorisation by law. There are statutes of law also specifying the sub-systems of general government and, within them, the organisations whose revenues are constituted by funds originating from such payment obligations. In Hungary, the taxes on (personal and corporate) income and the sales taxes (general and consumption) are collected by the central tax administration, while customs duties, revenue taxes and the taxes on foreign motor vehicles are collected by the customs and excise guard. The collection of local taxes and taxes on motor vehicles in domestic ownership is the responsibility of the local governmental tax authorities. Duties are imposed on the acquisition of property and are also collected by the county and Budapest local governmental duty offices. (The distribution of the latter two types of revenues and of personal income tax revenues between the central and the local government budgets will be covered in a later section.)

Some 8-10 per cent of the tax revenues of the general government system are booked among the current revenues of local governments (see Table 3.1).

It is clear from the figures in the Table that despite the reduction of the centralisation of incomes in the general government system, the share of local government tax revenues increased from 3 per cent to 3.7 per cent of GDP during the four-year period under review. Consequently, the share of local tax revenues increased from 8 to 10 per cent of the total tax revenues of general government.

**Table 3.1** Total revenue by level of government 1996 -99, in millions of HUF

	Central Budget (including extrabudgetary funds)				Social Security Funds				Local Government				General Government (consolidated)			
	1996	1997	1998	1999	1996	1997	1998	1999	1996	1997	1998	1999	1996	1997	1998	1999
<b>Tax Revenue</b>	516 416.5	588 793.1	694 827.0	840 563.9	0.0	0.0	0.0	0.0	101 274.0	135 652.0	179 090.0	191 495.0	617 690.5	724 445.1	873 917.0	1 032 058.9
1000 Taxes on income, profits & capital gains	81 788.7	120 118.8	130 234.4	122 167.2	869 300.0	1 079 724.0	1 265 436.1	1 370 127.7	0.0	0.0	0.0	0.0	718 711.5	916 842.2	1 069 063.4	1 139 804.7
2000 Social Security contributions	3 602.5	8 550.5	9 548.5	12 599.7	0.0	0.0	0.0	0.0	1 174.0	1 389.0	1 161.0	1 354.3	4 776.5	9 939.5	10 709.5	13 954.0
3000 Taxes on payroll and workforce	0.0	18 232.0	21 528.0	43 701.8	0.0	0.0	0.0	0.0	34 127.0	40 903.0	48 572.0	59 239.0	26 688.0	50 547.0	61 258.0	91 496.7
4000 Taxes on property	65 230.0	87 462.5	120 604.2	38 006.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	140 364.0	190 407.5	256 035.2	224 954.0
5000 Taxes on goods and services	1 010 134.4	1 147 991.3	1 305 041.9	1 595 049.7	19 117.0	19 095.0	17 642.8	3 241.4	67 635.0	94 235.0	125 451.0	173 468.8	1 029 808.4	1 167 890.3	1 322 684.7	1 598 291.1
6000 Other taxes	1 677 172.1	1 971 148.2	2 281 784.0	2 652 088.8	888 417.0	1 098 819.0	1 283 078.9	1 373 369.1	204 210.0	272 179.0	354 274.0	425 557.1	2 538 038.9	3 060 071.6	3 593 667.8	4 100 559.4
<b>Total Tax Revenue</b>																
<b>Non-tax Revenue</b>	172 196.5	203 400.7	156 789.3	186 417.5	4 937.0	3 674.0	426.0	2 245.6	18 761.0	36 293.0	38 482.0	38 664.9	191 813.5	240 000.7	192 819.7	228 194.5
Oper. surpl. of. dept. enterpr. & prop. Income	134 432.2	106 072.5	158 960.0	145 803.4	1 073.0	2 437.0	1 161.0	1 745.1	88 985.0	108 101.0	131 379.0	124 935.6	224 509.2	217 582.5	292 950.0	272 096.5
Fees, sales, fines	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contr. to govt. employee pension funds	62 923.4	43 165.2	67 697.7	82 485.8	8 320.0	4 872.0	6 244.0	78 244.9	24 420.0	31 151.0	38 816.0	55 488.2	89 243.7	70 991.2	100 046.1	215 499.4
Other non-tax revenue	369 552.1	352 638.4	383 447.0	414 706.7	14 330.0	10 983.0	7 831.0	82 235.6	132 166.0	175 545.0	208 677.0	219 088.7	505 566.4	528 574.4	585 815.8	715 790.4
<b>Total Non-tax Revenue</b>																
<b>Grants</b>	129 773.1	152 624.2	131 539.4	189 844.6	17 265.0	5 184.0	33 987.4	110 756.4	479 368.3	519 722.5	594 351.8	642 884.0	1 402.5	44 350.2	37 644.6	-1 601.2
<b>Total Revenue</b>	2 176 497.3	2 476 410.8	2 796 770.4	3 256 640.1	920 012.0	1 114 986.0	1 324 897.3	1 566 361.1	815 744.3	967 446.5	1 157 302.8	1 287 529.8	3 045 007.8	3 632 996.2	4 217 128.2	4 814 748.6
Total Revenue as % of GDP	31.6%	29.0%	24.2%	28.2%	12.9%	15.9%	18.6%	19.9%	11.8%	11.3%	11.5%	11.1%	44.2%	42.5%	41.8%	41.6%
GDP in Billion of HUF	<b>6 893.9</b>	<b>8 540.7</b>	<b>10 086.0</b>	<b>11 565.0</b>	30.2%	30.7%	31.4%	32.5%	8.0%	8.9%	9.9%	10.4%	100.0%	100.0%	100.0%	100.0%
Sub-national tax revenue as of % of total tax revenue																
<b>Memo:</b>																
Repayments of loans (as part of lending minus repayments)	253 371.0	241 226.3	89 106.1	51 061.5	1 160.0	11 831.0	17 085.2	839.0	42 842.0	93 627.0	28 527.0	28 621.8	297 373.0	346 684.3	1 333 707.3	79 784.7

The tax type revenues of local governments fall into two main categories: that of taxes and duties assigned or shared, and the category of local taxes (see Table 3.2).

Under the categorisation as per the above-defined aspects, group 'e' is comprised of centrally-imposed and collected personal income tax, part of which, as defined in the annual budget act, is transferred to local governments. This group also includes duties on the acquisition of property that qualify as assigned revenues, the sharing of which is also specified by law. The tax on motor vehicles is a special assigned task, a law-defined part of which is transferred by the local government collecting it to the central budget but - as will be discussed later - the amount of this type of tax revenue is influenced by the local governments by establishing its rate. Therefore, this type of tax revenue is shown in column 'b' in the Table, along with local taxes.

In the local taxes category, a local government may impose taxes, within its area of competency, on the following:

- the ownership of real estate and titles - of commercial value - relating to real estate,
- employment of labour,
- staying in the given municipality as temporary residents, and
- performance of business operations.

It should be noted that no local tax type is to be imposed by a local government on a mandatory basis.

The Table shows that the share of the revenues depending on local decisions has been increasing steadily within the total of local governments' tax revenues. By 1999, these revenues almost equalled the revenues originating from taxes assigned from the central budget, which is also an indication of the growing influence of local governments on the increase of their tax revenues.

The following sections provide a detailed account of the tax revenues of local governments.

#### *3.1.1.1 Personal income tax*

At the time of the introduction of the income payable by private individuals (PIT), in 1988, it was stipulated that it should be a revenue for the local authority of the municipality of residence of the citizen paying such tax. Since information on such tax revenues is available only on an ex-post basis, after the aggregation of tax returns, this principle could only actually be applied after a two-year delay. In 1988-1989, municipal governments received their share of the personal income tax revenue in proportion with the number of their residents, whilst in 1990, they received their share according to the taxpayer's place of residence. In each of those three years, the whole amount of the personal income tax revenue was assigned to local governments, although in 1990 (and ever since then), it was (and has been) based on the tax returns filed two years before the given fiscal year, instead of actual cash-based performance.

In 1991 and 1992, the share of PIT revenue assigned to local governments was reduced to 50 per cent - as a result of the growth in the weight of state subsidies and grants and the increase in the number of subsidy items. This process continued in 1993 and 1994 when the share of PIT assignment was reduced to 30 per cent. Up to that year, the entire transferred amount was received by the local government of the territory in which the given taxpayers lived.

The share of PIT transfer increased in 1995 to 35 per cent but under the then prevailing regulation this was to be used as the source for PIT revenue top-up for depressed municipalities in disadvantaged economic circumstances, the percentage payable to county governments being in proportion with the county's residents - to ensure reliable maintenance of regional institutions as well as part of the funding for the

income supplement benefits for the unemployed. Six per cent of the transferred personal income tax was separated for the above purposes, thus a total of 29 per cent was left at the place of income generation.

**Table 3.2** Classification of taxes of sub-central government. Local government. 1996-99 in millions of HUF

<b>1996</b>									
Category	A	B	c	d.1	d.2	d.3	d.4	E	total
1000 Taxes on income, profits & capital gains								101 274.0	101 274.0
2000 Social security contributions									0.0
3000 Taxes on payroll and workforce		1 174.0 <sup>(1)</sup>							1 174.0
4000 Taxes on property		18 618.0 <sup>(2)</sup>					<sup>(3)</sup>	15 509.0	34 127.0
5000 Taxes on goods and services									0.0
6000 Other taxes		67 635.0 <sup>(4)</sup>							67 635.0
<b>Total</b>		87 427.0						116 783.0	204 210.0
(% distribution)		42.8%						57.2%	100.0%
<b>1997</b>									
Category	A	b	c	d.1	d.2	d.3	d.4	E	total
1000 Taxes on income, profits & capital gains								135 652.0	135 652.0
2000 Social security contributions									0.0
3000 Taxes on payroll and workforce		1 389.0 <sup>(1)</sup>							1 389.0
4000 Taxes on property		22 671.0 <sup>(2)</sup>					<sup>(3)</sup>	18 232.0	40 903.0
5000 Taxes on goods and services									0.0
6000 Other taxes		94 235.0 <sup>(4)</sup>							94 235.0
<b>Total</b>		118 295.0						153 884.0	272 179.0
(% distribution)		43.46						56.00	100.0%
<b>1998</b>									
Category	A	b	c	d.1	d.2	d.3	d.4	E	total
1000 Taxes on income, profits & capital gains								179 090.0	179 090.0
2000 Social security contributions									0.0
3000 Taxes on payroll and workforce		1 161.0 <sup>(1)</sup>							1 161.0
4000 Taxes on property		27 044.0 <sup>(2)</sup>					<sup>(3)</sup>	21 528.0	48 572.0
5000 Taxes on goods and services									0.0
6000 Other taxes		125 451.0 <sup>(4)</sup>							125 451.0
<b>Total</b>		153 656.0						200 618.0	354 274.0
(% distribution)		43.47						56.63	100.0%
<b>1999</b>									
Category	A	b	c	d.1	d.2	d.3	d.4	E	total
1000 Taxes on income, profits & capital gains								191 495.0	191 495.0
2000 Social security contributions									0.0
3000 Taxes on payroll and workforce		1 354.3 <sup>(1)</sup>							1 354.3
4000 Taxes on property		34 581.7 <sup>(2)</sup>					<sup>(3)</sup>	24 657.3	59 239.0
5000 Taxes on goods and services									0.0
6000 Other taxes		173 468.8 <sup>(4)</sup>							173 468.8
<b>Total</b>		209 404.8						216 152.3	425 557.1
(% distribution)		49.21						50.79	100.0%

- Notes: (1) communal tax for business  
(2) building tax + land tax + tourism tax for buildings + community tax for private individuals + domestic vehicle tax  
(3) succession and gift duty + property transfer duty subjects to certain liabilities  
(4) business tax + tourism tax paid for residence

Between 1996 and 1998, the transferred share of PIT revenue increased to 40 per cent, however, the amount left at the place of income generation dropped gradually from 29 per cent to 20, whilst the share distributed on a normative basis increased from 11 to 20 per cent (including also the supplementary funding distributed to help municipal governments with lower than average personal income tax revenues to catch up with the more affluent ones). By distributing an increasing proportion of personal income tax based on normative principles, the regulation is mitigating the growing income discrepancies between municipalities.

Part of PIT is used directly to reduce income differences, and this part has been growing in importance over recent years - it quintupled during the past 5-year period. The appropriation for this purpose was aimed originally at reducing the revenue differences resulting from the differences in PIT revenues (left at the place of residence of the taxpayers). (The differences between types of municipality are indicated by the following details: when compared to PIT revenues in villages, local PIT revenues are 3.3 times higher in Budapest, 2.2 times higher in county right towns and 1.5 times higher in other towns.)

The substantial variance of revenues resulting from the steadily increasing local business tax revenues also needed to be addressed. (By the mid-90's, the per capita business tax income, when compared to that in villages, was 27 times higher in Budapest, 9 times higher in county right towns and 8 times higher in other towns. Indeed, in some municipalities, the per capita amounts of local business tax revenues were even higher - in one small town, this amount equalled about 150 times the village average. This differentiation has diminished by now but is still quite substantial.)

Accordingly, since 1999, in addition to the personal income tax revenue left at the place of income generation, the amount of the local business tax revenue is also taken into account in the establishment of the share of PIT aimed at reducing income differences - qualifying, in essence, as a subsidy. Instead of the actually collected amount of local business tax, an average potential income capacity, the tax payment capability of the local businesses is the basis of the calculations. In other words, the regulation does not take into account the actual rates applied by a local government within the maximum permitted rate, and it does not take into account any preferences or exemptions either. Another new feature of the regulation is that local governments with weaker income capacities are not only provided with supplementary funding, there is also a 'skimming' applied to the revenues of those with outstanding revenue capabilities. This provides more in the way of funding to the less affluent.

Today, PIT accounts for some 15 per cent of the current revenues of local governments.

#### *3.1.1.2 Motor vehicle tax*

The taxation of motor vehicles is regulated by a separate law. The taxes on vehicles with domestic licences and number plates are set by local governmental tax authorities. Taxpayers, the tax base and the range of tax exemption are specified by law while the actual tax rates are set - between the statutory minimum and maximum rates - by local governments, in their decrees. Under a decision made by a local government, a minimum of HUF600 and a maximum of HUF1,000 is payable as tax on each full 100kg and the final partial 100kg unit of weight of a vehicle, as stated in its licence. In the case of a motorcycle, trailer or caravan, minimum of HUF2,000 and a maximum of HUF5,000 is payable each year. An important rule of the law applied as a guarantee is that where a local government sets a rate over the lower limit the revenue resulting from the difference is fully retained by the local government concerned. The revenue up to the minimum rate is shared in equal proportions by the local government concerned and the central budget.

Revenues of local governments from vehicle taxes account for about 1 per cent of their current revenues.

### *3.1.1.3 Duties on the acquisition of property*

The establishment of the basis of duties and of the applicable rates is regulated by law. No deviation from the provisions of the law is permitted. The duty offices of the county and Budapest local governments are entitled to collect duties on the acquisition of property (inheritance, donation of gifts, transfer of property for valuable consideration) of which county right towns also have a share - in proportion with the revenues generated in their territories. An average of 50 per cent of such revenues are retained by the above two types of local government while the other 50 per cent is absorbed by the central budget.

The real estate registration duty is also collected by the duty offices, however, no less than 90 per cent of such revenues are transferred to the central budget and only 10 per cent is retained where it is collected.

In respect of such revenues, the general rule is that they are not collected to settle the costs of service provision, rather, they are used as a general contribution to the funding of the performance of the tasks of the local governments concerned.

Duties on acquisition of property are related to the acquiring of property free of charge (inheritance, donation as gift) or to transfer of property for valuable consideration. The act on duties establishes the amount of a duty based in the majority of cases on the transaction value of the property acquired through a transaction expressing its market price. The duty payable on the acquisition of property is calculated based on the transaction value also in the case of the acquiring of titles (of commercial value).

Succession duty is payable on the acquiring of property after the death of the previous owner, while gift duty is payable on the acquisition of property by the recipient of a gift. Duty is payable on the inheritance or reception as a gift of real estate, movable property, as well as titles of commercial value. The duty is calculated based on the transaction value net of the taxes specified by law. The law imposes the same rate in the case of both types of duties, establishing three categories according to the relationship between the testator or donor and the recipient. The duty payable on acquiring residential real estate is lower than the general rate of duty in each of the types of duties and categories of relationships.

Another large group of duties on the acquisition of property is made up of duties payable on transfer of property against valuable consideration. This type of duty is payable typically on the acquiring of real estate or title of commercial value relating to real estate against valuable consideration, as well as on acquisition in other ways not falling under the obligation of payment of duty on succession or on a gift. In respect of movable property, duty is payable on acquisition through auction and on the acquisition of motor vehicles and trailers. The general rate of duty on acquisition of property against valuable consideration is 10 per cent. In the case of the acquisition of residential real estate, it is 2 per cent on the part of the value of the real estate up to HUF 4 million and 6 per cent on the part of the value over HUF 4 million. In the case of acquisition of motor vehicles, the duty is HUF 10 on each cubic centimetre of the capacity of the engine, in the case of acquiring a trailer, the duty is HUF 5,500 up to 2,500 kg and HUF 12,000 over 2,500 kg.

