

Paradigms and inherent management risks in the regulation of local authorities following the political transformation

The end of the Cold War and increased globalization has affected governance around the world. The decline and virtual disappearance of centralized socialist forms of rule has led many countries toward increasing minimalist government and reliance on the free market. Modern liberal democracy has become increasingly influential as the dominant model for government. These trends have had a significant impact on local government. In an effort to slim down and foster good governance, national government has shed responsibility for providing citizens with basic services and implemented policies favouring decentralization. This increased the role for local governments who increasingly provide services that citizens have come to expect. (Lazin, 2014)

In the course of our research, we examine the utilization of the opportunities offered by the former socialist, Central and Eastern European municipalities in terms of technical development, including e-government, and their willingness to take part in e-participation, from the beginning of liberalization. The liberalization processes and obstacles of the municipalities of different countries are in many respects, but they have not followed the same path.

In Poland, for example, large industrial centers in the western region - not far from the European trade axis - have developed at a much higher rate than the settlements in the eastern region through the process of liberalization. The latter have typically been unable to generate low fiscal returns, poor economic development over a long period of time, and a low entrepreneurial and investment spirit by geographic distance from development networks. The government has centralized the decentralization process mainly through financial instruments (to a considerable extent with the EU Structural Fund) and, like Hungary, has little control over the county governments (voivods). Local governments were solely responsible for implementing central policies.

Romania was strongly committed to the Europeanisation of the government system, but fiscal decentralization is less advanced and, as such, local autonomy is rather limited. Romanian municipalities perform a number of new functions, but they still receive a large amount of government support in the areas of education, health, roads and public health. The autonomy introduced in the new Romanian local government law was still formal, although in the post-

accession period the "Europeanisation" also accelerated, but is typically closer to the classic Weber model.¹ At the same time, it should be noted that in Hungary most of the above-mentioned sectors are under state control.

This research reported on here focussed on the process of reform at the local level; mandatory tasks, local tax policy, local independent financial management, liberalization processes and their effects, state intervention and stabilization process, and cloud-based service management.

The effect of the political transformation on the system of local administration in Hungary

In establishing the modern local authorities in Hungary after the political transformation the legislation practically as a counter pole to the communist state establishment – made efforts to delegate the highest possible number of tasks to the local authorities guaranteed wide economic independence to realize them and consequently administered different revenues and revenue generating powers to cover the expenses induced by the obligation to meet the tasks.

Law LXV of 1990 on local authorities (subsequently ötv.) provided liberal operational and economic frameworks that guaranteed a high degree of freedom in relation to the former economy with directive plan instructions. In order to limit the former central authority the law among others ensured

- taking steps independently in local public affairs
- regulating independently and in individual affairs freely manage tasks and public affairs lying within its competence
- conducting local political elections
- being entitled to central budgetary normative funds to carry out compulsory tasks and powers defined by Parliament
- having the right to framing its organisation and system of functioning independently
- having the right to impose local taxes
- being in command of local authority properties on its own
- managing its revenues independently

¹ In more detail: Fred Lazin: Local Government Reforms in Eastern Europe after the Collapse of the Soviet Union: Some Observations, Croatian and Comparative Public Administration, 2014/3; https://hrcak.srce.hr/index.php?show=clanak&id_clanak_jezik=191492

- conducting enterprising activities at its own risk

Looking at it from a constitution law aspect the system of local authorities with a strong independence came into being as a fourth power, which, in addition to the above tools, was characterized by the identical constitutional status of players of different magnitudes, strong ownership rights and a highly restricted power of the central authority. The law differentiates five levels of local authorities, namely: village, town/city, capital, capital district and county, which have different powers and perform different tasks sometimes even in parallel. Each and every settlement regardless of its size and location was awarded the right to carry out local administration and regulate local public affairs.

