

FISCAL DECENTRALIZATION IN HUNGARY*

Péter BORDÁS**

ABSTRACT: *The scope of local responsibilities has remained fundamentally unchanged over the past years. However, it may vary from country to country and time to time which public services are considered local and which ones are truly organized and provided locally. Therefore, we may distinguish between public services of a local character as “suggested” by the theory of fiscal federalism and those specified as such by various governments based on the particular circumstances and policies. Although the rearrangement of tasks may be perceived as inherent to modern states, the economic crisis of the past decade has intensified reform processes in various countries. The revaluation of governmental roles represents one manifestation of this, calling attention to the stronger role of the state in such cases as opposed to the more liberal ideas prior to the crisis. Thus studying the direction of change has become due especially in view of Hungarian processes, as in recent years the responsibilities of the local level have been revaluated in this country also. One of the key elements of this process involved the reconsideration of the local government system and the scope of local services. The significance of the topic is also underlined by the data recently published by Eurostat for 2016, according to which the expenditure of the Hungarian local government system as a percentage of the GDP dropped to 6.1%, which represents a continuous decrease from the 12.6% level measured in 2010.¹ Of course, such data are not meaningful on their own and it is worth examining the reasons and scrutinize the circumstances and results of such a change; therefore, the present study aims to investigate these issues.*

KEYWORDS: *Fiscal decentralization; public finance; local public goods; fiscal transfers; local government*

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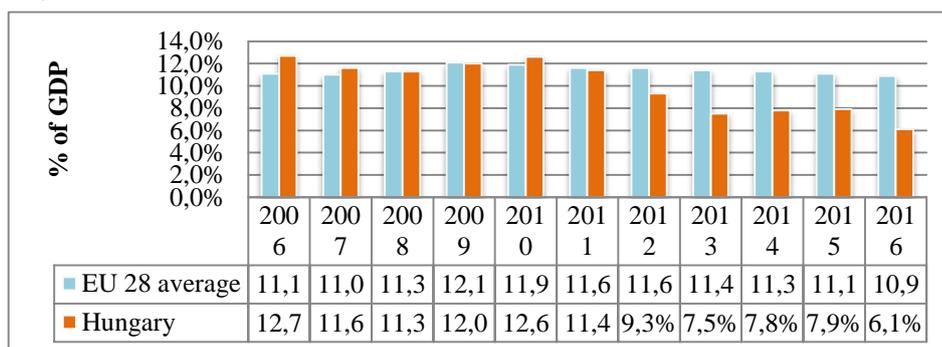
** Ph.D. research fellow, MTA-DE Public Service Research Group, Faculty of Law, University of Debrecen, HUNGARY.

¹ Government revenue, expenditure 2006 - 2016, Available at: <http://ec.europa.eu/eurostat/data/database>

1. THE REVALUATION OF LOCAL GOVERNMENT ROLES AFTER THE CRISIS

The expenditure of local self governments as the percentage of the GDP reflects various features, including the size of tasks delivered by local governments, the degree of local autonomy, and the relationship between local and the central government. It has been a recurring question how extensive the financial and task autonomy of local government units should be and what should be decentralized by the central government. After the economic shock, European states reacted differently to the challenges, which is also well indicated by Eurostat data. Without the presentation of the timeline data of the 28 member states, it may be stated based on the scale of budget expenditures that in most member states of the European Union the role of the local level has not changed, what is more, it has increased; thus tasks were not taken away from lower-level governments or their grants were not reduced.

Table 1. Local Government Expenditures in Hungary from 2006 to 2016 (percentage of GDP)



Source: Compiled by author, based on Eurostat data

The study of data reveals that in most member countries the role of the local level has either not changed significantly or it has increased, for example, in such countries like Belgium, Finland, Denmark, and Sweden. We can mention five countries where the budget expenditure of the local level has decreased to a larger extent: the United Kingdom, Lithuania, Portugal, and to the greatest extent Ireland and Hungary. In the case of Ireland, the local expenditure levels have decreased to 2.2% from the already relatively low level of 6.6%. In the case of Hungary, the budget expenditure of the local government as the percentage of the GDP has decreased from 12.7% in 2006 to 6.1% (see Table 1) which represents a drop to almost half of the former value. The reasons for such a decrease are multifaceted.