A common feature of the duties on the acquisition of property is that the obligation of the payment of the duty is borne by the recipient, irrespective of the legal title of acquisition, in proportion with his or her actual share of the property. Furthermore, the act on duties grants preferences and benefits as well, in each of the three types of duties.

### *3.1.1.4 Local taxes*

For the local governments established in Hungary in 1990, a system of local taxes was developed, in order to enable local governments to perform public services in line with the local characteristics and requirements, and to provide them with means for financial management. Among the sources of local government own revenues, local taxes play a role of great importance.

The **building tax** is imposed on buildings and parts of buildings, for residential or other purposes, in the territory of competence of a given municipal government, and the owner of such building is the taxpayer. The tax base is established as the useful floor area of the given building (in square metres) or its adjusted transaction value. The maximum annual amount of the tax on buildings is HUF 900/m<sup>2</sup> or 3% of the adjusted transaction value. Objects that are exempt from this type of tax include temporary lodging (of necessity), buildings owned by social or health care institutions, budgetary organisations, churches, etc.

**Land tax** is imposed on vacant sites in the area of competency of a local government. The taxpayer and the tax base are subject to the rules laid out with respect to the building tax. The maximum annual amount of the tax on land is HUF 200/m<sup>2</sup> or 3% of the adjusted transaction value, subject to decisions made by the local government concerned.

The **communal tax payable by private individuals** is another type of tax relating to real estate. Such tax is payable by private individuals who may also be taxpayers of building or land tax as well as private individuals holding rental rights of residential real estate owned by entities other than private individuals, in the territory of competency of a given local government. The annual amount of the tax may be a maximum of HUF 12,000 by taxable item or residential real estate rental right.

The **communal tax payable by businesses** relates to the employment of labour. In this case the tax base is comprised of the adjusted average statistical number of the persons employed by the taxpayer in the territory of competency of the given municipal government and the maximum annual amount of the tax is HUF 2,000 per capita.

**Tourism tax** is payable by a private individual staying at least one night as a guest, as well as by the owner of a building suitable for use as holiday accommodation - not qualifying as residential real estate - in the territory of competency of the local government concerned. The tax is based in the first case on the number of whole or part guest-nights spent in the municipality or the boarding charge payable for whole or part guest-nights, while in the second case it is based on the useful floor area of the given building. Private individuals below the age of 18 or over the age of 70 are exempted from the obligation of paying tourism tax when staying in a municipality, as are individuals staying in health or social institutions, and those staying in the territory of a municipal government on account of employment or studying (or for the purposes of business activities, etc.).

The **local business tax** is payable on business activities and/or the existence of a head office or other unit of business in the area of competency of a local government. The tax is payable by the entrepreneur or owner of the business. Business operations may be permanent or temporary, and the basis and rate of the tax may also vary, accordingly.

In the case of permanent business operations, the tax is based on the net sales revenue of the products/services sold, net of the cost of goods sold, the value of subcontractors' performance and the costs of materials. (In 1999, the maximum rate of the tax equalled 1.7 per cent; since 2000, it has been 2 per cent.)

In the case of temporary business activities, the tax may be established on the basis of the calendar days of the performance of the activities.

### **3.1.2 Non-tax revenue**

Most of the non-tax revenues of general government are collected in the central budget. The local government share of such revenues accounts for an estimated 30 per cent (see Table 3.1).

The following items qualify as non-tax revenues:

- ***'Income from business operations and property'*** includes payments on profits of business activities, dividends on shares and other participations, concession fees, amounts paid on investment assets and interest revenues.
- ***'Administrative fees and duties, non-industrial and ac-hoc sales'*** include institutions' service charge type revenues relating to their activities and the revenues from procedures of bodies in their capacity as authorities, procedural charges, fees and duties. A common feature of fees and duties is that both are related to the use of services provided by elements of the general government system. It is an important characteristic of duties that there is no direct economic relationship between the amount charged and the cost of the service. One of the peculiar features of the Hungarian system is that duties fall into two main categories by economic content and function: duties payable on the acquisition of property, and duties payable in relation to state administration and court proceedings. The first category qualifies as tax type revenues, as has been outlined above.

In the second category, the duties usually paid in the form of stamps for state administration procedures are revenues of the central budget. In the case of local governments, such duties are, at times, settled in cash. In the course of state administration procedures, the proportion of duties collected by local governments, in cash, is rather small. These may be applied only in cases and at rates specified by centrally issued statutes (e.g. duty on data supply which may be charged, in specific cases, for data issued from registries of citizens addresses of residence, or cattle ownership papers - cattle licences - issued in proof of origin of livestock).

In the case of service charge type fees, however, the costs of the service or some of its elements are taken into account in the calculation of the charges, although other aspects - e.g. social considerations - are also taken into account.

- The category of ***'fines and late performance charges'*** include environment protection, nature conservation, historical monument protection and construction administration fines, along with late performance penalties and damages.

The annual budget act specifies the amount (share) of the environmental fines to be retained by local governments. The distribution of the fines imposed and collected by inspectorates for the protection of ancient monuments and the amount (rate) of the construction administration fines that may be imposed by local governments are specified by relevant sectoral statutes.

- ***'Other non-tax revenues'*** include donations, gifts made by participants of the private sector, the sales of used and/or superfluous assets, VAT settlements and value added taxes on products and services for which local governments have made out invoices, and the VAT on tangible and intangible assets sold by local governments.

### ***3.1.3 Inter-government financial relations - Grants***

The budgets of local governments are connected to the other three sub-systems of general government primarily through the subsidies (grants and other types of funding) received from them.

The funding from the Health Insurance Fund for the performance of health-related tasks and the funding from the Labour Market Fund for the performance of tasks relating to the system providing services and benefits for the unemployed are presented in Section 4.7, as part of the detailed description of the health and social service providing systems.

Further to the above-detailed personal income tax, local governments receive state contributions and subsidies from the central budget. The appropriation for such funding is included in the chapter of the Ministry of the Interior. These funding sources constitute the main part of subsidies.

Other chapters of the central budget may also provide funding to local governments to promote various technical/professional programmes but the total amount of such subsidies is not very large.

### 3.1.3.1 *State contributions and subsidies*

These funding sources fall into three distinct groups, the *first* one of which is comprised of the central budgetary contributions paid to local governments based on normatives, the spending of which is fully discretionary.

The *second* group is also made up of normative contributions by the central budget but they may be spent only on specific goals.

In the case of the subsidies falling into the *third* group, the allocation is based on individual decisions and these subsidies may also be spent only on specific purposes.

#### 3.1.3.1.1 Normative state contributions (from the central budget) for unrestricted utilisation

For the performance of their mandatory responsibilities, local governments are automatically entitled to normative contributions from the central budget. This, however, is not a form of task-financing, as the spending of such subsidies is not subject to restrictions. A local government decides at its own discretion, how much it spends on what tasks. Initially (in 1990), global contributions dominated (relating at first to the total number of residents, later to the number of individuals in the various age groups). Later on, however, the share of contributions based on the indicators of more concrete tasks (number of children in crèche, kindergarten, primary and secondary schools, those using the services of student hostels, social institutions, etc.) made up an increasing part of the total funding. The aim of this, however, was to improve the allocation of such funding from the central budget among local governments.

There is only one item that is directly related to the revenues collected directly by the local governments. Each forint of the actually-collected holiday accommodation charge is matched by two forints of subsidy - this makes up less than one per cent of the total budgetary subsidies.

The following Table sums up the legal titles and unit amounts of normative state subsidies, and the personal income tax allocated on the basis of normative rules, in 1998 and 1999. The detailed presentation of these using recent data is necessitated by the fact that some two thirds of the total subsidies from the central budget and local government share of personal income tax are made up of these items.

**Table 3.9** Normative state contributions of local governments and the legal titles and unit amounts of the personal income tax revenue allocated on the basis of normative rules in 1998 and 1999

	<b>Legal title</b>	<b>1998 amount</b>	<b>1999 amount</b>
<b>I.</b>	<b><i>Normative state contributions</i></b>		
1.	Duties relating to holiday resorts	HUF 2/ HUF 1 from tourism tax	HUF 2/ HUF 1 from tourism tax
2.	Municipal administration, communal services and sports related duties	HUF 1,200/ capita, total number of permanent population	HUF 594/capita residents
3.	District administration duties	uniform HUF 4,000,000  HUF 200 / capita permanent population of district of service provision  HUF 70 /capita total permanent population of municipalities designated by the Government	uniform HUF 4,650,000  HUF 233/ capita population of district of service provision  HUF 81 /capita residents of municipalities designated by the Government
4.	County/capital city administration and sports related duties	HUF 150 /capita permanent population	HUF 169 /capita residents
5.	Tasks of basic social and child welfare service provision a) basic contribution b) family assistance and/or child welfare service c) village guardian service	HUF 933 /capita HUF 300/capita  HUF 900,000	HUF 965/capita HUF 328 /capita  HUF 980,000
6.	Specialised child protection service	HUF 400,000 / recipient	450,000/ recipient
7.	Institutional service providing permanent and temporary accommodation a) Institutional service provision b) Performance of methodology related tasks	HUF 292,000 /recipient	HUF 323,200 /recipient uniform HUF 6,000,000
8.	Daytime social institutions service provision	HUF 60,000 /recipient	HUF 77,100 /recipient
9.	Temporary institutions for the homeless	HUF 120,200 /capita of capacity	HUF 159,800 /capita of capacity

10.	Psychiatric and institutional service provision for addicts and for people with disabilities	HUF 391,000/recipient	HUF 432,500/recipient
11.	Crèche service provision	HUF 161,000/recipient for 365 days of care	HUF 128,000/recipient for 261 days of care
12.	Education at kindergarten	HUF 67,000/capita	HUF 80,000/capita
13.	Schooling - in grades 1-6 - in grades 7-8 - in grades 9-10 - in grades 11-13	HUF 72,000/capita HUF 75,000/capita HUF 76,000/capita HUF 96,000/capita	HUF 83,000/capita HUF 83,000/capita HUF108,000/capita HUF108,000/capita
14.	Vocational education and training at school a) - 9 <sup>th</sup> and 10 <sup>th</sup> grade of vocational school and secondary vocational school organised in accordance with the act on education (OT) - 11 <sup>th</sup> grade of vocational school and secondary vocational school organised in accordance with the OT b) vocational - theoretical education and training in vocational schools as per the act on public education (Kt.) c) vocational - theoretical education and training in secondary vocational schools as per the Kt, d) vocational practical training - practical training in vocational school according to the Ot. - practical training in secondary vocational school according to the Ot. - practical training as per the Kt. in apprenticeship school and secondary vocational school - practical training in vocational school as per the Kt.	HUF 68,000/capita  HUF 70,000/capita  HUF 77,000/capita  HUF100,000/capita  HUF 25,000/capita HUF 45,000/capita HUF 45,000/capita HUF 30,000/capita	HUF 80,000/capita  HUF 80,000/capita  HUF 90,000/capita  HUF105,000/capita  HUF 50,000/capita HUF 50,000/capita HUF 50,000/capita HUF 50,000/capita
15.	Services provided in the way of special care a) special schooling of mentally handicapped children b) early development, care c) improving preparation	HUF130,000/capita  HUF 94,000/capita HUF130,000/capita	HUF194,000/capita  HUF105,000/capita HUF145,000/capita
16.	Basic arts education a) musical, fine arts and crafts b) dance, dramatic and puppetry arts	45,000/capita 45,000/capita	49,000/capita 40,000/capita
17.	Student hostel services and services for students not residing in hostel	135 500/capita	152,000/capita

18.	Contributions to the performance of other public education responsibilities a) arts education in the form of parallel education - training in vocational school - training in secondary vocational school b) catching up education for students of vocational school c) services for children and students with serious problems of fitting in with their community, learning and behaviour disorders d) services for children and students commuting to kindergarten and primary school e) services for children and students attending kindergarten and primary school of association formed to maintain such institutions f) children and students at kindergartens and primary schools in municipalities with populations below 3,000 g) children and students at kindergartens and primary schools in municipalities with populations between 2,999 and 3,500 h) organised meals at institutions i) daytime programmes for children at primary school j) library maintenance, procurement of teaching materials, IT training	HUF 25,000/capita HUF 30,000/capita HUF 9,600/capita  HUF 3,200/capita  HUF 10 500/capita  HUF 12,000/capita  HUF 20,000/capita  HUF 10,000/capita  HUF 13,700/capita HUF 3,800/capita HUF 2,200/capita	HUF 60,000/capita HUF 60,000/capita HUF 21,200/capita  HUF 12,000/capita  HUF 12,500/capita  HUF 16,000/capita  HUF 22,000/capita  HUF 11,000/capita  HUF 16,000/capita HUF 5,500/capita HUF 1,830/capita
19.	Performance of tasks of local public cultural activities and maintenance of local public collections	HUF 555/capita permanent population	HUF 635/capita residents
20.	Performance of tasks of cultural activities and maintenance of local public collections in counties and the capital city	uniform HUF 48,500,000 plus 145/capita permanent population	uniform HUF 53,000,000 plus 210/capita residents
<b>II.</b>	<b><i>Personal income tax allocated on the basis of normative rules</i></b>		
2.	Share of the PIT of county governments - for all county governments - based on population - based on number of users of services rendered by institutions	HUF 210 million HUF 450/capita HUF 10,800/capita	HUF 250 million HUF 540/capita HUF 14,471/capita
3.	Municipalities at disadvantage from social, economic and infrastructure related aspects	HUF 1,695/capita permanent population	HUF 2,041/capita residents
4.	General tasks of villages	HUF 2,000,000	HUF 2,000,000/village

5.	Municipal administrative, communal and sports related tasks	In 1998 only as a normative state contribution	HUF 421/capita residents
6.	Tasks relating to inhabited areas outside the municipal administrative areas	-	HUF 2,000/capita residents outside municipal administrative area
7.	Cash and in-kind social and child welfare benefits (based on a composite indicator it was presented in annex 3 in 1998, financed partly from re-allocated personal income tax)	HUF 500-12,500/capita	HUF 2,500-12,500/capita
8.	Subsidising of acquiring of dwellings and housing maintenance (based on composite indicator)	In 1998 it was part of the contribution as per II.7	HUF 500-4,000/capita

The subsidy mechanism applied to reduce income differences - outlined in Section 3.1.3.1.1 on personal income tax - is also considered as belonging here.

#### 3.1.3.1.2 State contributions for specific purposes allocated under normative rules (from the central budget)

The majority of such subsidies are related to development projects of local governments. This category includes so-called targeted grants where a law defined that a proportion of the planned appropriations of certain priority investment expenditures are provided from the central budget - automatically if the relevant conditions are met - for local governments, while the remaining amounts are to be provided by the local governments concerned, along with any possible extra expenditures. The central subsidy, therefore, is not adjusted to actual expenditures.

Where a local government is not capable of raising its own funds, a local government in depressed or backward areas may be granted supplementary funding from the subsidy (grant) budget available for the reduction of regional inequalities, managed under the decision-making competencies of the county development councils. Over recent years, such targeted grants have provided practically all municipalities in Hungary with healthy drinking water, primary schools have been built, and hospitals and clinics have acquired new instruments and equipment. More recently, such grants have been aimed primarily at environmental projects, e.g. waste water collection and treatment, and the establishment of solid waste depots.

This category also includes other grants approved in the annual central budget act - these are also to be spent on specific tasks. Within this category the following subsidies and grants are used for operational purposes: contributions to the operation of district notary offices, local governmental fire departments, local minority governments, subsidies relating to the provision of drinking water and sewerage services for households, subsidies relating to public education responsibilities comprising various items, and the income supplement benefits for children, people not covered by the central unemployment benefit, and elderly citizens. In some of these cases, the central contribution equals the amount actually paid out by local governments - e.g. the child raising benefit (GYET).

The following types of grant are for development purposes: refunding of some of the contributions by households to public utility developments, the subsidising of disaster prevention operations in cellar systems and natural embankments. The conditions for access to such grants and subsidies are also specified by the budget act.