In the system that was created the right to self-governance belonged to the settlements themselves, owing to which the system conforming to the Hungarian settlement network became fragmented. Due to the liberal nature of the regulation regarding the establishment of new settlements further “independent republics” came into being. An important criterion of this high level of independence is that self-imposed tasks are only limited by the fact that certain activities (e.g. establishing credit institutions, operating police-like authorities) are expressly prohibited by other laws (Vigvári, 2009). As regards their constitutional position the settlements were not legally obliged to cooperate in fulfilling the compulsory tasks stipulated by the laws. Practically, this model was a political intent ensuing the political transformation of the change of the regimes, which deemed that the monopoly of the single party system was terminable in this way. Interestingly, however, as a result of the reform of the council system, by the 1980s political frameworks lacking “only” political pluralism came into being. To conclude, we can say that instead of an integration of local authorities that followed European trends, it was the one settlement one local authority model that came into being and so a highly disintegrated system was created in 1990.

Performing tasks and operation

In allocating tasks and powers differentiation, which should have been implemented in the case of settlements of different levels and sizes, was neglected. The Ötv. did not exclude this opportunity but in most cases the separately independent local authorities were unwilling to make use of the opportunity of partnership. The definition of compulsory tasks and powers was in a number of cases observable with difficulty and the local governments themselves

interpreted them differently. The only concrete list appeared later in the supplement to the procedure of debt settlement by local authorities in law XXV of 1996. In order to restore the solvency of local authorities, to continuously meet the demands of lenders in a property proportional manner and in the interest of fulfilling obligatory local authority tasks Parliament passed a bill defining the extent of basic services for the population, according to which law it is only negotiable assets in excess to perform these tasks may be included in debt settlement. Right from their establishment and until the passing of the 1996 law, local authority tasks were not determined and clearly defined and also their numbers changed continuously. The extent of obligatory tasks remained equivocal in a number of respects but due to the precise direction of the situation became more and more consolidated and the number of bankrupt local authorities decreased from year to year.

Another interesting point is that by weakening the local authorities of the capital and the counties, these entities were practically assigned institution maintaining roles (gymnasias, swimming pools, doctors' surgeries, etc.) by the law, whose economical maintenance is at least of a dubious nature and the outcome is a lack of operational funds. County local authorities do not have a right to impose local taxes. Counties, towns of county rank, and to a lesser degree the capital and its districts solved a number of tasks in unrequired parallel, while joint solutions of the tasks were not at all encouraged. Despite the fact that their revenue generating opportunities are restricted most settlements do not make use of the opportunities offered to increase their revenues legally, so, for example their intention to form notarial districts or create partnerships is low and stick to having their own independent offices and maintaining their institutions that can be operated at high specific costs (Jókay et al., 2004). Suffice it to say that the high decentralization of public tasks is motivated by the practice of "conflict decentralization", since right from their establishment they have been assigned tasks continuously, e.g., fire department, government document offices, social provisions, etc., while the resources to perform these tasks have not been made available to them.

In regulating local authorities in Hungary the determinant way of thinking was that of New Public Management (NPM) right from the beginning. Accordingly, local authorities kept to the fore the maintenance of services but are unwilling to do concrete "productive" activities and so local authority owned public utility companies and outsourcing appeared one after the other. The former operate as partnerships subject to the general rules of corporate governance

and the latter operates on clear market or public private partnership (PPP) principles. Besides, the number of local authority publicly financed institutions was also very high so it can be rightly said that in many cases the execution of a task did not meet even basic requirement of economies of scale.

The powers of public administration offices included only legal supervision and could not influence the management of a settlement. The powers of the local notary included only the supervisory check of institutions and compulsory internal checks did exist. The government could only check the lawfulness of operation and the decision making procedure. Independent of this, in the case of most local authorities that ran into difficulties indebtedness was also followed by carrying out notary duties. If, as the guardian of law, the notary had done a good job, indebtedness might have been avoided or it might have been much less serious. Settlements usually struggled with deficiencies of organizational operation and the absence of internal audit and a competent economic expert was clearly discernible.