Thus the problems emerging as a result of the crisis have presented the option of government intervention not only internationally, but also in Hungary. (Nagy, 2015, 203.) The need for and practice of increasing state roles can be perceived from the 2010s, which is rooted in a number of issues. According to Csaba Lentner, these are the following: the lasting crisis of the neoliberal economic model, revaluated state roles in the field of public authority functions, counteracting bust cycles in the area of interventions in social policy,

the renaissance of Keynesian economic philosophy since 2007, a Hungarian state operation capable of a successful switch in fiscal and monetary policy and sustainable growth. (Lentner, 2015/b)

2. THE BUDGETARY ANALYSIS OF HUNGARIAN PROCESSES

Following the adoption of the new Act on Local Governments², besides the introduction of the task-based financing of local governments, centralized solutions have come to the foreground in the organization of numerous responsibilities. The present study focuses on the period between 2006 and 2014, which includes the time prior to the crisis, the change of government in 2010, and the first years of the new system introduced under the name of “task-based financing”³. Eurostat continuously collects data on the expenditures of the local government subsystem and its functional distribution for all member states of the European Union, thus including Hungary also; 2014 represents the last processed year related to such data. The statistical office categorizes expenses into 9 task groups the study of which reveals how much is spent on different tasks.

The formerly mentioned reasons and processes are revealed by data included in Table 2. On the one hand, we can see that the expenditures of the local level have dropped slightly in the year of the crisis, which may be attributed to the austerity measures adopted at the time. Such a decrease did not continue but spending returned to the previous level by 2009-2010, one of the reasons probably being the approaching election, which is usually associated with the general increase of local budget expenses. Then from 2011 the expenditure of the local level as the percentage of the GDP decreased again, as the precursor to the new system. From 2012 the results of the new act on local government taking effect gradually are clearly discernible, as the number of tasks and simultaneously with that the weight of the local budget decreased.

Table 2. Local Government Expenditures by functions in Hungary from 2006 to 2015 (percentage of GDP)

Sector/ public services	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
General public services	1.9	1.8	1.7	1.8	2.2	1.9	1.9	1.7	1.9	1.8
Local defense	0.2	0.1	0.2	0.2	0.2	0.2	0.0	0.0	0.0	0.0
Economic affairs	1.0	0.8	0.8	0.9	1.3	1.0	1.1	1.2	1.4	1.4
Environmental protection	0.6	0.5	0.4	0.3	0.4	0.4	0.4	0.7	0.8	0.9
Housing and community amenities	1.1	1.0	0.9	1.2	0.6	0.5	0.5	0.6	0.6	0.8
Health	2.0	1.8	1.9	1.9	1.9	1.9	0.8	0.3	0.3	0.3

² New Statue on Local Governments (Act CLXXXIX of 2011)

³ This is the name used for the central government grant system of local governments.

Recreation, culture and religion	0.6	0.6	0.6	0.6	0.8	0.8	0.6	0.7	0.7	0.7
Education	3.8	3.5	3.4	3.4	3.7	3.2	2.7	1.2	1.1	1.2
Social protection	1.5	1.5	1.5	1.6	1.6	1.5	1.2	1.1	1.0	0.8
All expenditure:	12.7	11.6	11.3	12.0	12.6	11.4	9.3	7.5	7.8	7.9

Source: Compiled by author, based on Eurostat data⁴

Let us have a more detailed look at these data according to the different tasks. The expenditure on general operation has not changed significantly with the exception of the election year of 2010, when it showed a slight increase. The increased spending on local economic affairs and environmental protection is another interesting trend, as these have practically doubled since the crisis. The proportion of the expenditures on housing and recreation⁵ is just the opposite, as these fell to half of the former level in Hungary after 2009. The third change that should be highlighted is present in the areas of healthcare, education, and social affairs. These reveal best the reasons behind the fact that the expenditure of the local government sector dropped to half of the former level.

3. THE EFFECT OF THE CENTRALIZATION OF EDUCATION, HEALTHCARE, AND SOCIAL AFFAIRS ON LOCAL BUDGETS

The presence of factors influencing the strengthening of state involvement and the appearance of the concept of “good governance” provided a basis for the reevaluation of state roles. The delivery of local public services does not necessarily take place by means of a local government organization, budgetary body or company, there are various options for their implementation. One of these is a solution directed and financed from a central level by the state. Such a centralized system cannot be deemed bad in itself; it can be assessed based on its efficiency and performance in practice, if at all. In terms of the delivery and financing of local tasks, the greatest changes may be observed in recent years in the case of educational, healthcare, and social tasks, as also confirmed by data.

Public education may be considered a typical example for the category of local public services referred to above; as Gábor Péteri also argues, it is beneficial if there is a close association with the local level, the settlement in the organization of public education. (Péteri, 2016, 494.) The transformation of the responsibilities of local governments in public education started in 2012; one of the key justifications for this may be found in the Kálmán Széll Plan, which provides a basis for the idea that *the state has to return to the world of education*. It argues that *the quality of education cannot depend on the situation and ad hoc decisions of local governments, in this regard the state can create order*.⁶

⁴ Government revenue, expenditure and main aggregates 2006-2015, Available at: <http://ec.europa.eu/eurostat/data/database> (date of access: January 27, 2017)

⁵The community recreation concept in this category refers to such tasks in Eurostat practice as the operation of public swimming pools and spas, building and maintenance of community spaces, playgrounds.