#### 3.1.3.1.3 Specific state subsidies granted on a case-by-case basis for specific purposes

This category is also comprised, for the most part, of development subsidies. On the one hand, this area includes subsidies promoting the implementation of large local governmental investments and reconstruction operations involving health institutions (hospitals) and cultural institutions (e.g. theatres) relating to regional responsibilities. These are decided on in separate acts of law and the amounts of such subsidies - in view of the total costs of the given projects and, in recent years, in view of the given local governments' own resources - are established based on the proposals of the ministries concerned. This type of subsidy has become rather fragmented recently - the group of subsidised projects now includes ones of smaller budgets and in some cases ones that are not even serving regional purposes. In order to put an end to this practice, the range of central earmarked subsidies has been restricted by law, since 1998, to projects of over HUF 200 million. Decisions on the provision of financial support to smaller projects are made by the regional development councils using the above-mentioned budget along with the decentralised budget of a targeted nature, introduced to provide support to local governments not only in the group that is categorised as disadvantaged.

On the other hand, this category holds smaller subsidies adopted in the budget act (support of the maintenance of theatres, orchestras, choirs, ferry services, etc.).

Furthermore, mention should be made of the financial support of the category of 'Local governments in a disadvantaged position for reasons beyond their control' which is provided for local governments that do not have sufficient revenues, despite various supplementary contributions of an 'equalising nature', for the performance of their mandatory tasks, primarily for the poor, local, revenue-generating background. The budget act specifies the normative conditions under which a local government can have access to such a subsidy. Its utilisation is linked, of course, to the operating (current) expenditures but it is not fixed to any specific target.

This type of funding source includes the aid provided to help cover expenditure relating to so-called force majeure occurrences (natural disasters) on which the Minister of the Interior and the Minister of Finance make joint decisions on a case-by-case basis. The development of the subsidies provided to local governments is presented in Table 3.4.

**Table 3.4** The profile of central grants to local governments, 1996 -1999 in millions of HUF

Year	Specific Grants			General Purpose Grant			Total
	Current		Not Conditional	Objective criteria		Discretionary	
	Conditional			Without own tax effort	With own tax effort		
	Standard Costs	Actual* Costs					
<b>1996</b>	436,321.8	6,573.2	26,227.1		1,416.9	8,829.3	479,368.3
<b>1997</b>	493,748.5	8,648.4	3,264.7		2,919.8	11,141.1	519,722.5
<b>1998</b>	544,113.8	11,033.8	22,950.4		3,411.7	12,842.1	594,351.8
<b>1999</b>	605,149.4	3980.3	11,473.6		4,147.6	18,086.1	642,884.0

Note: \* Child allowance was centralised in 1999

In view of the correspondence to the figures in Table 3.1 - of current revenues only - the above table does not include grants and subsidies relating to development projects either, but they are detailed in the section on state subsidies and grants.

The above-detailed grants and subsidies are taken into account in Table 3.4 as follows:

- The normative grants relating to task indicators, as per sub-section 3.1.3.1.1, and the specific grants (net of child allowance) for operational purposes, as per sub-section 3.1.3.1.2, and the subsidies provided by the Health Insurance Fund, the Labour Market Fund and the line ministries, are in the column ‘specific, conditional, standard cost’.
- The fully funded child allowance is in the column ‘specific, conditional actual costs’.
- The contributions relating to the number of residents, as per sub-section 3.1.3.1.1, are in the column ‘specific, not conditional’.
- The grant relating to the tourism tax, as per sub-section 3.1.3.1.1, is in the column ‘general purpose, with own tax effort’.
- The operating subsidies allocated on a case-by-case basis, described in sub-section 3.1.3.1.3, are presented in the column ‘general purpose, discretionary’.

### **3.2 Sub-national expenditure**

In accordance with the policy of diminishing income centralisation, another key objective of the Hungarian budget policy is to reduce the income reallocating role of general government, and to keep the general government deficit under control.

To this end, the proportion of current spending of general government was reduced between 1996 and 1999 from 46.6 per cent to 44 per cent of GDP.

Within the above figures, the current local governmental spending diminished from 11.1 per cent to 10.4 per cent of GDP.

The development of current spending between 1996 and 1999 is presented in Table 3.6 by sub-system and function.

The largest proportion of current expenditure of local governments is made up of spending on education, health and social/welfare responsibilities. The typical expenditure indicators of these three systems of service provision are presented in Table 3.7.

The education, health and social/welfare areas account for 32-33 per cent, 19-20 per cent and 15/16 per cent, respectively, of the total current spending of local governments. The expenditure of local governments on education, health and social/welfare functions accounts for 66-67 per cent, 43-51 per cent and 10-11 per cent, respectively, of the total general government spending on the relevant areas. (The reasons for the substantial shift that has been observed over the years under review in the area of health care services is explained in the Section on the detailed description of the sector.)

The specifics of the above three areas, the role of local governments in the performance of responsibilities and the division of funding sources between the state and local governments are described in detail below.

**Table 3.6** Current expenditure by function and level of government, 1996- 99 in millions of HUF

*Social security contributions paid by government units are included in the figures, they are not consolidated!*

	Central Budget (including extrabudgetary funds and social security funds)				Local Government				General Government (consolidated)			
	1996	1997	1998	1999	1996	1997	1998	1999	1996	1997	1998	1999
1 General Public Services	135,421.6	156,230.0	228,563.4	243,261.5	103,109.0	130,676.0	133,746.0	173,033.0	190,248.0	254,454.2	320,037.4	366,198.1
2 Defence	64,551.5	79,068.1	86,850.6	104,317.2	234.0	294.0	646.0	556.0	62,603.6	78,161.9	87,261.7	98,319.5
3 Public Order & Safety	115,718.8	147,899.5	183,990.2	207,725.3	7,613.0	9,239.0	12,307.0	15,140.0	114,360.9	147,384.6	183,868.7	198,609.0
4 Education	266,748.4	325,296.3	383,404.2	438,664.2	248,798.0	298,886.0	346,551.0	393,397.0	367,962.3	443,340.4	529,613.9	594,091.7
5 Health	378,309.3	451,535.1	532,622.3	609,958.9	152,673.0	177,859.0	204,309.0	224,583.0	299,503.8	390,648.7	473,108.9	513,095.2
6 Social Security & Welfare	1,071,861.5	1,271,961.4	1,524,670.8	1,756,764.8	113,267.0	133,674.0	177,007.0	194,037.0	1,089,270.1	1,278,146.3	1,554,527.8	1,746,477.1
7 Housing & Community Amenities	5,833.5	15,777.0	21,089.5	29,228.5	71,520.0	85,867.0	97,273.0	103,811.0	60,985.0	75,927.0	89,028.0	92,318.0
8 Recreation, Cultural & Religious Affairs & Services	83,545.4	55,672.1	76,948.4	97,273.2	32,781.0	37,178.0	50,734.0	55,830.0	95,097.5	76,537.2	102,718.6	120,036.8
9 Fuel and Energy	1,452.6	1,859.3	2,731.9	3,284.6	0.0	0.0	0.0	0.0	1,185.7	1,778.3	2,353.3	2,647.4
10 Agriculture, Forestry, Fishing, and Hunting	95,995.1	97,298.5	124,658.4	156,468.7	5,378.0	6,328.0	6,680.0	8,200.0	94,159.8	97,857.1	128,017.2	157,872.7
11 Mining, Manufacturing, & Construction	7,800.4	7,093.3	6,091.9	6,450.1	1,034.0	851.0	2,483.0	900.0	8,779.9	7,910.8	8,466.3	7,064.2
12 Transportation & Communication	95,739.7	103,638.7	130,245.7	146,597.6	9,615.0	10,797.0	16,814.0	14,612.0	93,150.1	106,855.4	131,572.5	119,812.3
13 Other Economic Affairs	75,262.6	96,926.7	122,994.6	148,361.3	5,283.0	5,308.0	8,792.0	11,648.0	70,623.0	73,967.6	94,970.5	109,920.8
14 Other functions	686,848.8	899,856.2	803,918.9	922,611.1	16,374.0	13,377.0	19,837.0	10,066.0	666,594.8	919,820.5	820,331.4	967,140.3
<b>15 Total current expenditure</b>	<b>3,085,089.2</b>	<b>3,710,112.2</b>	<b>4,228,780.8</b>	<b>4,870,967.0</b>	<b>767,679.0</b>	<b>910,334.0</b>	<b>1,077,179.0</b>	<b>1,205,813.0</b>	<b>3,214,524.5</b>	<b>3,952,790.0</b>	<b>4,525,876.2</b>	<b>5,093,603.1</b>
16 Current government expenditure % of GDP	44.8%	43.4%	36.6%	42.1%	11.1%	10.7%	10.7%	10.4%	46.6%	46.3%	44.9%	44.0%
GDP in Billion of HUF	<b>6,893.9</b>	<b>8,540.7</b>	<b>10,086.0</b>	<b>11,565.0</b>								

**Table 3.7** Expenditure indicators by the three most important policy sectors. Local Government. 1996-1999 in millions of HUF and as a percentage.

	Education				Health				Social Security & Welfare			
	1996	1997	1998	1999	1996	1997	1998	1999	1996	1997	1998	1999
Local expenditure (on policy sector), in millions of HUF	248,798	298,886	346,551	393,397	152,673	177,859	204,309	224,583	113,267	133,674	177,007	194,037
	%	%	%	%	%	%	%	%	%	%	%	%
Local expenditure (on policy sector) as a proportion of total local expenditure	32.41%	32.83%	32.17%	32.63%	19.89%	19.54%	18.97%	18.63%	14.75%	14.68%	16.43%	16.09%
Local expenditure as a proportion of total government expenditure on (policy sector)	67.62%	67.42%	65.43%	66.22%	50.98%	45.53%	43.18%	43.77%	10.40%	10.46%	11.39%	11.11%
Proportion of local expenditure (on policy sector) covered by specific grants	63.19%	64.28%	65.01%	65.74%	97.21%	94.32%	93.12%	94.25%	75.25%	81.86%	59.67%	52.89%
<i>(taking into consideration also the allocation of the normative PIT)</i>									75.25%	82.58%	84.35%	84.45%
Proportion of local expenditure (on policy sector) covered by non-tax revenues	10.22%	9.89%	9.62%	9.63%	5.21%	5.46%	5.57%	5.92%	15.51%	16.13%	14.64%	15.17%

#### 4. EVALUATIONS ON SUB-NATIONAL AUTONOMY AND NATIONAL FISCAL CONSTRAINTS

##### 4.1 General presentations of the sub-national government system: Summary on government finance reform policies

Local governments constitute the fourth sub-system of general government. Besides functioning in direct contact with citizens, local governments perform functions in almost all areas of state responsibilities (see Table 4.1). By performing legislative tasks (issuing decrees and resolutions) at their own particular levels and by carrying out sectoral administrative, supervisory, taxation service provision and financial management responsibilities, they have a fundamental impact on the prevailing social atmosphere.

**Table 4.1** Expenditure assignment – actual status of the legal framework

		General Government	Local Government
1	General public services	Xx	X
2	Defence	Xx	X
3	Public order & safety	Xx	X
4	Education	X	Xx
5	Health	X	Xx
6	Social Security & Welfare	Xx	X
7	Housing & community amenities	X	Xx
8	Recreation, cultural & religious affairs	Xx	X
9	Economic services	Xx	
10	Fuel & energy	Xx	
11	Agriculture, forestry, fish farming and game management	Xx	
12	Mining, manufacturing & construction, except fuel & energy	Xx	
13	Transport & communications	Xx	X
14	Other economic affairs	Xx	
15	Other functions		

The roles of the various sub-systems of general government are described in the table below showing the number of budgetary organisations performing various tasks and the numbers of their employees, in a breakdown by type of organisation in charge of maintaining such organisations, and by their sectors of operation.

**Table 4.3** Budgetary organisations of autonomous financial management, broken down by sector, and the average numbers of full time staff, as at 31 December, 1999

Branches of the national economy	Number of budgetary organisations of autonomous financial management				Average number of full-time employees			
	Central	Social security funds	Local govt.	Total	Central	Social security funds	Local govt.	Total
Public administration, fiscal administration, defence mandatory social security	449	46	3,984	4,479	172,703	8,637	190,122	371,462
Education	104		2,329	2,433	50,317		167,607	217,924
Health, social/welfare services	55		771	826	30,512		145,574	176,086
Real estate transactions, lease, services supporting economic activities	81		117	198	7,031		4,837	11,868
Commercial boarding, catering			20	20			926	926
Power, gas, caloric energy and water supplies			19	19			360	360
Agriculture, game management, forestry	3			3	210			210
Fish farming				0				0
Mining				0				0
Construction	1		2	3	109		259	368
Trade, repairs of vehicles				0				0
Transport, warehousing, postal and telecommunication services	1		11	12	2,573		147	2,720
Manufacturing			1	1			4	4
Other community and personal services	48		459	507	6,252		15,010	21,262
<b>Total</b>	<b>742</b>	<b>46</b>	<b>7,712</b>	<b>8,500</b>	<b>269,707</b>	<b>8,637</b>	<b>524,842</b>	<b>803,186</b>

Source: Ministry of Finance, ÁHIR statistics database

#### 4.1.1 Legislative framework of local governments

The Hungarian local governmental system was developed in 1990, as part of the process of the system change. The key guarantees of the operation of local governments, as a separate factor of sovereign power are laid down in the Constitution, in accordance with the provisions of the European Charter of Local Governments.

Under the Constitution, local governments have equal rights, meaning, that the elimination of the soviet type council system subordination and superordination was also terminated. Consequently a one-tier local governmental system was established. The Constitution only acknowledges local governments.

The Constitution stipulates that constituents are entitled to local self-governance, which is comprised of the autonomous and democratic management of local public affairs.

Constituents exercise local self-governance through the council, made up of their elected representatives, or through referenda. Local governmental elections take place once every four years - in the years of the general elections.

The Constitution provides that a local government is entitled to raise its own revenues - for the performance of its legally-defined duties - and that it is also entitled to state subsidies that are proportionate to such duties. A local government is entitled to establish the types and rates of local taxes within the limits specified by law.

A local government has autonomy in managing its revenues. The central budgetary subsidies allocated for fixed purposes make up only some 10 per cent of their annual budget totals (net of the local government expenditures financed by the health insurance fund). A local government may undertake business activities at its own risk - bearing responsibility for such activities - but such operations may not threaten the performance and exercise of statutory local government duties and powers. In respect of public issues, the management of which is undertaken by a local government on a voluntary basis, a local government may take any action not specifically prohibited by law.

Further fundamental rights of local governments include: the freedom to establish associations with other local governments; the freedom to establish interest protection alliances with other local governments to promote their interests; co-operating with local governments of other countries, within their scope of responsibility; and becoming members of international organisations of local governments. In respect of public matters concerning the local community, a local government may submit an initiative or motion to the relevant authority.

Under the provisions of the Constitution, the fundamental rights of local governments also include the autonomy of regulation and administration concerning local public affairs, including the issuance of decrees which are not contrary to higher level legislation. A decision made by a local government may be reviewed only if it violates the law, and may be cancelled only by the Constitution Court - or a court of law in respect of issues dealt with by a local government as an authority. A local government develops its own organisational structure and operating regime within the limits set by law.

A local government may introduce symbols and establish local decorations and titles of recognition of merit.

Based on the provisions of the Constitution, the key issues of the operation of a local government are regulated in detail by Act No. LXV, of 1990, on local governments (Ötv.), which is an act of law whose adoption and amendment takes a two-thirds majority of votes in Parliament. By way of guarantee, the act on local governments states that local public affairs may only be assigned to a body other than a local government under exceptional circumstances. This regulation ensures that it is not possible to reduce autonomy by transferring local public affairs to the scope of responsibilities or powers of public affairs. In exercising its powers, a local government proceeds under legal protection - to secure this right, a local government may apply to the Constitution Court.

Under the provisions of the act on local governments, the tasks of providing for certain public services may only be imposed on local governments by law. A municipality may be obliged to perform various duties depending on its size, population and/or other factors.

The local government act also provides that, where a mandatory duty and/or power is imposed on or assigned to a local government, the Parliament is to provide the necessary funding for the performance and exercise of such tasks and power, deciding on the amount and mode of the budgetary contribution.

Under the act on local governments, a local government is entitled to determine the ways and modes for the performance of the various duties, depending on the requirements and demand of the local population and its financial resources. A local government decides whether to make arrangements for the provision of a certain public service itself (through its own institution, a contractual arrangement or purchasing the service) or to co-operate with other local governments (in the form of a local governmental association) to provide for the performance of the given responsibility.

In the majority of cases, of course, responsibilities are performed by local governments through their own budgetary organisations. Since 1990, external organisations - primarily churches - have been playing an increasing role in Hungary in the areas of education, the provision of social/welfare services and even in health services. The provision of support (funding) to such external organisations is decided on by the local government council. (Education institutions operated by churches are practically fully financed by the state, therefore, the 'obligation' in this area is no longer as definite as it used to be.)