Financial effect, processes

The financial system of local governments is also rather complex. On the one hand they are entitled to normative funding for compulsory tasks and on the other they may conduct entrepreneurial activities but in the sense of § 88 of the Ötvin every case it is the local authority that is answerable for the soundness of the business. Despite, in a number of cases local authorities were keen on providing the self-imposed tasks when the operation of the business was already clearly in danger. The law on debt settlement passed in 1996 made it also clear that there is no government aid available in the case of insolvency while earlier the unified local authority financial fund made it possible to finance current deficit from capital income, even at the expense of a loss of wealth. Totally contrary to the European attitude financing current deficit from credit was also possible (Jókay-Veres-Bocskay, 2009). There were numerous reasons for passing law XXV of 1996 and it can clearly be regarded as the most important economic tool for checking indebtedness. The former excessively liberal regulation resulted in the economic impossibility of local authorities since the management of these practically lacked financial supervision of any kind and the appointment of a financial committee was made compulsory only in settlements with populations of over 2000 inhabitants.

Another factor that cash flow attitude to bookkeeping and breaching essential rules of accountancy made it possible to abandon payment of invoices to deadline – in some cases even for months. In such cases the invoices were not entered into the books but simply put aside and so although they figured as undertakings of obligation due to the contracts entered into but did not appear as actual expenditure.

In addition to the typically public revenues the legal environment expressly reinforced the opportunity for a local authority to act as a legal entity. It declared that a local authority might carry out entrepreneurial activities on condition that these activities do not jeopardise the execution of its compulsory tasks or more exactly, it might only engage in businesses in which its liability does not exceed the extent of its financial contribution.

According to the Ötv the revenues of a local authority are as follows:

- Own revenues (local taxes, levies, fines, received finances, proceeds on properties, dividends, rents, other revenues)
- assigned central taxes (personal income taxes, and other shared taxes)
- proportional normative public subsidies allocated to the execution of compulsory tasks
- subsidies allocated to the performance of socially important objectives
- allocations provided for large-scale investments or developments

The change in the economic situation, however, necessitated the introduction of local taxes, primarily, that of the capital stock tax. In 1992 a considerable change occurred and up to five hundred local authorities introduced local taxes and correspondingly revenues from local taxes also increased considerably. While in 1991 only four billion forints, in 1992 already 17 billion forints were generated from local tax related revenues. Following the 1994 general elections and after the amendment of the law on local taxes in 1996, the number of local authorities imposing local taxes increased continuously and by 2015 99% applied local taxes as revenue sources (Darabos, 2016, 125.p.). The local capital stock tax provides a safe regular revenue but due to its crucial role it may also result in numerous financial problems. This type of local tax generated high revenues for local authorities already in the early stages following the social transformation but its collection exceeded their administrative and supervisory capacities. This tax generates a high proportion of the total local tax related revenues but it is based on sales revenues adjusted by costs and so it is highly sensitive to cyclical fluctuation and inflation. This kind of revenue is the source of serious risks since individual settlements

may be considerably hit financially by the move out of a company or a decrease in the sales revenue. Consequently, the move out of a company with a crucial sales revenue or its poorer financial performance during a recession may result in a considerable drop in the capital stock tax. This, in return will make the planning of precise local tax revenues very difficult. In addition, regions with smaller settlements can make use of imposing local taxes to a lesser extent, while those with more sizeable settlements (economically stronger) can use it more widely and so it is the larger settlements that can mostly benefit from the advantages of local taxes. At the same time and also considering the above conditions the burden of local revenues differentiate the revenues of individual settlements according to their regions.

Besides the usual local tax and duty revenues, revenues from property utilization may also play an important role. The basis of this was provided by the fact that at the time of the social transformation, mostly city and county local authorities acquired considerable business resources and let them out or sold them in the course of property utilization. Due to slack rules for asset management and the lack of technical knowledge the efficiency of this form of utilization is questionable since, as it has turned out in a number of cases it also involves opportunities for corruption and malpractice. In conclusion, the changes in 1990, the new public administration model emerging at the local level radically transformed financing, central subsidies and the opportunities for the generation of local revenues. The fact that the law on local authorities provided practically unrestricted freedom in making decisions inherently involved the danger of the financial balance waver. Although the provision of financial resources was placed on new theoretical bases, their limitations were out of proportion with the unlimited nature of the freedom to make decisions, mentioned earlier.