⁶ Point 5 of the Kálmán Széll Plan.

Therefore, it seems that transformation was started to ensure a uniform standard of service, followed by references to cost efficiency in public policy debate, according to which the performance of this task represents a major burden for local government budgets, which may also serve as one of the reasons for indebtedness.⁷

Changes started in the education sector in 2012, as also indicated by the figures, first with the takeover of the responsibilities of county governments (operation of secondary schools, hostels), followed by the centralization of primary education in 2013; as a result, the expenditure as the percentage of the GDP dropped from 3.2% in 2011 to 1.2%.

Within the framework of this new solution, since the 2013 school year the state performs the tasks of public education by means of a budgetary body under the supervision of the Ministry of Human Capacities (more precisely the central office operating under the supervision of the Minister of Education), which model has triggered criticism from various professional groups in recent years. Maybe especially as a result of these professional arguments, at the beginning of the 2016 school year organizational changes took place and the new Klebelsberg Center was established with 59 school district centers. This step taken towards deconcentration also proves that in the case of these local public services centralized performance of responsibilities carries in itself numerous problems; one of the reasons for this may be the large distance from the place of task performance and information, together with the inflexibility of overtly large organizations, and the fact that a larger task performance size does not necessarily result in a more economical and effective operation.

The decrease of local healthcare expenditure (first in 2012, then to a more significant degree in 2013) also contributed to the results shown in the table. As a result, the local healthcare expenditure in the Hungarian system dropped from 1.9% of the GDP to 0.3%, which is well below the EU average (1.5%).

This process of change already started in 2008 according to István Hoffman, when the Social Security Funds were turned into the appropriations of the budgetary subsystem from the former independent subsystem. (Hoffman, 2016, 447.) The real change came about as of January 1, 2012, as shown by budget data also, from which point the institutions providing specialized care maintained by the county and metropolitan local governments were taken over by the state.⁸ Thus the county level lost its other, formerly significant role. The process did not stop here and the decrease seen in the local budget data continued, as in 2012 the institutions providing specialized inpatient care operated by local governments and the related institutions for specialized outpatient care were taken over by the State Health Service Providing Center.⁹ The last step towards the centralization of healthcare tasks was taken in 2013 with the takeover of institutions operated in the form of business associations,¹⁰ and their simultaneous transformation into budgetary bodies. (Hoffman, 2016, 448.)

Reforms also affected social public services, especially social care services related to individuals, even if it impacted local budgets to a lower extent than the two above-

⁷ There is no doubt that the expenditure on education had been the highest among local budget expenses since the 1990s but it cannot be proven that the operation of primary schools put local governments on track for indebtedness.

⁸ Act CLIV of 2011.

⁹ Act XXXVIII of 2012.

¹⁰ Act XXV of 2013.

mentioned tasks (this represented approximately half a percentage of expenditure decrease).

As one of the first steps adopted in 2011, by emptying the already mentioned role of county governments as maintainers of institutions, the social and child protection institutions were removed from the county level. Subsequently, in 2012 a decision was made regarding the takeover of certain specialized social care and child protection institutions¹¹ Then, as a continuation of transferring social care institutions into state maintenance, as of January 1, 2013 40 social care and 137 child protection institutions were taken over by the state from the local governments. (Hoffman, 2016, 340.) The assumed tasks, similarly to educational and health responsibilities, were transferred under sectoral control, to the so called Directorate-General for Social Care and Child Protection.¹² At the same time, it should also be noted that from March 2015 the social support system was also transformed. The income-compensating part of social grants was transferred to the district offices of the government office, while the local governments kept the expense-compensating forms of support, the name of which was uniformly changed to municipal support.

It should also be noted that the increase in state involvement may be perceived not only in the three areas of public services mentioned above, but in numerous other cases affecting the tasks of local governments, which to a lower extent also influenced budgetary expenses. I would not like to provide a detailed analysis of particular public responsibilities, I only wish to provide additional evidence for the changes in state roles. Thus, for example, also in the case of waste management public services, water utilities services, district heating services, parking public services and chimney sweeping-industrial public services.

Of course, the shift towards the central level in the relationship between the state and lower-level governments may be detected in many other changes in regulations and the delivery of public services. Fundamentally, we can see that on the one hand this is about the displacement of the private sector from the area of public service delivery, with the strengthening of local government ownership roles, the price of which in many cases involves the limitation of decision-making authority (to conclude contracts, set prices, organize services). (Bartha, Horváth, 2016, 910.) It is an interesting feature of the phenomenon that the changes in themselves can be considered rational solutions of public service delivery, with references to some kind of a public interest in the background. However, overall the regulation extending to almost all aspects of local public services and also affecting their financing significantly decreased the role of local governments.¹³ The decrease may also be detected in the structural and quantitative changes of local budgets as we have also seen in the case of the above series of data.