In the area of communal public services - water supplies, waste water collection and treatment, maintenance of public places, waste management and treatment, district heating, burial services, chimney sweeping, management of residential and other real estate in collective ownership etc. - arrangements involving budgetary organisations are less frequently applied. These tasks are carried out primarily by business organisations established by local governments. In the majority of cases, the local council carries out the tasks of pricing authority with respect to such services. Exceptions include burial services, the charges payable for the lease of non-residential real estates, and the fees of certain heating, technology-related operations and activities of the maintenance of public places where the private sector also plays various roles. However, the charges and fees for such services cannot be established by organisations of the private sector without prior approval by the local government concerned.

In the case of public transit operations maintained by the municipal governments of larger towns, fares approved by the local governments concerned may be introduced only with the consent of the Ministry of Finance, in view of the central price subsidies.

Pursuant to the pricing act and the accounting act, the establishment of fares is to be based on the reasonable costs of the public transit operator and a fair profit margin.

The discretionary decision-making competency of local governments is, of course, restricted by the relevant sectoral laws and other statutes of law in respect of the organisation of their public services. For instance:

- the act on public education lays out the mandatory number of hours of teaching for teachers, the requirements and parameters of class organisation, the possibilities for dividing classes into groups, the time frames for the programmes of students (mandatory and voluntary activities in class, outside class, separate individual activities etc.);
- the acts on social/welfare services specify the technical/professional parameters of the institutions concerned, the minimum amounts of the various income supplement benefits, the parameters of subsidies for the acquiring and maintenance of residential real estate etc.

There are no central regulations on the staffing of local governments, however, a local government has to establish the staffing limits for its institutions. Nor is there any central regulation establishing the appropriation of wages - salaries and other benefits - in a breakdown by local government or for the entirety of the local governmental sector. There are two acts of law establishing salary categories and the regime of promotions for civil servants of mayor's offices and for the public servants employed by the institutions. The basic salary specified in the act on civil servants is only a recommendation for local governments - it is possible to deviate from the centrally specified norms in either direction (but only to a limited extent if downwards). The act on public servants specifies the minimum wages, from which it is possible to deviate upward.

A specific rule applying to the entirety of the public sector is that employees are entitled to a 'thirteenth month' salary as a mandatory additional benefit.

The system of salaries is supplemented by additional benefits payable in amounts equalling the percentages of the so called 'benefit base', as specified by law. The most important benefits include:

- executive benefit,
- benefit associated with titles granted to employees of outstanding performance,
- language proficiency benefit.

In addition to guaranteed wages, the status of public servants provides a number of additional benefits to employees: a higher degree of protection under the labour code (a restricted range of reasons for the termination of employment, and higher amounts of severance pay) and longer paid holiday.

In addition to the two acts above, the Labour Code also contains provisions in respect of the conditions of employment. Local governments and their budgetary organisations are also obliged, by law, to co-ordinate their decisions concerning employment with the local organisations of employees. The central government cannot intervene in this area.

In respect of their responsibilities, local governments are fully autonomous within the framework specified by legislation.

#### **4.1.2 *The assets of local governments***

One fundamental precondition for the autonomy and operation of local governments is that they have the assets required for the performance of their responsibilities. The fundamental conditions for the supply of local governments with assets were created by the act on local governments, based on the Constitution. Local governments as owners of assets are entitled to the same rights and bear the same responsibilities as any other entities of the economy. In respect of the assets of local governments, the rights of ownership are exercised by the local council and the modes of asset management are to be regulated in decrees issued by the local government.

The key objective of providing local governments with assets was to transfer the assets relating to the performance of the mandatory public services to the organisations that are in the best position for the maintenance and enhancement of such assets, in line with their best interests.

Local governments were provided with assets in several steps:

- in 1990, the state-held real estate, movable property, funds and securities that used to be managed by the soviet-type councils and their bodies (dissolved pursuant to the act on local governments) and used primarily for the purposes of administrative, health, social, education and cultural services, were transferred to the ownership of local governments;
- in 1991, pursuant to the called-for property transfer act, real estate managed by real estate management organisations established by the former councils, used for residential and non-residential purposes, as well as the assets of public utility companies established by the former councils, some real estate qualifying as ancient monuments or historical buildings and areas under protection for the purposes of nature conservation, were transferred to local governments;
- in the wake of the transformation and privatisation of state-held companies, substantial portfolios of shares and other securities were, and are still being, transferred to local governments. Some of the most important sources of such securities have been the transfer to municipal governments of shares equalling up to 25 per cent of the state-held electricity utilities, and up to 40 per cent of the state-held gas supply utilities, in proportion with the local population. (This latter portfolio will be increased to 100 per cent, under a decision passed by the Constitution Court, over a period of 6 years beginning in 2000.)

In order to protect property relating to the performance of mandatory local government responsibilities, the act on local governments places some restrictions on the freedom of the property management operations of local governments.

Assets that may be used exclusively for public purposes and cannot be used for profit generation, qualify as non-marketable. Such assets are defined as follows:

- public roads and related structures,
- public squares, parks, waters and public aquatic facilities,
- documents, materials in archives of local governments,
- all other items classified by a local government as such, in its decree.

Property that may be disposed over by a local government (e.g. through lease, or sold) having met certain conditions specified by law or a decree issued by a local government, qualify under the law as marketable with restrictions. Such assets include:

- public utilities, institutions, public buildings,
- ancient monuments, historical buildings, areas under protection for nature conservation and items of historical/cultural heritage,
- all of the movable and immovable assets classified as marketable with restrictions by the local government in its decree.

According to the act on the transfer of assets, the sale or the transfer of the right to use ancient monuments, areas under protection for nature conservation and items of historical/cultural heritage, require the approval of the relevant ministry.

Under the Act on water management, a local government may operate water utility assets in local government ownership through its own institution, budgetary organisation or a business organisation established with majority local governmental ownership. In any other case, the right of operation may be transferred only under a concession contract.

Real estate and movable property not falling in either of the two categories above are part of the marketable (business) assets of local governments, which they may dispose over at their discretion.

#### **4.1.3 Relationship between local governments and the state**

The relationship between local governments and central state bodies are regulated by the act on local governments. The fundamental principle is that local governments are not subordinate to any body.

By virtue of its legislative activities, the Parliament plays an outstanding role in this system of relationships, specifying the legal status of local governments, their exclusive scope of responsibility and power, their mandatory responsibilities, the guarantees for their operation, their financial resources and the fundamental rules on their financial management.

An important power of the Parliament - specified in the act on local governments - is that it may, following strictly defined procedures, dissolve local government councils whose operations are contrary to the provisions of the Constitution. The Government is entitled to initiate the dissolution of such councils - having asked for the opinion of the Constitution Court. (Over the ten year period since the system change, the first such action has only recently been taken.)

The President of the Republic has a relatively limited scope of power with respect to local governments.

Pursuant to the Constitution, the President of the Republic sets the date for the general local government elections.

Pursuant to the authorisation granted by the act on local governments, the President of the Republic decides, based on initiatives by the local governments concerned, on granting the title of 'town' to villages, on the establishment and integration of villages, on the termination of the integration of villages, and on the names of towns and villages.

Another power of the President of the Republic is related to the power of Parliament to dissolve a council, and the President of the Republic exercises the right of appointing a Commissioner of the Republic for such periods.

The most important power of the Government is its legal control of local governments, which is exercised by the Ministry of the Interior through the public administration offices. This type of control extends only to the legal compliance of decisions/resolutions made by local governments - it does not cover aspects of expediency or the appropriateness of such decisions.

The Government specifies the qualification requirements of local public service employees, it governs the performance of state administration responsibilities and provides for the requisites of implementation.

Ministers have a limited set of powers relating to local governments. They regulate the technical/professional requirements of the institutions maintained by local governments that fall within their respective sectors, along with the qualification requirements for employees, and compliance with such regulations. A minister may request local governments to supply data and information concerning their sectoral responsibilities, and local governments are obliged to supply such data. Under the titles and conditions specified by the annual budget act, they may provide local governments with funding support to enable the implementation of specific technical/professional programmes.

#### ***4.1.4 Experience related to the system of the scope of duties and responsibilities***

The experience relating to the scope of duties and responsibilities should be appraised from two perspectives: on the one hand, from the aspect of the segregation of duties of the state from those of local government, and on the other, from the aspect of distribution of duties and responsibilities within the local government system.

The segregation of duties of the state from those of local governments is considered as properly arranged, in general. It was established in 1990, and only minor clarifications have been introduced since then e.g. in recent years, the offices generating documents for citizens have been gradually transferred from the Ministry of the Interior to district centre local governments; the role of the central government in the provision of benefits and services for the unemployed has been reduced while that of local governments has been increased (as will be described in more detail in Section 4.6.2.1.4). The transfer of new tasks has always been accompanied by the transfer of the relevant state subsidy and the right to generate revenues. (The impacts of this are reflected in Table 3.1).

Experience shows that local governments do provide for the performance of the mandatory duties imposed on them by law. We have no information of any local government not performing its statutory duties. Of course, the standard of task performance does depend on the income position of a local government, its organisational capabilities, and personal and material resources. The established competition also prompts

local governments to perform their duties to the highest possible standards. (This is strengthened by the free choice of schools, doctors, etc.)

It has also been found that none of the traditional central government duties are performed by local governments. It is possible, however - and in some cases this possibility is exploited - for local governments to support the performance of tasks belonging to central government (e.g. police, colleges, etc.).

The most substantial problem of the Hungarian local government system is that the small area responsibilities of public services are not clearly assigned to the proper levels of organisations. Some of the duties that used to be carried out by certain municipalities before the system change are still carried out by those municipalities, and the operation of the inherited institution structures are becoming increasingly cumbersome for the municipalities concerned.

An excessive degree of decentralisation has evolved in the system of scope of duties and responsibilities. The smallest municipalities have almost identical duties and responsibilities to those of the capital city. The organisation of the performance of tasks for conurbation areas is not provided for in the system. This has not been yielding efficient solutions for there is little propensity to establish economic associations when they are not mandatory. International and domestic experience also show that larger associations are not usually established on a voluntary basis.

Another task for the near future is the delegation of task performance to the conurbation, sub-county level, which can be accessed within a day.

No clear-cut arrangement has been introduced that would assign regional tasks to institutions, or regional functions to county governments - or to county right towns as a regulated exception - along with the necessary financial and other operational requisites for such task performance. A persisting problem is that municipalities may unilaterally transfer their institutions performing regional duties to county governments which are obliged to take over and operate such institutions - and municipal governments may just as unilaterally take back such institutions. Another problem that has not been resolved since 1990 is that the ownership of assets should always be transferred along with the relevant tasks (those who were given ownership rights in 1990 are now only obliged to transfer the right of utilisation to the new organisation in charge of maintaining an institution).

The establishment of a regional level of government covering several counties has gained importance, also from the aspect of EU accession. These constitute some of the tasks to be carried out, in the near future, as part of the reform of the public administration system.

As has been outlined in Section 4.1.1, sectoral laws and other statutes all aim to ensure that each of the 3,200 local governments and the almost 8,500 institutions interpret and perform the mandatory tasks in the same way. This does not, in itself, lead to functional problems. The reform of the local government system is not aimed at reducing the number of institutions or local governments, rather, it is aimed at achieving a more reasonable system of deployment of responsibilities. A more concentrated scheme of the allocation of tasks may make it possible to replace the current normative subsidy system adjusted to the fragmented regime of task performance with a regulation comprised of a substantially smaller number of elements, based primarily on global subsidies. These will be described in detail in the following Section.

#### ***4.1.5 Reforms implemented recently and those still to be carried out***

The Hungarian system of local government was reformed in 1990-1991, replacing the local authorities that used to operate under central direction, with real local governments with proper autonomy in terms of

economic operations and decision making. The steps of the reform of resources are described in Section 3.1.3.

Following the system change in local government, in 1990 and 1991, further improvements and developments were introduced in the regulation of local governments, for instance:

- The establishment of the Hungarian State Treasury, on 1 January, 1996, resulted in the introduction of a so-called net-financing system for local governments. The most important feature of this system is that local governments receive contributions and other forms of funding through the Treasury net of the taxes and contributions on wages and other types of pay. This constitutes a ‘cash-saving’ funding arrangement as the above-mentioned taxes and contributions are directly credited by the Treasury to the accounts of the central budget, the Health Insurance Fund and the Pension Insurance Fund.

Nevertheless, Hungarian local governments were not turned into a subject of the Treasury - they keep their accounts with the commercial banks of their choice, not with the Treasury, and the function of counter-signature by the Treasury was not introduced, either.

- In 1995, statutory restriction was introduced on borrowing by local governments, limiting it to 50 per cent of the total aggregate amount of the key revenues earned by the local government itself.
- Legislation was also introduced, in 1995, to regulate debt settlement of illiquid local governments. The criteria for illiquidity were specified along with the procedure for debt settlement. (Who, when and where should initiate the procedure, what are the tasks of the court, appointment of a trustee, the role of the trustee during debt settlement in the financial management of the local government, the mode of the establishment of a debt settlement committee, the adoption of a crisis budget, preparation of a re-organisation programme, preparation of a compromise proposal, negotiation for compromise with the creditors, distribution of the assets by court where no compromise is reached.) At the end of the procedure, a local government cannot be dissolved. To ensure this, a local government may receive a central budget subsidy - supplementing its own resources - to enable the local government to perform its mandatory tasks at the minimum acceptable level.
- In respect of the subsidies allocated in order to reduce excessive income differences between municipal governments, the capacities of local governments to generate local business tax revenues has also been taken into account since 1999. (This will be elaborated on in detail, later on.)

It has been growing increasingly clear over the past decade that the elimination of the functional problems laid out in Section 4.1.4 necessitates a transformation of the deployment of the responsibilities and powers of the local government system, as outlined in the same Section. Some progress has been made in that direction by transferring the task of guardianship and construction administration of the first instance to the towns functioning as district centres but no real breakthrough has taken place as yet.

In Spring 2000, the Government decided on the directions for the continued development of the institutional and financial system of general government. According to the Government decision, in order to ensure efficient and transparent utilisation of public moneys, the definition of the range and sub-systems of general government need to be reviewed, along with the general and specific regulation of the tasks of the various sub-systems. To this end, the scope of responsibilities and powers of the state have to be reduced through the regulation of technical/professional and organisation efficiency requirements on the one hand, while on the other hand there is a need for a perceptible reduction in the number of institutions, and for the simplification of their internal organisation structures. The planning and decision-making process related to the budget of the sub-systems of general government need to be converted into a spending and task oriented process.

The parties in Parliament agree that the current system of the deployment of responsibilities and powers in the local government system is not the most appropriate or the most efficient solution, but in respect of the

mode of its rearrangement one should expect heated debates. Even local governments themselves have different views on the matter.

From a professional angle, the following distribution of duties seems the most reasonable:

A district local government scope of duties should be established as has been already mentioned, existing only in respect of a few types of responsibility in the Hungarian local government system. This would not result in an increase in the number of local governments. Whilst keeping the number of local governments unchanged, the scope of responsibilities of municipal governments - towns - performing the roles of district centres would be broadened, while those of governments of smaller municipalities would be narrowed. The tasks involved should primarily be the ones that demand increased expertise and resources, including the maintenance and development of kindergartens, nursery schools, schools, the organisation of social/welfare benefits, and the maintenance and improvement of roads between municipalities.

Furthermore, the mandatory - regional - roles of county governments should be clearly specified, terminating the permeability between them and municipal governments. This should result in transferring the property to the local government that maintains the given institution, terminating one of the functional disorders as mentioned in Section 4.1.4.

At a regional level, it seems justified, in the longer-term, to create elected local government bodies. The tasks of maintaining and developing institutions serving several counties - hospitals, secondary schools etc. - and infrastructure development tasks (e.g. main roads, motorways) should be delegated to this level of local government.

Under a Government resolution, a review of the deployment of responsibilities and powers of local governments is underway. The effort is co-ordinated by the Minister of the Interior and is carried out with the involvement of the line ministries and the associations of local governments. It should be noted, however, that the amendment of the act on local government needs a two thirds majority in Parliament, which necessitates a broad political consensus.

In co-ordination with the review of local government tasks and the rational deployment of responsibilities and powers, the regulation of the resources of local governments also needs to be improved - local revenues should be increased at the same time as restricting the increase of income differences.

## **4.2 Local discretion - tax administration and relation to central government**

For the local governments established in Hungary in 1990, a system of local taxes was developed, in order to enable local governments to perform public services in line with local characteristics and requirements, and to provide them with the means for financial management. Among the sources of local government own revenues, local taxes play a very important role.

Under authorisation by, and in accordance with, the provisions of the Act on local taxes, the council of elected representatives of a municipal government (village, town, Budapest, town of county rights or district, hereinafter referred to as 'local government') may issue decrees imposing local taxes. A local government is not under any obligation to introduce and collect local taxes. The act on local taxes establishes the right of taxation. It should be noted that the right of a local government - and its related responsibilities - concerning the adoption of decrees imposing local taxes are identical, in terms of content, to the right of Parliament concerning the adoption of a law on taxation, with the only difference being that a local tax is payable only and exclusively by residents and businesses of the municipality where such tax is imposed. In this case, the state has partially transferred its traditional right of taxation - reserved for Parliament - to local governments within the limits specified by law. It is an important possibility which means that a municipality is in charge of formulating its own local taxation policy. By imposing or not

imposing taxes, and by selecting the tax types and the rates to be applied within the limits established by law, the local government can substantially influence the economic policy of the given municipality and the revenue structure of the local budget.