As regards financial instruments it is only the bank deposit and free financial instruments kept in government securities can be considered liquid. Bonds issued by local authorities may be classified here. Characteristically, these were bonds denominated in foreign currencies. In addition to these bonds were frequently combined with loans from foreign banks and foreign currency loans from domestic banks. It is evident that in contrast to European routine, deficit was also financed by taking loans in a number of cases. This form of financing involved a lot of risks and often took occurred by ignoring market conditions, and what is not unimportant, contrary to the principles of prudent operation, through the involvement of banks. Considering the fact that most of these bonds were subscribed to banks lacking a secondary market this freely available resource involvement was also a hidden provision of credit. In the middle of 2000s local authorities had access to sources of foreign currencies at extremely

favourable rates of exchange and so by using them to finance forint based investments they managed to get good returns. Since in a number of cases this borrowing did not involve concrete objectives and covered longer periods, it meant putting the ensuing cycles in pawn mostly as a result of the exchange rate boom (CHF, Euro) at the end of the 2000s. The credit spiral operated practically after 1997 as well since following the withdrawal of central subsidies at the turn of the millennia, the exhaustion of privatization and local revenues the interest in obtaining credit became livelier again. As a result, credits obtained accounted for 1.7%, 3.1% and 4.7% of local revenues in 1996, 2005 and 2006, respectively. At the turn of the millennia 13.9% of local authorities, but in 2005 20.3% of them were compelled to take up loans to finance their operations and in parallel the local authority share of state debt increased from 1.4% to almost 3%.² Most local authorities, however, illegally offered their otherwise not negotiable properties or ones belonging to their initial stocks as securities but in acting this was it was not only the local authorities that breached the law but the financial institutions as well, since contrary to the stipulations of the law on local authorities restrictedly negotiable properties of the initial stocks of local authorities were accepted as securities. Negotiable properties kept on the file at the wrong value brought considerable property losses to local authorities and the lack of real time book-keeping and financial sanctioning of managers in a number of cases made the timely recognition of near bankruptcy situations impossible. These issues were also further aggravated by the guaranties granted for the loans taken out by privately owned companies of local authorities, which did not only mean the indebtedness of local authorities but in the long run brought about their bankruptcy as well. Since in most cases the banks were not practically involved in the bankruptcy proceedings so the process meant a considerable burden of refinancing for them. It has also to be stressed that own resources provided for certain investments also originated in bank loans and a characteristic anomaly was that a lot of settlements embarked in investments that exceeded their load-bearing capacities. These investments were mostly related to the construction of infrastructure, public utilities and gas pipeline networks.

The model of local authorities thus created played a positive role in the peaceful economic transition and the process of social development of democracy but right from the very beginning it failed to prove satisfactory to perform administrative tasks successfully and efficiently thus meaning that decentralization asserted the principle of subsidiarity without

²In more detail: The report of the National Audit office in operation in 2006

much success. Economic development, the debt management constraint of the national economy, the reduction of the former presence of the state (privatization, and the reform of the public finances) meant serious challenges and also led to enforced solutions. In the years following the social transformation the realization of the model of the entrepreneurial local authority was on the agenda despite the fact that they were not prepared for it either economically or personally. The liberal regulation mentioned earlier replaced the strict, rigidly controlled system of council administration. In most cases the earlier president of the council became the mayor and the old council staff remained in place. These officials were unprepared to meet the challenges of the entrepreneurial world, were not knowledgeable about company law or bank law, as our experience reveals, and had no idea of exchange rate policy, interest rates, dividends, etc. From 1996 onwards the principle of the entrepreneurial local authority was gradually abandoned and the model of the service providing local authority came to the forefront.

Winners of the liberalization processes of the 90s

Briefly, some of the successes of the local investment encouraging and business activities of local authorities are also to be mentioned. Local authorities that acquired former large-scale public companies or invested part of their assets in business partnerships, or made their settlements appealing to outside investors really did become winners of the process in the long run. Here we must first of all mention the successes of towns of county rank, smaller towns and villages outside the capital. Until the middle of the 90s it was typical that the investor paid a visit to the local authority with the investment proposal and the authority evaluated the proposals in various ways in its plans for settlement development, if it had any at all, and usually it was the case that no similar idea for development was brought up locally. It was in the second half of the 90s that rudimentary plans appeared that later led to the establishment of industrial parks mostly in towns of county rank.