¹¹ Act CXCI of 2012.

¹² Government decree no. 316/2012. (XI. 13.)

¹³ Even if in some cases the exclusive or majority ownership role of the local government may have the opposite effect also because in many cases these companies were operated under local government interest previously also.

4. LOCAL GOVERNMENTS IN A NEW GUISE?

As a final consideration in terms of the transforming roles, we should discuss how the outlined changes may be evaluated from the perspective of local government roles. The local government system developed after the change of regime basically followed an institution-operating and maintenance model, which was closely related to the decentralization processes. As a result of changes after 2010, we may ask the question how this former role has changed.

The development of the income system, the limited use of resources, the stronger budgetary limits, and the reduction of the number of public tasks to be provided locally indicated a new role for the current local government system. While the county local governments received regional development and regional planning and related resource distribution functions, (Barta, 2017) in the case of the municipal governments, besides their role of providing public services, the former economic organization, coordinating role received more emphasis as also revealed by Eurostat data. (Lentner, 2015/a, 31-48.) All this may be associated with the process described in terms of debt consolidation and the crisis of decentralization. (Pálné, 2016, 201-203.) By taking back social, healthcare, and educational tasks, the role of local governments resulted in the strengthening of their already existing tasks and the appearance of new ones. As Tamás Horváth M. argues, in the area of local government task performance, besides the solutions of the liberalization era, public company remunicipalization, i.e., the provision of local public services by local government companies, became stronger all over Europe, thus also in Hungary. (Horváth, 2016, 263-274.) Therefore this also resulted in the strengthening of the economic organization, coordinating role of local governments.

One of the reasons for this is that public customers lost control over requirements set for public services, at the same time, the setting of consumer fees was not effective, as I have already noted in connection with waste management. (Horváth, 2016, 263-274.) Therefore, in the processes of change of recent years it has become important especially in the case of local governments having a wider corporate group to also make economic management more effective. (Lentner, 2016, 63-86.) The problem was brought to the surface by the economic crisis and the public ownership forms of the market economy were perceived differently in Hungary and in most of the countries of the former Eastern block. (Horváth, 2015, 168-169.) Thus in this case the Hungarian local government roles became more important, especially due to the change of the financing system, which encourages the settlements to save their resources into their companies from limited use and inclusion.

The organization and coordination of public employment that was included among local economic tasks by Article 13 of the Act on Local Governments provided a further impetus to the organization of local economic tasks. The public employment programs operated since 2012 have attempted to stimulate the local economy. This way the local governments have appeared in several economic activities where they previously had had no expertise, they had not been present on the market. These include, among others, the production of fruits and vegetables, renewable energy sources, manufacturing of construction industry products, livestock breeding, etc. The magnitude of this is well indicated by the fact that the number of people employed in the programs reached 208,000 on a monthly average in 2015, and overall almost 345,000 people participated in it in

some form during the year.¹⁴ The figures indicate it well that the employers, thus also local governments, participate in the economy more and more strongly also on the employer side in the spirit of growing state involvement.

Finally, we may also mention local investments implemented from EU grants, which are closely related to the development of the local economy, in the case of some local governments concentrating significant human resources on the implementation and coordination of these tasks.

5. CONCLUSIONS

As the former examples also indicate, the local governments received a new guise also, which is not yet fully developed but is closely related to the revaluation of state roles and factors affecting their growth. It is clear that the former role as maintainers of institutions has decreased and the economic organization and coordination roles have increased, even though their extent may vary based on the settlement category and region.

The relationship between the delivery of local public services and budget expenses can be seen well, as the two have decreased simultaneously. This is unique in international comparison as due to the crisis the exact opposite happened in the member states of the European Union: the redistribution of the local budget in view of the GDP shows an increase. Although I would like to emphasize that centralized task performance does not represent any quality, efficiency or economical standard in itself. I share the point of view of István Balázs, who claims that the newly developed system does not go contrary to the provisions of the Charter of Local Self-Government, as we can find examples in several other countries where primary education tasks or for that matter healthcare responsibilities are provided by means of state institutions. However, he calls attention to the fact that the centralization process goes against the objective stated in the preamble of the document, namely that local self-government should be reinforced continuously, which may also be perceived as the prohibition of withdrawal. (Balázs, 2012, 37-42.)

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¹⁴ Based on the annual report of the Ministry of the Interior. Available at: <http://kozfooglalkoztatasi.kormany.hu/download/2/b1/91000/Besz%C3%A1mol%C3%B3%20a%202015%20%C3%A9vi%20k%C3%B6zfoglalkoztat%C3%A1sr%C3%B3l.pdf> (Date of access: April 17, 2017)

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