Accordingly, the replacement of the former, centrally controlled, council taxes with a system of local taxes was a significant reform in the Hungarian taxation system, in 1991. The key goal was to establish new sources of tax in order to enhance local autonomy, and increase the proportion of local governments' own revenues within their budgets, in line with the key objectives of the general government reform.

A local government may impose the following types of tax by issuing decrees: building tax, land tax, communal tax on private individuals and businesses, tourism tax, and local business tax.

The taxation right of a local government covers the following aspects:

- a) introduction of any or each of the above taxes, cancelling of already introduced taxes and amendment of its decrees on taxation (an interim amendment, however, cannot result in an increase of the tax burdens on taxpayers);
- b) determination of the date of the introduction and the definite or indefinite term of a tax;
- c) establishment of the tax rate in view of local circumstances, the revenue requirements of the local government and the taxpaying capacities of the taxpayers, without exceeding the statutory maximum rates;
- d) introduction of exemptions and/or allowances in addition to those specified by law.

In order to prevent over-taxation, and for the provision of guarantees, a taxpayer cannot be obliged to pay more than one type of tax with respect to a given taxable item, and the rate of a tax may not exceed the statutory maximum.

The most frequently applied locally imposed tax type is the local business tax which accounts for some 84 per cent of all local government tax revenues. The increasing need for local tax revenues is indicated by the fact that over a fifth of local governments imposing local business tax apply the maximum permitted rate. In respect of other taxes, the vast majority of local governments apply far lower rates.

In general, local governments exercise their taxation right in a carefully planned way, in view of the local conditions, taking into account the taxpaying capacity of the local population.

The autonomy of local governments has, in general, been successfully exercised in the area of taxation. Local taxes have been collected for some ten years, now, as part of the Hungarian taxation system. The number of local governments collecting local taxes and their revenues has been steadily increasing. In 1999, a total of 2,970 local governments - 93 per cent of all local governments - applied local taxes. Local taxes accounted for some 18 per cent of all current revenues in 1999 - to be compared with the mere 3.5 per cent in 1990 when 'council taxes' were collected.

**Table 4.4** Local taxes

Type of the tax	Number of municipalities levying taxes in 2000
Building tax	687
Land tax	380
Communal tax for private individuals	1,858

Communal tax for businesses	764
Tourism tax	514
Local business tax	2,226
<i>Form this using maximum tax level</i>	<b>436</b>
<b>Number of tax levying municipalities</b>	<b>2,970</b>

In accordance with the autonomy of taxation, no direct central measure has been taken in order to increase local governmental revenues. In an indirect way, however, a local government tax authority is helped by the fact that - subject to statutory limitations - they may ask for and may be given information by the central tax administration on the taxpayers operating in their areas of competency. This arrangement substantially facilitates the identification of hidden taxes. Local governments are supplied, free of charge, by the Ministry of Finance, with software required for the administration of PC-based tax registries, in view of the necessity of a uniform system of registration.

The proportion of local taxes within local governmental budgets seems low in comparison with corresponding figures of other OECD Member States. It should be noted, however, that in the majority of those countries, for instance, the wages of teachers are paid by the central budget while in the Hungarian system of financing such expenditures are paid from the local budgets. A look of the budgets of Hungarian local governments in a comparable structure reveals a 20-25 per cent share of local taxes.

#### **4.3 National regulation of the framework for non-tax revenues**

The rules on the establishment of service charge-type fees are specified by decrees issued by the Government and the line ministries concerned. In some cases, these also specify the mandatory allowances to be applied by local governments (e.g. for families with at least three children).

In local governments, the most commonly applied types of such fee are meal charges in the education system and the fees for services paid to kindergartens, crèches, student hostels and welfare homes. Such fees have to cover the unit costs of the service providers.

Communal services are still performed by budgetary organisations in certain local governments. In such cases, the related service charges are included in the aggregate revenues of the local governments concerned. The service charges are set by the local governments 'on a commercial basis'.

Charges and fees applied by a local government are established and announced by local governments in decrees.

There are no restrictions on a local government in the establishment of the rental/lease fees charged for its real estate (public places, real estate for residential and non-residential purposes) and assets, or on the tariffs charged for communal and public utility services (water supply, sewerage, district heating, garbage collection, burial services etc.). These are established on a commercial basis, in compliance with the provisions of the Pricing Act which provides that, in the establishment of fees and tariffs, justified costs and a fair profit margin are to be taken into account.

The above principle applies also to the establishment of the fares of local public transport operated by a local government, however, in this case, in view of the fares subsidy from the central budget, prior consent from the Ministry of Finance is required before the fares established by a local government can be announced.

A local government is entitled to establish, within the limits set by law:

- the fee payable for services provided in social/welfare institutions in view of the costs of such services and the income position of the recipient. The fee charged for such services may not exceed 80 per cent from the recipient, and the remaining 20 per cent may not be lower than 20 per cent of the minimum amount of old age pension;
- the fees payable for services in crèches, kindergartens and student hostels cannot exceed the per-recipient amount of the current costs of service provision;
- the prices charged for meals in education institutions cannot exceed the amount of the per capita nutrition raw material norm specified in the relevant decree issued by a local government. The raw material norm has to contain the calorific value established by law.

This centrally-issued law also provides that discounts are to be granted to families with three or more children when pricing such meals.

Local government non-tax revenues include only those that are directly collected by (credited to accounts of) local governments or their institutions. The fees paid for services collected by business organisations owned by local governments are not included in this category. The information system of general government does not hold information on this latter type of revenue.

On the whole, non-tax revenues have been increasing (by 66% over the four year period under review). The relative diminishing of some of the elements of this group of revenues (e.g. revenues from fees) may be explained by the fact that local governments no longer perform some of their tasks through their own budgetary organisations (e.g. communal services, school meals, laundries for hospitals and social homes). They either have them performed by their own business organisations or purchase such services from outside organisations.

In the course of planning the annual budget, when all the revenues of the general government system are taken into account, the tax and non-tax revenues of local governments are also taken into account. The amounts of such revenues are estimated from the (actual) performance data of the previous year, that are available through the local government information system, as well as on the basis of macro-economic trends (GDP growth and inflation).

#### **4.4 National policies on design of grants systems**

The year 1990 was something of a milestone in the regulation of the funding sources of local governments. The regulation of funding sources denotes here the allocation of funds from the central budget. In the regulation of such funding sources, besides the quantity of public services, their delegation to the various levels of local government is also taken into account.

Over the four decades leading up to 1990, central allocation was based primarily on the application of direct techniques and that system was only loosened, to some extent, in the second half of the Eighties, although the transformation of the earlier direct regulation system had already been started in the soviet-type council system - primarily by the introduction of normative elements in the allocation of central subsidies for development e.g. by the application of county-targeted subsidies, or the per capita quota for development.

The fundamental transformation of the system was launched on 1 January, 1990, when an entirely new regulatory system was introduced whose development took a period of 2-3 years.

The centrally controlled, expenditure-oriented financial regulation system was based on the establishment of expenditures on an individual basis, then the state subsidy was determined as the difference between the specified amount of spending and the local revenues. This was replaced by a resource-orientated regulation system where the potential spending of a local government for the provision of public services was determined on the basis of the disposable resources (funds) realised by local governments. Since 1990, government bodies have been developing the elements of indirect resource regulation (i.e. the conditions under which a local government is entitled to central budgetary subsidies and to the collection of revenues) to replace the earlier technique.

The central regulation in the annual budget acts covers state subsidies and contributions, as well as assigned personal income tax. The priorities determined for the general government system as a whole, including public education and social service provision, the increase of wages and benefits, and the focus on fixed investment, are promoted in the area of local governance through the total amount and regulation of the two types of funding sources taken together.

Financial regulation includes differentiating elements as well as elements aimed at a certain degree of equalisation, reducing excessive differences in income.

Accordingly, the funding sources of local governments from the central budget are made up of assigned personal income tax, and state subsidies and contributions, making up the predominant proportion of the revenues of local governments (more than 40 per cent).

Local government financial regulation is not based on the financing of concrete tasks, although it does take into account the tasks to be carried out and their funding requirements. There are certain normative contributions that cover the cost requirements of the given tasks, but they are small in number. The basic principle of resource regulation is that the central budget contributes to the performance of the mandatory duties specified in the Act on local governments and the sectoral laws for which local governments also have to contribute their own, and shared, tax revenues.

This system is aimed at prompting local governments and their institutions to perform economical financial management, whilst complying with the standards specified in the sectoral laws. Therefore, from the regulatory system aspect, the regular assessment of the funding requirements of the various tasks, and the related normative contributions, is immaterial.

A comparison of Tables 3.1 and 3.6 reveals that the total amount of operating-type revenues is always larger than that of operating-type expenditures. (In the latter, a restriction has been applied in order to reduce the share of the general government system within GDP to below 40 per cent by year 2003.) This shows that assets have not been used up to cover costs of operations. In the case of some local governments, however - especially where the income generating capacities are weaker - capital revenues have, in some cases, been used to cover operating expenditures as well.

Even more important is that the financial regulatory system has been stable for years, minor corrections are applied only to improve allocation and they do not reduce transparency or predictability.

The system of subsidies is a little complicated but this originates from the functional problems described in Section 4.1.4. Though the mechanism is understandable and does not increase the administrative work load already in existence, some simplification is required, based on the proposed alterations to the local government system (Section 4.1.5).

## 4.5 National control on borrowing

Under the Act on local governments, a local government may take out loans and issue bonds, subject to the condition that the core assets of a local government, the contributions and subsidies/grants provided by the state, the personal income tax and the revenues taken over within the general government system for operating purposes, cannot be used as collateral security for such loans and bonds.

As mentioned in the reform actions outlined in Section 4.1.5, certain restrictions have been applied to borrowing by local governments, since 1995.

Under the local government Act, the ceiling for annual commitments by a local government resulting in debt (borrowing and associated expenses, bond issues, provision of guarantee and surety, leasing) equals the adjusted current own revenues of a local government, the latter meaning 70 per cent of the local government's own revenues (from local taxes, duties, interest, fines, and other specific revenues) net of short-term commitments and liabilities (capital repayment, interest payment and lease fees) falling in the given year.

In other aspects, a local government is to comply with the general rules applicable to financial institutions (which are enforced by banks).

Borrowing by local governments is not subject to any other external control. A local government does not need approval from anyone for its borrowing or bond issue.

Borrowing abroad is not subject to any specific restrictions in addition to the general rules.

There is no regulation on whether a loan is to be used for operating or investment purposes. Shorter than one year - liquidity - loans are usually used for current expenditures, longer term loans are usually used for investments.

A local government may take out a loan from any financial institution under commercial conditions. Borrowing is usually preceded by a tendering procedure and eventually the financial institution that has given the best bid is selected. It is often the account-keeping bank of the given local government that places the bid with the best terms and conditions. There is no central restriction on the term of a loan taken out by a local government.

A local government may choose an account-keeping bank once a year, not later than 31 October, and their institutions are obliged to keep their accounts with the same bank.

Special rules:

- Where a local government (just like any other organisation conducting its own financial management) participates in an organised residential construction effort it may take out a loan, with interest subsidy provided by the state.
- Interest subsidy is also provided for loans taken out by associations of waterworks, for development projects.

The role of financial market operations in the management of local governments is reflected in the Table below.

**Table 4.2** Indebtedness of municipalities: local net debt, 1997-1999  
(in millions of HUF)

	1997	1998	1999
General government deficit/surplus	-153.8	-632.0	-392.3
General government gross debt	5 455.3	6 284.7	6 973.4
Local government deficit/surplus	65.2	-8.8	23.0
Local government gross debt	49.6	69.9	76.3
Local government deposits and securities	201.8	198.4	238.0
Local government net debt	-152.2	-128.5	-161.7

Past experience has shown that Hungarian local governments do not get indebted, and do not threaten the deficit of the general government system, therefore, there seems no reason for any modification of the current regulations. It is often mentioned as a criticism that local government participation in the capital markets is overly modest. This is true but it should also be noted that the high interest rates applied as a result of the accelerated inflation (close to 30% in 1995) - which has been reduced to below 10% since 2000 - did not stimulate the process, either.

Privatisation following the system change, and the local government revenues originating from the process, did not stimulate local government borrowing either, since they did not need to borrow to finance their investments. The end of the privatisation process has led to such additional revenue sources being depleted, therefore, over the next few years, local governments will need to rely more heavily on the loan market. This is also strengthened by the expected continued dramatic decrease in inflation.

In general, the state does not assume liability for local governments. In some exceptional cases, however, when a local government takes out a loan for a project of substantial social value e.g. a large environmental protection project, a state guarantee is sometimes provided. In such cases, the state demands counter-guarantees.

In the case of local government insolvency (see Section 4.1.5) a debt settlement procedure is launched, governed by a separate regulation. The procedure may be initiated by the local government itself, or its creditor, at the court. This occurs when a local government or its budgetary organisation has a debt which is more than 60 days overdue.

During the debt settlement procedure, the local government only has to provide the mandatory tasks specified by law, for the performance of which it continues to receive the statutory state grants.

In its verdict, the court orders the launching of the debt settlement procedure, and designates the financial trustee. In the compromise phase of the procedure, the local government and the creditors have to attempt to agree on the settlement of the debt, on the basis of which payments may be made.

No commitment may be undertaken and no payment may be effected without the co-signature of the financial trustee.

Where no compromise is reached between the local government and its creditors, the court provides for the allocation of the marketable assets of the local government. The debts may be settled to the extent of such assets, the order of settlement of creditors being established by law. Regular personal payments, receivables covered by lien or bail and public debts are ranked first. The debt settlement procedure cannot result in the liquidation of the local government concerned, as the assets required for the performance of the basic services are retained throughout the process.

In the course of the procedure, temporary support from the central budget is restricted to the payment of interest on loans taken out by the local government for the purpose of debt settlement, along with the fee payable to the trustee. The amount of such interest must be paid back to the central government.

Since the entry into force of this law, some ten debt settlement procedures have been initiated, each of them by the local government concerned. Debts have mostly arisen from investment projects launched by local governments. Usually, the debts of municipal governments to suppliers, contractors or banks reached amounts where no realistic chance was seen for their settlement in the foreseeable future, even by rescheduling.

## **4.6 Local discretion – expenditure**

The questionnaire asked each country to identify three policy sectors where local government played a major role in the delivery of a public service. For Hungary, these three sectors were “public education”, “social benefits and services” and “health” (see Sections 4.6.1 – 4.6.3).

### **4.6.1 Public education**

The Constitution of the Republic of Hungary lists the right to education among the fundamental rights and obligations. The state provides for the implementation of this right by extending public education and public cultural activities to cover the entire population, as a universal system, by providing for free and mandatory primary education, secondary and higher education accessible for all, in accordance with everyone’s capabilities, and by providing financial support to those participating in the education system.

The two large areas of the education system are: 1) public education, providing for general education/culture and vocational education and training; and 2) higher education, comprised of college and university. Of these two areas, public education is the venue for task performance by local governments, therefore, the structure of public education will be presented in the following Sections.

#### *4.6.1.1 The fundamental structure of public education*

The structure of public education, in accordance with the above provisions of the Constitution, is regulated by the Act on public education, establishing the rights and obligations of both those performing the tasks and those using their services.

Pursuant to the law, the public education system is comprised of the following constituent elements:

- education at kindergarten,
- education and teaching at school - including vocational education and training provided under a separate act - on vocational education and training -,
- education in student hostels.

These duties are performed by the following institutions of public education:

- kindergartens,
- primary schools,
- vocational education and training schools (apprenticeship schools and vocational schools),
- grammar schools and secondary vocational schools,
- basic arts education institutions,
- student hostels.

Special education and teaching institutions are the versions of the above types of school for young people with disabilities, for whom education and training together with children without disabilities is not suitable.

The Hungarian public education system - in line with the practices of the whole of the developed world - is based on the principle of education being obligatory. If a child has attained the degree of personal development required for attending school, compulsory education covers the period between 6 and 16 years of age. In accordance with international trends, however, public education policy aims at extending the period of compulsory education, so children who started school in 1998 or later, will have to attend school up to the age of 18.

Compulsory education imposes an obligation, primarily on parents, to ensure that their children duly attend school, failing which

- parents lose the entitlement to the grant for schooling which is provided by the state, for all children, as a basic citizen's right,
- they may be fined for the contravention,
- ultimately, the right of supervision of the parent may be restricted or cancelled, and the child may be taken under state guardianship under child protection measures.