An industrial park is practically a holding company that provides sites with various services for industrial development on a single area. Both from organizational and operational aspects there are several schemes for its establishment. Industrial parks also providing services outside their sites are usually local authority independent, profit-oriented businesses which are supported by the town with its own means and in most cases is also a joint owner. In this case

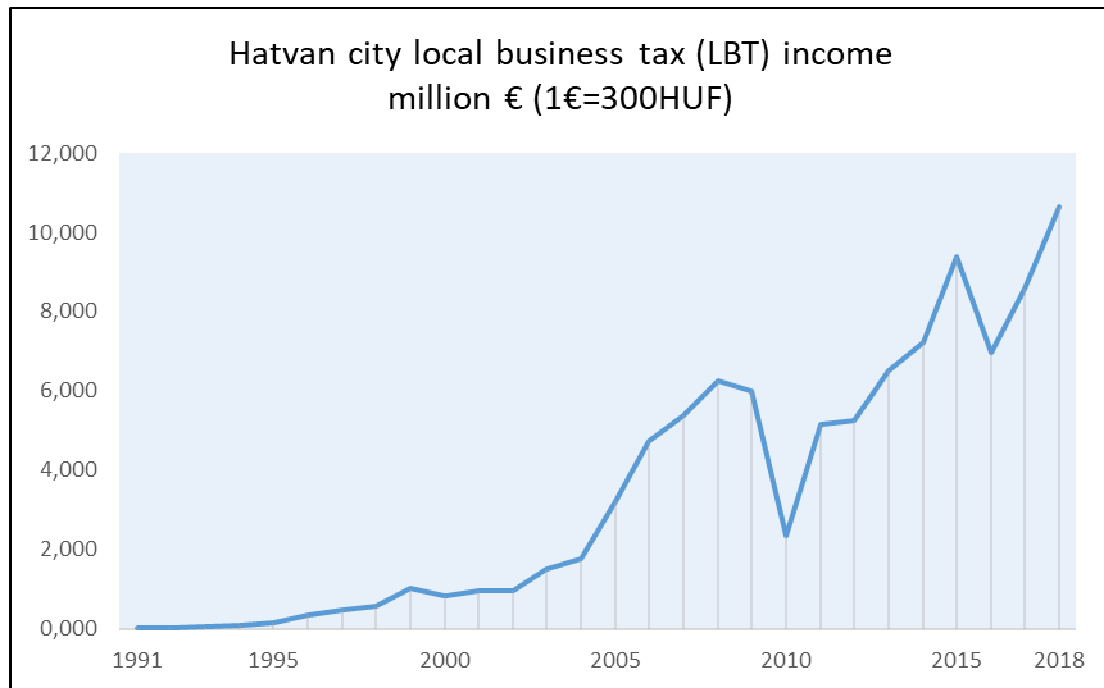
the project if offered by the industrial park, which also finds investors on its own. The local authority only intervenes in the process with administrative (architectural) regulations, occasional subsidies (tax allowances, reduced rental rates, allowances on the price of the site, improvement of public utilities, bus routes, etc.), most of which are parts of state subsidies and are not dealt with in detail in this study.

The first industrial parks in Hungary came into being during the first years following the social transformation. In Győr, the local authority launched a greenfield investment with a partner from Austria (to attract new investors). In Székesfehérvár, Videoton (a formerly state owned company) created an industrial park so as to make cooperation with western companies and the adaptation to western markets possible. In the same location Loranger, an automobile works supplier that came to be based in the town carried out the reconstruction of the former military site. Soon further industrial parks emerged in the north-western part of the country, around foreign investments of larger-scales. It was in this way that industrial parks for Opel and Suzuki were established in Szentgotthárd and Esztergom, respectively, and Flextronics settled down in an industrial park in Sárvár. Then in the middle of the decade developments further away from the western border also took a start. In southern Transdanubia two larger county seats Pécs and Kaposvár, in northern Hungary Ózd and in the Great Hungarian Plain Kecskemét which can be reached from Budapest in one hour on the motorway took the lead. The government started to make arrangements for the preparation of the Industrial Park Project in 1996 and the Ministry for Economics published the first tender for the title of Industrial Park. Over two years beginning from 1997 the number of industrial parks rose from 28 to 112 under the influence of government measures. In accordance with the conditions stipulated by the law and in the tendering systems businesses operating in an industrial park are eligible to submit project proposals for the award of subsidies tied to the classification of an industrial park and make use of preferences. As regards the establishment and efficient operation of industrial parks it has been a characteristic trend that they were first established in the western half of the country and the crossing of the Danube and then that of the Tisza took place only later (Kullmann, 2000.).

The town of Hatvan, which is located in the southwestern part of Heves County and is the seat of Hatvan district, lies on the banks of the river Zagyva. The town of over 20 thousand inhabitants was famous primarily for its food – sugar factory and canning factory – industry. As regards transport, it is located in an excellent place on road No. 3 and next to the M3

(1980) motorway as well as on the railway between Budapest and Miskolc. It is the third largest town in Heves County.

Following the establishment of the motor-electronic section of Bosch in 1998 another four electronic companies have become settled down in the newly established industrial park since 2001. The development of the local capital stock tax of the town of Hatvan can be seen in the figure below.



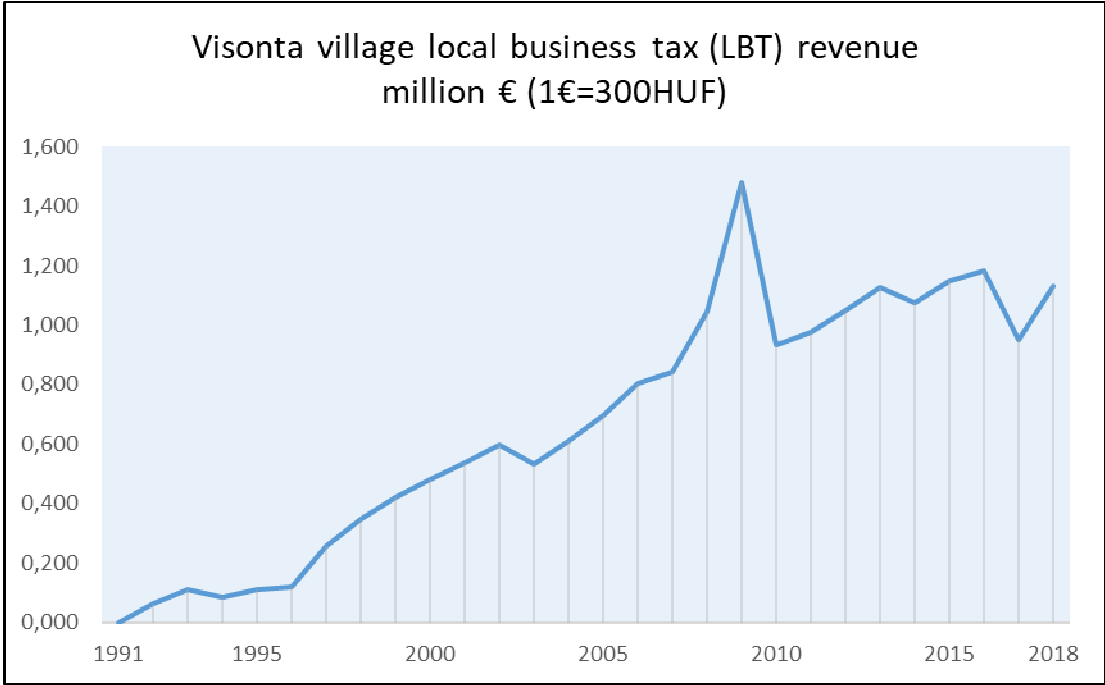
Source: The mayor's office of the town of Hatvan, notary

The economic recession, which started in 2008, reached its peak with the companies that had settled down and the effects of corrupt practices in the automobile industry on the turnover figures resulted in a decrease in 2016.