#### 4.6.1.2 Performance of public education responsibilities

The governance and direction of the public education system is a state responsibility under the act on public education, and local governments are the key service providers.

The Act on local governments states that local governments are obliged to provide for education at kindergarten, and teaching and education at primary school, while county governments are in charge of providing for secondary education, vocational schooling and student hostel services.

In addition to local governments, public education institutions may be established and maintained by the state, local minority governments, national minority governments, churches, business organisations, foundations, associations and other legal entities and organisations without legal personality, as well as private individuals, having acquired the right to pursue such activities, as provided for in the act on public education.

The structure of the organisations maintaining the various types of school, along with the numbers of students in higher education, are presented in the Table below.

**Table 4.5** Main data of educational institutions 1999/2000

<b>Denomination</b>	<b>Local government</b>	<b>Central budgetary institution</b>	<b>Church denomination</b>	<b>Foundation, natural person</b>	<b>Other</b>	<b>Total</b>
<b>Kindergartens</b>						
<i>number of institutions</i>	4,364	33	74	142	30	4,643
<i>Pupils</i>	350,454	2,940	5,230	5,655	1,425	365,704
<i>Teachers</i>	29,878	324	459	590	158	31,409
<b>Primary schools</b>						
<i>number of institutions</i>	3,401	31	177	75	12	3,696
<i>Students</i>	896,631	12,757	42,270	7,470	1,473	960,601
<i>Teachers</i>	77,068	1,216	3,479	919	147	82,829

<b>Specialized secondary schools</b>						
<i>number of institutions</i>	84	2	8	18	1	113
<i>Students</i>	5,721	94	314	1,353	22	7,504
<i>Teachers</i>	332	14	28	54	3	431
<b>Apprentice schools</b>						
<i>number of institutions</i>	314	8	8	22	4	356
<i>Students</i>	103,061	670	1,971	3,441	391	109,534
<i>Teachers</i>	7,482	105	163	144	25	7,919
<b>Secondary schools</b>						
<i>number of institutions</i>	808	37	87	100	22	1,054
<i>Students</i>	332,134	11,247	21,523	17,811	3,864	386,579
<i>Teachers</i>	27,099	1,421	2,365	1,213	219	32,317
<b>Universities, colleges</b>						
<i>number of institutions</i>	0	55	28	6	0	89
<i>Students</i>	0	153,707	10,227	7,582	0	171,516
<i>Teachers</i>	0	16,127	3,336	1,673	0	21,138

The task-setting provisions of the Act on local governments are detailed by the Act on public education. Pursuant to the Act on public education, the local government of a village, town, district of Budapest, or county right town, is obliged to provide for the following services:

- education at kindergarten,
- teaching and education at primary school,
- education at kindergarten and teaching at primary school of children of national and ethnic minorities,
- education and teaching of children with mild degrees of disability, capable of attending school with other students without such disabilities.

A county government and the local government of Budapest is to provide for the following services:

- secondary education,
- education and training at vocational school,
- secondary and vocational education and training of children of national and ethnic minorities,
- student hostel services,
- adult training,
- basic arts education,
- special pedagogic services (guidance for continuation of studies and career selection, logopaedic services, medical physical education, etc.)
- technical pedagogic services (pedagogic evaluation, technical/professional consultancy, information, organisation of substitution services, etc.),
- teaching and education of children with severe disabilities.

The co-ordination of the public education system and the territorial organisation of its operation, are based on the task performance, institution network operation and development plans prepared by the Budapest municipal government and by the county governments - taking into account the opinion of, and in co-operation with, the Budapest district governments and the local governments operating in the various county territories, respectively. These plans contain the evaluation of the status of the organisation of the provision of public education services, the tasks to be performed and the medium-term admission plan for the territory of the capital city and for the various counties. The development plans are prepared in a way that enables the checking of the way in which local governments meet their obligations of task performance relating to public education.

The Budapest municipal government and the county local governments may initiate the conclusion of co-operation agreements with local governments operating in Budapest, or in their territories, respectively, concerning the organisation of certain, district-type, services relating to public education (including, for instance, the performance of tasks relating to compulsory education, the concentrated provision of services for members of national and ethnic minorities, providing for the possibility of changing schools, etc.).

A local government may perform its responsibilities in any of the following ways:

- establishing and maintaining its own institutions,
- participating in institutional associations (in this case the participants of the association agreement have to agree on the bearing and distribution of costs as well), or
- by an agreement concluded with another local government or organisation in charge of school maintenance, concerning the provision of public education services.

A local government may establish a new public education institution or it may extend the range of duties of an existing institution, if the personal and material requisites and the budget for the launching of the operation or for the performance of the new tasks are available or can be secured.

A local government may close down its public education institution or may terminate the performance of a public education service if it makes arrangements for the continued performance of the given responsibility or service to appropriate standards in a way as will not impose disproportionately large burdens on the children, students or parents concerned.

A local government may transfer - partly or in full - the right of ownership or maintenance of an education/teaching institute to entities maintaining schools organised on an ideological basis, or to other entities, if they continue the provision of education services to appropriate standards for the children and students whose parents do not intend to have their children educated at an ideologically committed or at a new institution, in a way as will not impose disproportionately large burdens on the children, students or parents concerned.

A local government maintaining a public education institution determines its district of operation (admission). The children and students resident in that district cannot be refused admission by the given kindergarten or school.

It should be noted that, in contrast to the practices of a number of other European countries, the scope of responsibilities of local governments includes the employment of teachers as well.

The Act on public education contains exacting requirements concerning the qualifications of those working as pedagogues (teachers, instructors). Such jobs may only be held by holders of relevant college/university degrees.

The wages of employees of the public education system are centrally regulated, however, in addition to the wages guaranteed by the act on public servants, they are entitled to a professional multiplier. A teacher who has an additional qualification besides his or her basic professional qualification, that is used in at least 10 per cent of his or her working time, is entitled to an additional 5-10 per cent wage supplement.

#### 4.6.1.3 *Financing of public education*

The costs of the provision of public education services are financed from the contributions from the central budget, the revenues generated by the institutions themselves, the payments made by the users of the services, and the funding sources of the organisations in charge of maintaining the institutions.

The contribution by the central budget (see Section 3.1.3) is comprised of normative state contributions for discretionary utilisation, normative contributions for specific purposes, and other contributions for specific purposes, and the contributions provided from the chapter of the Ministry of Education, primarily for specific priority professional purposes.

Normative contributions include 1) basic contributions: for the various phases of education and teaching, and for other services of public education (basic arts education and provision of student hostel services); and 2) supplementary normative contributions: for supplementary services of public education (daytime care for children, teaching to help catch up), and to provide for the requirements of specific conditions of public education (education and training in small municipalities, services for commuters from other municipalities, etc.).

Part of the normative subsidies for specific purposes provide funding for specific benefits (for the procurement of technical literature and books by teachers, textbooks by students), another part provides funding for the performance of district-type responsibilities (e.g. subsidies to public foundations for public education constituting one of the bases for the implementation of the above-mentioned 'development plan', or the subsidising of special professional pedagogic services). Furthermore, contributions for specific purposes may be applied for in order to provide support for the further training of teachers.

Table 3.7 shows that such contributions cover 63-66 per cent of the current expenditures of local governments.

Students and those sustaining them make various rates of contributions to the financing of services. The weight of this category is determined primarily by the proportions of services free of charge, and services provided for a service charge or a tuition fee, within the range of services provided by a given school. These sources constitute the non-tax type revenues of the education sector, accounting for 10 per cent of current expenditures.

Education at kindergarten, primary school, secondary school and vocational school (including the activities of special activity groups and sports groups), student hostel services and activities, are provided free of charge. Service charges cover a small fraction of the costs incurred. Such charges are payable in basic arts education, daytime care for children, participation in adult education and training, and meals at schools. Tuition fees are usually established based on per capita costs. Tuition fees are paid by the student primarily for services extra to those comprised in the curriculum.

Based on the funding regulation system (see Section 3.1.3) that is not a task-financing system, local governments supplement the resources required for their expenditures from their own local revenues – this is in addition to the central contributions and institutional revenues. This latter item accounts for 26-27 per cent of the current expenditures of public services in public education.

#### 4.6.2 *The system of social/welfare benefits and services*

Pursuant to the provisions of the Constitution Court, provision for those in need is a priority responsibility.

The provision of social/welfare benefits and services is the widest area of the general government system, covering the benefits and services for the unemployed, the system of pensions, pension-like benefits,

sickness benefits and family allowances, the state and local governmental social/welfare institution system and the provision of financial support to non-governmental bodies performing social/welfare services.

Following World War II, the provision of social/welfare benefits and services was almost exclusively a state responsibility. After the system change, besides the provision of services by the state and local governments, the activities of church organisations and civil organisations as well as social/welfare enterprises and self-provision have been playing increasingly important roles.

#### *4.6.2.1 The state social/welfare system*

In the social/welfare system, the role played by the state takes the form of benefits and services provided by the central budget, the Social Security Funds and the Labour Market Fund. The most important of these are outlined below:

##### 4.6.2.1.1 Pensions and pension type benefits

At present there are two pillars in the compulsory pension system:

- the pay-as-you-go system of mandatory social security pension, and
- the private pension with some fully funded elements.

Those concerned have to participate in both pillars or only in the pay-as-you-go pillar, on a mandatory basis. All employees become members of the mandatory social security system without having to conclude any contract. A certain percentage is deducted from employees' wages by way of a social security contribution (8% in 1999). The contribution paid by employers on the wages of their employees (22% in 1999) is another source of revenue for the state pension fund. The amount of pension benefit is established on the basis of the service period of an employee and the average wage earned during the 5-year period preceding the date of retirement. Entitlement to the old-age pension is reached after a minimum 20-year service period, and reaching the relevant retirement age. (The retirement age has recently been increased, in Hungary, to 62 years of age but men and women born before the introduction of the new rules are subject to more favourable rules on an interim basis.) In order to protect people earning low incomes, there is a statutory minimum pension. This sustenance threshold is also the basis of the calculation for a variety of social benefits.

Since 1998, it has been possible for citizens to join supplementary private pension funds, as well. Thus, the mandatory pension system is supplemented by various forms of self-provision through the non-profit oriented voluntary pension funds, and the pension insurance products offered by commercial insurance companies.

Employees who join private pension funds, as well, pay 2 per cent of their wages to the mandatory social security fund and 6 percent to the relevant private pension fund.

Employers may supplement the contributions of their employees to the relevant private pension funds, by way of social benefits.

Disability and casualty disability pension benefits are also parts of the group of pension-type benefits.

##### 4.6.2.1.2 Sickness benefit

An employee is entitled to a sickness benefit, during his or her illness, of reduced earnings from the social security fund they use on a mandatory basis. The amount of the sickness benefit depends on the earnings of

the given employee, in proportion with his or her insurance contribution. During the first 15 days, the sickness benefit is paid by the employer, after that period the benefit is financed by the social security fund.

Sickness benefit for the purpose of nursing one's child is provided for children up to the age of 14. The number of sickness benefit days is reduced as the child grows older. For individuals who are members of private pension funds, the state sickness benefit is supplemented by the private pension fund.

#### 4.6.2.1.3 Various forms of financial support for families

The provision of financial support for families is primarily a responsibility for the state. The central budget provides some benefits as a basic citizen's rights, and others, for families, on a means-tested basis. Family allowance, maternity contributions and schooling contributions are provided as basic citizen's rights. However, the entitlement to the higher amount of childcare benefit - available up to the infant's age of two - is subject to employment. All families are entitled to a minimum of financial support. In families with at least three children, and depending on their income positions, the state enables the parent to raise children at home under an employment relationship, up to the age of 8 of the smallest child (this is the 'child raising subsidy').

These forms of financial support are funded from the budget chapter of the Ministry of Social and Family Affairs. In addition to the direct subsidies, families with children are also granted a personal income tax preference, the rate of which increases in proportion with the number of children (the role of this latter has increased over recent years). The family tax preference provides more substantial assistance to families raising children with disabilities.

#### 4.6.2.1.4 Benefits and services for the unemployed

The provision of benefits and services for the unemployed is primarily a state responsibility, for which a separate fund has been created. The revenues of the Labour Market Fund originate from the contributions by employees and employers on wages and from the vocational education and rehabilitation contributions. Subsidies and benefits from the fund may be provided for those who meet the statutory criteria (e.g. specific length of prior employment, obligation of co-operation with labour organisations).

On the one hand, the Labour Market Fund participates in the operation of the system of benefit and service provision for the unemployed through active instruments of employment (e.g. job creation). Such subsidies are provided to employers - instead of employees - undertaking an employment obligation therefore, from the aspect of social benefits, this type of subsidy qualifies as a prevention. This Fund provides funding for vocational education and training and for employment for rehabilitation purposes. On the other hand, the Labour Market Fund disburses unemployment benefits, to which all former employees are entitled, based on their employment relationships. In 1999, the unemployment benefit was provided for a period of one year (in 2000 this was reduced to 9 months).

#### 4.6.2.2 *The local governmental social/welfare system*

The provision of social/welfare benefits for households as well as the various institutional services are part of the mandatory responsibilities of local governments.

Such duties are required to be performed, in a differentiated regime, in municipalities (depending on their size, population and capacity) and county governments.

The following are provided by all municipal governments in the framework of basic social/welfare services, on a mandatory basis:

- allowance for the elderly,
- regular social aid,
- dwelling maintenance aid,
- nursing benefit,
- temporary aid.

In the system of personal care, a municipal government - in Budapest a district government - is obliged to ensure:

- the provision of meals,
- household assistance,
- family assistance.

The local government of a municipality with over 2,000 permanent residents is obliged to provide for institutional daytime care for the elderly.

In addition, the local government of a municipality with over 10,000 permanent residents is obliged to provide for the maintenance of an institution (or institutions) for temporary accommodation for the elderly.

Further obligations of the local government with over 20,000 permanent residents include the provision for an institution (or institutions) for daytime care.

The local government of a municipality with over 30,000 permanent residents is also obliged to provide interim accommodation arrangements.

The obligations of benefit/service provision of a local government cover the residents of the municipality and homeless people staying in the municipality on a permanent basis, except if the institution is maintained jointly with other municipal governments under institution maintenance associations, or if a local government maintaining such institutions has undertaken to provide such services for residents of other municipal governments as well, under agreements with such other municipal governments.

A county government and the Budapest municipal government provide for the organisation of specialised services and for the performance of methodology-related responsibilities.

The territory of service provision of social institutions providing specialised services, maintained by a county government, extends to the entire territory of the given county. A local government that does not have a necessary institution may agree with the county government on providing the relevant services for the residents of the given municipality by the institution designated by the county government.

In determining the territory of service provision for an institution, it is a particular criterion that the distance between the institution and the places of residence of the users of the service should not be greater than 100 km.

In the capital city - unless otherwise provided for in an agreement between the Budapest municipal government and the district council concerned - the Budapest council provides for the organisation and maintenance of night shelters and temporary accommodation for the homeless.

A county, or Budapest methodology institution, is in charge of promoting the technical/professional operations of social/welfare institutions maintained by themselves, those operated by local governments in

their respective territories, or of such institutions with their head offices in their respective territories, maintained by non-governmental organisations and of participating in technical/professional supervision of the operations of such social/welfare institutions.

#### 4.6.2.2.1 Household social/welfare benefits and services

After the system change, the entirety of social policy as a system of benefit and service provision was established by Act No. III of 1993 on social administration and social/welfare benefits. The fundamental goal of the legislator was to ensure that decisions concerning the groups of the population concerned - strengthening the means-testing-based features of social policy - should be made where the necessary information was available. Accordingly, social policy was delegated to the scope of responsibilities of local governments.

Part of the social/welfare benefits for residents are fully financed by the budget while it provides contributions to the funding of others. All local governments receive a basic contribution from the central budget - based on indicators reflecting the number of residents, the age profile of the population and their social position. Some income supplement benefits are supplemented by central budgetary contributions.

The conditions of entitlement to some of the household social benefits - e.g. the supporting of families with children with income below a specific level, the provision of financial support to the elderly - are specified by the act on social/welfare benefits and services. In this area the amounts or rates of benefits are established, in most cases, on the bases of the smallest amount of the old age pension or a specific percentage thereof. (The minimum old age pension was HUF 16,000, in 1999.)

Under the provisions of the law, councils of municipal governments issue social/welfare decrees - in view of the local social conditions and their financial resources - establishing the mode and system of providing aid to residents, the conditions of access to social/welfare benefits and the amounts/rates of benefits.

The statutory minimum financial support is to be provided by all local governments. They may establish additional benefits, depending on their social/welfare objectives and financial resources.

In the case of part of the financial support forms provided for residents in cash e.g. subsidy for the maintenance of dwellings, interim aid, burial aid, local governments provide access to benefits on the basis of means testing criteria established by themselves. In this area, the various municipalities have different possibilities of providing aid for those in need in their communities.

Applications are submitted by residents to the local mayor's office. Decisions on applications are made by councils of local governments under the relevant decrees issued by local governments or - if the responsibility is delegated - by the social committee or mayor.

Furthermore, in the case of a certain group of local governmental social/welfare matters, decisions are made by the notaries, under statutory authorisation. These will be dealt with below.

A municipal government provides the following cash and in-kind benefits:

- ***Allowance for the elderly***

Elderly people who have not acquired entitlement to old age pension receive income supplement benefit.

A total of 75 per cent of the amounts paid out by local governments under this title may be re-claimed from the central budget.

- ***Income supplement benefit for the unemployed***

Income supplement benefit may be applied for by individuals past the entitlement of the unemployment benefit, if the total per capita income in their families is not in excess of 80 per cent of the minimum old age pension as may change from time to time.

Local governments may claim 75% of the amount of such benefits, each month, from the Labour Market Fund.

Besides the disbursement of benefits, local governments participate in the provision for the unemployed by organising public work for the community. For this purpose, local governments may apply for 60-70 per cent of the costs of employment for community purposes from the active employment budget of the Labour Market Fund, through a competitive bidding system.

- **Regular social aid**

This category is comprised of the aid provided for disabled people who have not acquired entitlement to social security benefits and of the financial assistance provided for those out of the system of unemployment benefit.

A total of 75 per cent of the amounts paid out by local governments under this title may be re-claimed from the central budget.

- **Dwelling maintenance subsidy**

This type of assistance is provided to help those in need to maintain their accommodation. It may be granted to those living in dwellings of sizes and quality not exceeding the minimum recognised size and quality of dwelling, as specified by the local government concerned.

- **Nursing allowance**

This is provided to help home care by the family of individuals permanently in need of nursing. Under the act on nursing, medical expert opinion must establish whether the individual concerned is severely disabled or is temporarily ill and under the age of 18.

- **Temporary aid**

An individual in an extraordinary, sustenance-threatening situation, who cannot provide for his or his family's sustenance, may receive this type of aid. Such situations may result from extraordinary expenses e.g. entailed by ill health or natural disaster.

- **Burial aid - public burial**

Burial aid is provided to enable a worthy burial for a deceased relative. If there is no relative, or such relative is not capable of providing for burial, the local government concerned provides for the burial.

- **Public medical services**

This is a subsidy for free medicine and medical supplies for individuals in ill health (including access to medicinal spas and medical appliances).

- **Entitlement to health services**

This type of benefit provides access to free health services for individuals who have not acquired entitlement to social security services through employment or in any other way. Entitlement is established by the mayor of the local government concerned.

The coverage for such subsidies is provided by the state for disbursement by local governments, in the case of travelling aid for physically disabled people, and aid for enlisted soldiers joining the army, or disbursement by the social security bodies, based on a decision made by the notary, for personal allowances for the blind, and aid for families of enlisted soldiers.

#### 4.6.2.2.2 Child protection service

The duties of local government concerning the protection of children are specified in Act No. XXXI of 1997 on the protection of children and guardianship administration. This Act has imposed an obligation of provision for basic duties of child welfare on all municipal governments, however, it also enables local governments to establish and operate the system of service provision in view of the size of the given municipality, its burden-bearing capacity and the requirements of the population.

Child protection services and institutional expenditures are financed from the local governmental budget. The central budget provides a contribution to such benefits. A local government may re-claim 75 per cent of the regular child protection benefit, each month, while there is a normative subsidy provided for child protection institutions in addition to the basic normative social and child welfare subsidy.

#### 4.6.2.2.3 Institutional services

Services providing for personal care for those socially in need are ensured by the state and local governments. These types of services are comprised of basic and specialised services, and are distinguished by the fact that basic services are to be provided by all municipal governments. The tasks of the provision of specialised services are distributed according to the size and public administration status of municipalities.

##### **A. Basic services**

This category includes the following types of service:

- ***Meals***

Meals are provided by local governments as an in-kind benefit, on the basis of social criteria, through kitchens established for this purpose and/or using kitchens of other social institutions (e.g. daytime homes), for those in need.

- ***Household assistance***

In the framework of household assistance, employees of the given local government provide assistance to individuals in need, who are not capable of fending for themselves.

- ***Family assistance***

Family assistance provides assistance to families threatened by social and/or mental hygiene problems, through nurses and nursing centres.

Local governments are provided with a normative state subsidy for the performance of basic social services. A supplementary contribution is available for the family assistance service and the village caretaker services providing the basic services in small villages.

##### **B. Specialised services**

In the area of specialised services, the key roles are played by local governments. This is illustrated by the following Table showing the distribution of social institutions by maintaining organisation.

**Table 4.6** Number of social institutions in 1999

Type of institute	Number of institutions			Total
	Local governmental	under supervision of other bodies		
		Total	of which: church	
Crèche	531	15	0	546
Day nursery	23	7	1	30
Social/welfare home, institute	355	79	38	434
Home for children with disabilities	31	8	1	39
Club providing accommodation for the elderly	141	3	1	144
Home for addicts and the homeless	87	8	1	95
Other home providing accommodation	115	4	3	119
Club for the elderly (daytime)	1241	26	11	1267
Institution for people with disabilities (daytime)	59	1	1	60
Institute for addicts (daytime)	8	1	0	9
<b>Total</b>	<b>2,591</b>	<b>152</b>	<b>57</b>	<b>2,743</b>

Source: Statistics on local governments

- ***Funding of institutional services***

For the maintenance of their social institutions, local governments receive normative state contributions related to the performance of the various specialised services, and based on the number of individuals using the services of such institutions. Furthermore, those using the services are required to pay service charges, as specified by the organisations maintaining the institutions. Such service charges are, however, capped, based on the user's income or the minimum old age pension.

To finance local government participation in the social benefit and service providing system, the state (including the central budget, the Social Security Fund and the Labour Market Fund) used to provide 75 per cent of the current expenditures, and this was increased to 84 per cent, in 1997, with the introduction of the additional tasks prescribed by the Act on the protection of children. (The rate of state contribution includes normative contributions and personal income tax distributed under normative rules, which have been playing an increasingly important role within the range of social resources, since 1997.) The service charges paid for the services provided by the institutions cover some 15-16 per cent of the expenditures. Therefore, the local governments have to contribute some 10 per cent to the expenditures of this group of public services from their own resources.

#### 4.6.2.3 *Social services provided by organisations other than the state and local governments*

The provision of social/welfare services is promoted by the launching of an increasing number of non-governmental organisations providing such services. Most non-governmental organisations are operating in the non-profit oriented sector though profit oriented businesses - not very many as yet - are also entering the sector.

Churches and charity organisations have entered all areas of social service provision.

Non-governmental organisations provide, in part, various missing state or local government services, or they widen the range of available services. Where they perform state or local governmental responsibilities, they are also entitled to state contributions.

A municipal government and a non-government organisation may conclude a service provision agreement concerning the provision of mandatory local government responsibilities, which makes the conditions of use of services predictable and stable for citizens.

An increasing number of non-profit-oriented organisations are operating in the social area, as well - the majority of these are foundations and associations. The number of social non-profit organisations in the priority areas of social service provision is shown in the Table below:

Some 50 per cent of the total revenues of non-profit-oriented organisations originate from state subsidies. Private contributions also make up a substantial percentage, indicating social responsibility.

Social enterprises operate primarily in the area of special social services, providing personal care. Institutions providing care and nursing are operated by businesses. There are still very few enterprises in basic services - some organisations operate in the area of home nursing services.

**Table 4.7** The number of non-profit-oriented organisations in the various priority areas of social service provision

<b>Activity</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
Child and youth protection	518	579	649	689
Family protection	343	376	396	414
Support of those with impaired health conditions	662	760	888	946
Supporting of the elderly	248	291	341	368
Self-assistance	156	148	124	97
Social service provision for the needy	167	270	308	389
Other	1,054	1,072	1,176	1,149
<b>Total</b>	<b>3,148</b>	<b>3,496</b>	<b>3,882</b>	<b>4,052</b>

*Source:* Social statistics yearbook 1998

### **4.6.3 Health care**

The state is responsible for the health of the population and for the provision of the requisites and conditions for the maintenance, protection and restoration of the health of the individual.

The legislative and technical/professional frameworks of this area are specified by three conceptual laws - the Health Act, the Health Insurance Act, and the Act on Medicines.

Funding for the operation of health care services of proper standards and quality is provided by the state from the central budget and from the budget of the Health Insurance Fund.

Responsibility for the organisation and management of the health sector is shared by Parliament, the Government, the Minister of Health, the National Public Health and Medical Officers' Service (hereinafter referred to as ÁNTSZ) and local governments. The Comprehensive Health Policy is established by the Government in co-operation with the Health Insurance Fund (hereinafter referred to as OEP).

The tasks of public health, health administration and co-ordination are performed by the central and regional/local bodies of ÁNTSZ. This latter set of tasks includes the licensing and technical/professional supervision of health institutions (hospitals and family doctors' offices) and the operation of a number of local health protection and preventive programmes.

In line with the structure of the Health Act, the following sub-systems belong to this sector:

- Public health (health improvement, protection of families and women, youth health protection and sports health care services) aimed at improving the health of the population and protecting health. It is also in charge of monitoring and analysing the health of the population and the risk factors influencing it, as well as the implementation of related programmes and services and their regular evaluation.
- Environmental and municipal health.
- Nutritional health.
- Radiation health and epidemics related activities (screening, inoculations).
- Occupational health.
- Emergency service provision.
- Rescue, ambulance service.
- Rehabilitation and natural medical therapies (spas, climatic medical institutions).
- Homeopathy.
- Blood supplies.
- Medical scientific research.
- Disaster health services.
- Activities of medical experts.

The health sector in its broader sense includes other related areas, as well, including drug production; the wholesale and retail trade of medicines; nursing homes; and medical appliances. In an even broader sense, this area includes financial subsidies otherwise falling in the category of social services, relating to not being able to work (sickness benefit, disability benefits, maternity benefits).

The health sector is one of the largest sectors of the national economy with about 250,000 employees and entrepreneurs. Over 200,000 of them are working in medical curative institutions and in family doctor services, others are in the pharmaceutical industry, medicine trading, university education, and research. In Budapest, and at county seats, hospitals are among the largest employers.

Prior to the system change, the health sector was a very tightly closed system, and part of planned economic management. At that time, responsibility for service provision, and not quality and cost efficiency, was the only criterion to be met by the traditional sub-systems of the health sector and the corporate areas of the pharmaceutical industry and the trade of medicines. This together with state ownership led to institutions in the same system varying widely in terms of efficiency.

The funding of institutions providing health care services, managed by the ministry or county or local councils, was determined by the lobbying capabilities of the regional (county) administrative bodies. The budgets of institutions were established by the councils in charge of managing them, in principle in accordance with the tasks of service provision, but not in a normative system. The development of the service-providing organisation was funded from state resources in the same decision-making mechanism.

Basic services were organised on territorial principles, services were provided for the various territorial units by the appointed district doctors who referred patients to the relevant clinic or hospital when necessary. Higher levels of service provision could only be used by a patient if the institution designated for the provision of the given service referred him or her on to the next level.

The Health Act specifying the basic principle and operation of the system granted the right to free health services to all Hungarian citizens, however, citizens could not choose doctors or service providing institutions.

The most important steps after the political system change included the following:

- as a result of the establishment, in 1990, of the local governmental system, the health institution network that used to be operated by the councils was transferred into the ownership of local governments;
- the operation of health care enterprises that had already been licensed from 1989 became more dynamic;
- in 1992, the family doctor system was introduced;
- the entitlement to health care services was regulated, in 1992, by an amendment to the social security act (entitlement as a citizen's right was terminated), the transformation of the financing system was commenced;
- in 1993, normative, performance-proportionate financing was introduced in ambulant and in-patient services (ambulant services are financed in accordance with the German score system; hospital treatment is financed under the principle of homogeneous patient groups i.e. the American DRG system);
- social security self-governments (health and pension insurance) were established and the health self-government became an autonomous buyer of health services (in July 1998 the social security self-governments were terminated in order to strengthen the role of Parliament in these areas),
- from 1994, it became possible to establish voluntary mutual insurance funds (pension, health insurance and self-assistance);
- the reduction of hospital capacities commenced in 1995-1996;
- in 2000, the so-called practice right was introduced for family doctor activities as part of the health reform whereby a family doctor working in a district is granted a practice right, free of charge, which may be inherited by the spouse or a direct descendant.
- The practice right is a personal right of commercial value which may be sold and continued under a specific set of conditions.

The steady reduction of the number of hospital beds is illustrated in the following table:

**Table 4.8** Number of hospital beds by supervisory organisation

Number of licensed beds

Year	Subordinated directly to the Ministry of Health		Provincial	In Budapest	MÁV	HM, BM	Churches, foundations	Total
	Clinics	National institutions	Local government hospitals					
1990	8,845	10,283	64,908	18,065	2,345		240	104,686
1995	8,323	8,107	56,230	15,197	1,934	2,915	441	93,147
1997	7,653	6,936	52,101	12,715	1,600	2,213	859	84,077
1998	7,977	6,722	52,083	12,755	1,600	2,213	882	84,232

HM= Ministry of Defence, BM= Ministry of the Interior, MÁV= Hungarian Railways

Source: Health statistics yearbook, 1998.

The past decade has been a period of major changes for the Hungarian health sector and, despite any deficiencies, the system has progressed towards modernisation, increasing cost efficiency, the application of normative funding principles, and improved territorial distribution of service provision. However, the degree of development is not yet sufficient and the process has not become self-sustaining.

The key duties of the forthcoming period include:

- the prioritisation of prevention;
- the improvement of efficiency in the allocation of resources within the health sector;
- the improvement of cost sensitivity, and the strengthening of the performance requirement;
- the increase of wages of health sector employees, and a parallel reduction in the practice of ‘tipping’. (Legal wages are relatively low in comparison with those of employees with similar levels of qualification in the productive sector, so tips make up a substantial proportion of income. However, it is not equally accessible for all areas of the medical service.);
- the renovation of assets - equipment, instruments, etc.;
- the transparent separation of financing by the social security system and private insurers;
- a shift of the proportions within individual contribution payments towards self-provision (taking into consideration the principle of risk sharing);
- the strengthening of the service provision nature of curative services, where the insured citizen is not in an exposed and subordinate position;
- the implementation of measurement and analysis of service provider activities, from the medical profession and cost efficiency aspects;
- the simplification and improvement of transparency and control of the funding system (in harmony with the protection of privacy, business interests and competition).

#### 4.6.3.1 The operation of the health care system

The Hungarian health care system is, in essence, a comprehensive, mandatory, national health insurance system, based on employment, where health services are used, based on the insurance principle. The basis of the system is the Social Security Act, adopted in 1992, which declared that entitlement to the use of services is based on the obligation of a contribution payment. In practice, however, almost everyone is entitled to the services.

The services are essentially free of charge, with the following exceptions: medicines, dental braces, tooth retention service for adults, tooth replacement, sanatoriums, nursing homes, certain interventions (e.g. abortion and detoxification), fees payable for diagnostic examinations (e.g. driving suitability). In some cases service charges have been introduced for services used in hospitals and specialised clinics, on a case by case basis, and higher quality food and accommodation are also provided for a service charge.

The daily administration of the health system is carried out by the local governments in charge of service provision and the Health Insurance Fund and its network, comprised of 19 county Health Insurance Funds.

- The services whose funding is disbursed by the Health Insurance Fund, fall into two basic categories: 1) those financed by the Health Insurance Fund; and 2) those financed by the central budget. (This latter group has been described in the Section on social benefits and services.)

Services financed from the Health Insurance Fund:

- examinations aimed at ensuring prevention of illness, basic dental services, the family doctor service, ambulant service, in-patient services, maternity services, medical rehabilitation, ambulance services and casualty health services are free of charge;
- dental braces for people younger than 18 years of age, teeth retaining services for those older than 18, tooth replacement, meals of choice in in-patient institutions, higher standards of accommodation and sanatorium accommodation are partly financed by the patient,
- subsidised products are medicines (50-100 per cent), medical appliances (50-100 per cent), travelling costs and costs of medical treatment abroad.

The funding sources for the above originate from the following revenues of the Health Insurance Fund: wage taxes collected from employees and employers (employer health insurance contributions and the health insurance contributions paid by the insured) and the 'per capita taxes' (health contributions). These are supplemented by direct contributions from the central budget.

The separation of the functions of service purchasing and service provision has been a fundamental change. The Health Insurance Fund as a state body purchasing services concludes performance based contracts with hospitals, outpatient clinics and independent service providers.