The 1250 strong settlement in the district of Gyöngyös is a typical example of the maintenance power of stock corporations transformed from post-communist state-owned companies. The mining of lignite in the region of Visonta at the foot of the Mátra Hills started in 1969 and became one of the most important surface mining pits in Hungary. Industrial presence, however, affected the development of the settlement negatively for a long time since the industry did not enhance but hindered it. Preliminary assessments found that there was an at least 18 meter deep layer of coal beneath the entire settlement, the exploitation of which would have produced much higher returns than the cost involved in resettling the

village. Accordingly, in April 1961 a ban on building was ordained for the settlement of Visonta. As a result of numerous debates and conciliations the general plans or “Újvisonta” had been prepared by the spring of 1969 and were submitted to the Economic Committee of the Government, but according to the recommendation of the Ministry of heavy Industry the settlement remained in its place and the power station was obliged to cover the amount of coal under the settlement, which was planned to be drawn, from new explorations. In effect, the construction of living-houses started again after a ten year long moratorium and by the spring of 1974 the new resettlement was prepared together with compensation project for the buildings that had been technically damaged as a result of surface mining. The ten year long ban on building and the insecure situation resulted in a considerable drop in the number of inhabitants and a developmental lag in relation to other settlements in the region. Following the stabilization of the situation, however, the industrial production did not only provide employment for the inhabitants of the settlement but also became a considerable source of income after the social transformation (Netye, 2012., 221-229).

The development of the capital stock tax revenues of the village of Visonta is shown in the figure below.



Source: Joint Local Authority of Visonta, Notary

From 1992 onwards the government made decisions about mine-power station integrations in several steps, which resulted in seven integrations until 1994. From the early 2000s mines

were closed down continuously and by 2005 only a few surface-mining companies survived. MátraiErőmű Rt. (Mátra Power Station stock company) bought up former state-owned simultaneously operating capacities and so a single ownership and organizational management of the vertical integration was realized at the local level. The power station and the industrial park, which has been established since, is the biggest payer of capital stock tax in Visonta even today.

Berente is located in the district of Kazincbarcika in BorsodCounty. Chemical production in the region commenced in the 1920s and in 1949 BorsodiVegyikombinát (Borsodi Chemical Combinat) came into being, which has been in operation under the name of BorsodChem since the privatization following the social transformation. Formerly, Berente was part of Kazincbarcika and was separated as a result of a referendum in 1999 and so the 1300 strong settlement realizes a very high per capita capital stock tax in the region. In 2018 its total budget revenue was HUF 2.1 billion, out of which HUF 1.7 billion came from local taxes and 82% of this amount (HUF 1.4 billion) was capital stock tax. Whereas, it only received HUF 215 million from public finances.³

These settlements have considerable amounts from capital stock taxes at their disposal, which greatly enhances the safe operation of the local authorities and also following the entry into force of the new law on local authorities and the law on stability are to be taken into consideration as compensation items which laws decreased the revenues of the local authorities in question considerably since they became “payers” into the central budget.

The necessity of the debt management of local authorities

The Hungarian public-finance policy of after 2010 focuses on the solution for the problem of debts of local authorities. The ratio of local authority debts compared to the size of that of the central government was not considerable but by 2011 the audits carried out by the National Audit office (ÁSZ) revealed that the local authority subsystem showed a large degree of financial insecurity.⁴ Under the influence of the processes detailed above the bank exposure of local authorities' increased and the debt-spiral generating renewal of liquidity servicing loan

³In detail: The 10/2019 (05.30.) decree of Berente on the execution of the financial plan for 2018 http://www.onkportal.hu/data/rendeletek/allomanyok/2019-10_berente.pdf

⁴In more detail: A summary of the supervision of the financial situation and management systems of local authorities

agreements became general in a way that the large majority of local authorities failed to create the reserves needed to repay the liabilities. A further risk was posed by the fact that assets belonging to the principal funds of local authorities were also offered as securities to repay the loans and in addition to the unfavourable development of the exchange rates for the bonds issued their repurchase before the expiry of the duration and exchanging the foreign currencies to forint also brought about unexpected expenses. As a result of the more and more difficult operation and management debts due to suppliers increased and a further liquidity problem was the provision of financial backing needed to post-finance the EU supported projects. All of these – when the local level either under pressure of necessity or as a result of lack of thoughtfulness enters the road to indebtedness via opportunities to take up loans – pose enormous risks and the consequences of the assumption of risk emerge at the levels of creditors (banks, suppliers) or the central budget (Sivák, 2014., 302. p.).