Today, the Health Insurance Fund can conclude contracts with organisations in possession of the official licences. In the course of negotiations with the organisations maintaining the institutions, OEP has to keep to the capacity volume specified for the given area. (The conclusion of contracts for services in excess of the permitted 'quota' may be authorised by the Minister of Health.)

Performance-proportionate financing extends only to operational expenditures. Any refurbishment costs are borne by the organisations maintaining the institutions - local governments, in the majority of cases. (This will be detailed later.)

The key element of the financing of the normative financing system introduced in the area of family doctor services is a head quota - based on residents registration - which is established in view of the qualifications of the doctor and the demographic characteristics of the patients.

The majority of family doctor districts operate on a commercial basis, where the clinic and the equipment is provided by the local government free of charge, in return for the assumption of the obligation of service provision.

The launching of privatisation is an increasingly frequent arrangement among outpatient institutions and hospitals. This involves primarily services outside the range of basic services (e.g. laundry, catering, guard

services), and certain curative activities (e.g. diagnostics, dentists, curative gymnastics, medical spa services, etc.).

(The reduction in scope of the health sector in the local governmental sub-system - shown in Table 3.7 - is a result of the increasing number of business undertakings in the sector.)

In the area of basic health services, including family doctor services, all general doctors and paediatricians have signed contracts with the Health Insurance Fund, most of them are working for local governments, others on an independent basis. The majority of specialised doctors and employees in the health sectors are salaried public servants. Many doctors have private clinics operating outside the national health insurance system.

Hospitals are the dominant institutions of the health care system, employing over 40 per cent of the qualified employees in the health system and managing some 82 per cent of the social security funding of curative and preventive services. The introduction of financing by the social security system of the health sector has broken the uniformity of financing: in the multi-channel financing system, the Health Insurance Fund covers operation, and owners finance development and refurbishment.

The majority of chemists are in private ownership, however, the market is strictly regulated - medicines are heavily subsidised by the state.

The funding provided by the Health Insurance Fund covers wages of employees (physicians, nurses) the permanent costs (costs of public utilities) and variable costs (e.g. medicines used by hospitals). However, they do not cover fixed asset investments - including the depreciation and investment costs of buildings and medical equipment. These costs, which are borne by the owners of the institutions, are subsidised from the central budget because, for instance, in the case of an institution maintained by a local government, it is possible to apply for targeted and earmarked subsidies as basic citizen's rights.

#### *4.6.3.2 Local governmental task performance*

One of the fundamental laws introduced after the system change, the Local Governmental Act, specifies the provision of basic health services as a mandatory responsibility of municipalities.

The Local Governmental Act, however, does not specify the concept of this public service or the contents and depths of the various responsibilities. Those are specified by other laws. The responsibilities of municipal governments in the area of basic health services are established by the Act on health services, as follows:

In the area of basic health services, a municipal government is obliged to provide for the following:

- a) family doctor, family paediatrician services,
- b) basic dental services,
- c) duty service relating to the basic services,
- d) nursing services,
- e) school health services.

The council of a local government establishes and develops the districts for basic health services.

The council of a local government decides on the excavation, exploitation and treatment of medicinal mud and medicinal spring products, on the bottling and packaging of recognised medicinal waters and medicinal spring products and their sale, and licences such activities.

County governments and the Budapest government are obliged to make arrangements for the provision of health services outside the scope of basic services if such are not undertaken by municipal or district governments.

Town and regional hospitals provide the basic range of services while in regional institutions and the research and training hospitals - e.g. those operated by the Ministry of Health - more highly specialised services are provided.

The majority of hospitals are operated by local (municipal or county) governments while the national institutions and medical universities are operated by the central government. Furthermore, there are some private institutions whose operations are restricted primarily to various specific services. Some hospitals are supervised by churches, the Ministry of the Interior and the Ministry of Defence.

The following Table presents a summary of health institutions by maintaining organisation and type of institution.

**Table 4.9** Number of health institutions, in 1998, by supervising authority

Type of institution	Number of institutions			Total number of institutions
	Local government	Supervised by other authorities		
		Total	of which: church	
Hospital	116	49	9	165
District health service	1,749	2913	0	4,662
Paediatrician district	449	1012	0	1,461
Village dentist district	466	375	0	841
Special services for outpatients	335	43	0	378

*Source:* A book entitled 'Key financial data, service provision indicators and real property cadastre figures of local governments (1998)' (Az önkormányzatok főbb pénzügyi-, ellátottsági mutatói és ingatlanvagyon-kataszteradatai (1998).)

In summary of the above - referring back to the data in Table 3.7 - it is to be noted that the proportion of institutional revenues in the area of health services of local governments is much lower (only 5-6%) than in the other human sectors. The share of state - social security - financing is 94-97 per cent, therefore, a local government practically need not contribute to the current costs of the sector.

#### **4.7 General budget co-operation with central government**

The general government act and its implementing decree regulate the relationship between the central budget and local governmental budgets, and the contents and timing of interim reports.

By 15 May each year, the Government submits to the Parliament the budgetary guidelines for the next year. At the same time, it informs local governments of the key directions of the budget policy and of the preliminary concepts of the relevant financial regulation.

Along with the submission of the budget bill to Parliament not later than 30 September, the Government makes available for local governments the data and regulatory proposals pertaining to them. On the basis of those data and proposals, local governments learn the budgetary conditions originating from the macro-economic conditions (including wage increases, increase of material expenditures, investment expenditures and social benefits and services), the priorities of general government, the areas where larger increases are required and changes of tasks that may relate to them resulting from other acts of law. All of these determine the development of central funding sources to be provided for the local government sub-system. Most of the general expenditure conditions are not mandatory with respect to local governmental spending. (One exception is the area of wage increases, but only if the wage base specified in the Act on public servants or civil servants is changed, or the rates belonging to the various classification categories or the sectoral wage multipliers representing preferences are changed along with the household income supplement subsidies that are related to the minimum old age pension.)

The possibilities of spending on local public services are determined, ultimately, by the amount of funds from the central budget and the funds earned by municipal governments for discretionary spending. Taking these into account, local governments prepare the first phase of their budget concepts by no later than 30 November of the year preceding the budget year.

After the adoption of the Budget Act, the Minister of Finance and the Minister of the Interior announce, in a joint decree, the central funds to be allocated to local governments, by local government and by legal title.

Thereafter, in the second phase of planning, a local government compiles and adopts its own budget decree by no later than 15 March of the fiscal year. (In accordance with the provisions of the General Government Act, a budget is planned for one year, with an outlook of two more years.) No central body has to approve or counter-sign the contents of a local governmental budget. The disbursement of central funds, however, is dependent on the provision by the local government of general government information on its adopted budget decree, within 30 days of its adoption. A local government will not receive the normative state contributions and the personal income tax until it meets this obligation.

During a fiscal year, a local government may modify its appropriations, without restrictions, by issuing decrees, without having to supply the reasons to any government body.

In connection with the general government information system, interim cash flow reports are to be prepared during the fiscal year, by 15 April, 15 June and 15 October. Furthermore, a half-yearly report has to be prepared by 10 August and an annual report (closing account) by 15 March.

A local government adopts its closing account in a decree – or by an auditor's decree in cases specified by law – by no later than 30 April, and in which it also has to provide general government information. During the year, the council of the local government approves its budget report at the end of the first half and at the end of the third quarter of the year, in decrees.

The provision of general government information on financial management - implementation of the budget - cannot be regarded as giving accounts to any superior organisation. Undoubtedly, however, such reports do contain some data that can be regarded as giving accounts. For instance, if there is any difference in the indicators of normative state contributions relative to the planned amounts - on the basis of which financing was effected during the year - it is to be noted in the closing accounts and the difference is to be paid to the central budget (together with a penalty in the form of interest if it exceeds a certain limit) or it is to be re-claimed from the central budget. The closing accounts also enable accounting for fixed state subsidies, as well. (In the latter case, any deficit also results in an obligation to refund the central budget). The validity of the data cannot be checked by any government body, except for the State Audit Office which is the controlling body of Parliament.

The supervision of the legality of local governments, and the revision of local government decisions is performed by the public administration office (the territorial public state administration body of the government) and this is only done from a legal aspect.

The State Audit Office is obliged (and entitled) to carry out external audits of the financial management of local governments, under the legal regulations in effect.

The State Audit Office may perform the following inspections:

- a comprehensive inspection, carried out covering the entire process of financial management, based on the criteria of expediency, effectiveness and legality,
  - targeted inspection, auditing only a specific area of the financial management of a local government
  - thematic inspection when the auditing body inspects a specific area of financial management at a number of local governments at the same time, from the same perspectives,
- ex-post inspection when the effective implementation of any of the above types of inspection needs to be checked for the elimination of past irregularities or deficiencies,
  - inspection of the use of state financial assistance when the legitimacy of claiming and spending central budgetary subsidies are fully audited.

The organisation structure and the personnel of the State Audit Office are not sufficient for carrying out comprehensive audits of the entire process of the financial management of local governments, from the aspects of expediency, effectiveness and legitimacy, at the appropriate frequency. The relevant legal regulations do not regulate the frequency of comprehensive audits covering all local governments. This is the reason why, in the majority of local governments, instead of comprehensive audits covering all aspects of financial management, the audits performed by the SAO only cover certain sections of their financial management – currently, audits by the State Audit Office are focused primarily on the utilisation of state subsidies. However, legal remedy against orders to effect refund, is not resolved even in the case of the auditing of state subsidies. Local governments cannot apply to the court against the decision made by the State Audit Office. The remittance of refund belongs exclusively to the decision of Parliament.

With the current capacity of the SAO, a local government may be subject to a comprehensive audit once every 50-60 years. Another problem is that an SAO audit is only an ex-post audit.

In respect of external audits, mention should be made of the inspections of the tax and contribution payment discipline of local governments and their institutions, performed by the central tax administration.

The legal regulation of the internal control of local governments is already adequate as it imposes an obligation on local governments to perform institutional and internal controls and in the group specified by law (e.g. local governments with annual budgets and more than a year's loan debt portfolios of over HUF 100 million) to retain auditors as well. Furthermore, the Financial Committee also has controlling responsibilities.

Under the aforementioned general government reform, solutions will need to be found for the ex-ante control and in-process control of the resources of local governments from the central budget, and, in the longer run, for their revenues from the chapters and other sub-systems of general government. This type of control would be justified in the case of all the sub-systems where the conditions of subsidy for local governments are defined exactly, irrespective of whether they are defined by law or in tender invitations. Controls would be performed by the prospective General Government Office and its territorial bodies.

The powers of the State Audit Office would remain unchanged even after the introduction of this system of control, indeed, its capacities so released could be used in the future for the comprehensive audits of the financial management of local governments.

## ANNEXES

### ANNEX 1 - GENERAL GOVERNMENT AND ITS SUBSYSTEMS

General government is a system of financial management and balances performed and operated in support of the performance of public duties. In Hungary, the general government system is comprised of four subsystems, sharing public responsibilities and funding sources. The Public Finance Act specifies the following subsystems: central budget, extra-budgetary funds, local governments, and social security funds. It should be noted that economic organisations operating under commercial conditions, owned in part or wholly by the state (or local governments) are not taken into account as part of the general government system.

The general government system is comprised of central and local budgets which are relatively autonomous - they have their own revenues and expenditures.

The distribution of public responsibilities is based on the principle that tasks are to be assigned to the budgetary level where they can be carried out under the best possible circumstances. The primary criterion is that the organisation performing a responsibility should be as close to the people concerned as possible, in accordance with the principle of subsidiarity. The allocation of duties to the various levels of the general government system may, of course, also be influenced by political considerations. Hungarian local governments are regarded as relatively highly autonomous. The deployment of powers and competencies at the central and local levels is presented in detail below.

Financial management in the various sub-systems is based on the annual budget. The fiscal year is identical to the calendar year. The budget of a subsystem is a financial plan or a financial fund that contains the expenditures approved and the revenue estimates to be accomplished during the period covered by the budget, broken down by appropriations. The subsystems have to account for all movements of cash - all revenues and expenditures are parts of their budgets. In the subsystems of general government- the management of the budget is comprised of the obligation of the accomplishment of the revenue estimates and the right to spend the expenditure appropriations.

#### **The central budget**

The central budget is the central level of the general government system, with the exception of the budget of the social security system, that operates as a sub-system of general government, and those of the extra-budgetary funds. Each year, the Parliament adopts an act on the budget and on its implementation.

The central budget is comprised of chapters. A chapter of the budget is made up of bodies and appropriations under separate supervision and management, from budgeting, implementation and reporting aspects. The various state bodies (e.g. Parliament, the Constitution Court, the State Audit Office), ministries and some bodies with nation-wide competence (e.g. Central Statistics Office, Competition Office) are separate chapters, along with the Budgetary Settlements of State Debt and the Budgetary Borrowing and Debt Repayment, on account of their importance and volumes.

The budget of a chapter includes the revenues and expenditures of the central budgetary bodies comprised in the given chapter, along with the subsidies/grants of the sub-systems of the general government system

and of organisations outside the general government system. The Parliament specifies the local government share of centrally regulated taxes and duties, the titles and amounts of the normative central budgetary contributions of local governments and local governments of minorities, the earmarked and targeted and other subsidies and grants to be provided to local governments and local governments of minorities, as well as the regime of the distribution and disbursement of the subsidies payable for local governments of minorities.

The budgetary chapters are comprised of central titles and sub-titles. A budgetary chapter is comprised of appropriations and estimates - broken down into lower level components - related to one another from an organisational and regulatory aspect.

### **Extra-budgetary funds**

An extra-budgetary fund is a fund financing some of the responsibilities of the state, partly from sources outside the general government system, the operation of which necessitates separate financing within the general government system.

A fund is established by law specifying the purpose of the fund, its revenue sources, the range of expenditures that may be effected from the fund and the minister entitled to dispose of, and bearing responsibility for, the utilisation of the fund. One pre-requisite for the establishment of a fund is that it should be possible to directly assign to the fund the funding sources from outside the general government system under the titles of partly targeted tax-type payments, contributions related to the performance of specific tasks by the state, and the relevant types of fine. A fund is utilised in accordance with other funds and appropriations of similar or related purposes, managed within chapters of the central budget.

The budget and closing accounts of a fund are approved by Parliament.

At present, there are two extra-budgetary funds in operation: one of them is the Labour Market Fund whose functioning is based on insurance principles, providing for unemployment benefits and subsidies promoting employment; the other is the Central Nuclear Fund, financing the expenditures of the nuclear waste management of the Nuclear Power Plant at Paks.

By managing contribution revenues associated with employment (including employer contributions, employee contributions, the vocational training contribution, and the rehabilitation contribution) in a single uniform system, the Labour Market Fund aims at providing for:

- unemployment benefits,
- the subsidies promoting the employment of unemployed people,
- subsidies to promote the employment of individuals with impaired working capabilities,
- the financing of expenditure of the operation and development of the labour market organisation.

The key revenue source of the Central Nuclear Fund is comprised of the contributions paid by the Paks Nuclear Power Plant Ltd. The expenditures of the fund primarily include the operation of the nuclear waste storage facility, the preparations for the construction of a new waste depot, and the increasing of the capacity for the temporary storage facility of burnt-out fuel elements.

### **The social security funds**

The social security funds are part of the general government system as a mandatory insurance system of society, based on collective risk assumption - operating on the basis of insurance and risk sharing principles. The social security funds are comprised of the budgets of the Pension Insurance Fund and the Health Insurance Fund.

These funds finance and perform the statutory responsibilities of social security as specified by the relevant act of law, regulating the governance and operation of the social security system, the rules on the scope of power and procedures of the system, the range of its revenues and expenditures, the mode of its financial management, its assets and the relationship and co-operation of the social security funds with the central budget and the rest of the sub-systems of the general government system.

The Parliament adopts an act on the budget of the social security funds and on their implementation.

The revenues of the social security funds are made up of health insurance and pension contributions paid by the insured and their employers, and the central budgetary contributions. Income-proportionate contributions are withheld and remitted by employers to the social security organisation. The social security funds have certain capital type revenues as well: temporarily or permanently uncommitted funds may be invested in order to improve the standards of the services rendered by the system, or to cover its operating expenses. Furthermore, the social security funds may receive asset elements of businesses in bankruptcy as a compensation for unpaid employer contributions.

The main benefits and services provided by the social security system include: health services and sickness benefit, as well as old age, disability and casualty disability pensions, and survivor's pension benefits.

The services and benefits provided by the social security funds are guaranteed by the state. In some cases, the social security organisations perform the tasks of disbursement of the benefits financed from the central budget (maternity benefits, family allowances, child care benefit and aid, and medicine cost subsidies for those in need).

## ANNEX 2

**Table 2.1** Gross Domestic Product, 1996-1999, in billions of HUF. Market prices

<b>Year</b>	<b>GDP</b>
1996	6 893.9
1997	8 540.7
1998	10 086.0
1999	11 560.0