The problems were made more difficult that partnerships in which local authorities had majority ownership also accumulated considerable debts and the local authorities did not pay enough attention either to curb the debt stock of local authority businesses or to supervise PPP constructions.⁵Earlier, there were no securities to repay local authority loan or bond liabilities but the law of 2011 already relies on the findings of the ÁSZ and the experience from supervisions were also made part of later legislation. Since local governments were unable to manage their financial bankruptcy from their own resources, by 2011 it became clear local authority debt management could only be solved through the intervention of the state and so expromission in settlements with up to 5000 inhabitants was fully and in ones with over 5000 inhabitants was partially started. If this had not happened mass bankruptcies of local authorities, practically would have led to a state bankruptcy, the avoidance of which was a national economy interest. Efficient government operation with a balanced budget and a competitive economy is only possible if there are adequately operating local authorities.⁶The payment of the debts of local authorities took place in three stages – first the debt consolidation of settlement with up to 5000 inhabitants was solved and both forint based debts and debts generated by the artificial fluctuations of the exchange rates of Euro or Swiss Franc based loans were settled. In the second stage the debt stocks existing at the time of the assumption and charges calculated up to the date of assumption of settlements with over 5000 inhabitants, including the local authorities of the capital and the districts of the capital were

⁵In mordetail: Hegedüs-Tönkö [2006]

⁶In more detail: Kovács [2006]

partially assumed by the state. The assumption did not include the pre-financing of payment liabilities for subsidies from the central subsystem of public finances, directly from the EU or international organisations as well as meeting liabilities to pay in advance for VAT and other revenues and meeting liabilities for credits received by subsidized local authorities from water utility companies. (Lentner, 2014, 336. p.). Details of the consolidation are contained in law CCIV of 2013 on the central budget. The same law defines the system of conditions that is used to determine the basic extent of the assumption of debt. In the financing system of local authorities the calculation of tax-power potential, which starts from the “revenue-generating” potential, defined according to concrete considerations, is a frequently applied method. Namely, the basis for the calculation done by the Ministry of National Economy was the declared capital stock tax basis reported by local authorities in their six-monthly reports for 2012. The average achievable capital stock tax income is calculated by 1.4% (calculated at 70% of the maximum 2 % capital stock tax rate) in the case of each settlement, and is determined by dividing with the number of inhabitants on 1st January and so the per capita tax-power potential is

$$AE = (IA * 0,7)/C$$

After the calculations the settlements are classified according to different categories. The Finances Act defined four categories of settlements. Subsequently, the per capita data for tax power potential of the settlements within one category are arranged in an order of magnitude and the ones in the smallest and largest percentage group are left out. The data for the remaining 80% are used to calculate the corrected average of the category of settlements. Next according to the basis for extent of exemption of the individual settlements the per capita tax-power of the settlement the position of the settlements in relation to the corrected average of the category is determined.

The extent of state exemption	The given settlement AE	Corrected AE average of the given category of settlements (kAE)
40%	kAE<	100%
50%	kAE 0,75-1,00	100%
60%	kAE 0,5-0,75	100%

70%	kAE 0,5 >	100%
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This method of calculation became the basis for determining the extent of task financing and state subsidies allocated for providing compulsory local authority tasks as well as decreasing subsidies (!). The last stage of settlement consolidation took place in the spring of 2014 when the state also assumed the remaining debt stock of settlements with over 5000 inhabitants.

In order to maintain their financial stability local authorities are also subject to several restrictions in parallel to the consolidation. The law on the national wealth, for example, cut the rights of local authorities to establish partnerships and to acquire shares in partnerships and they can only take part in economic organisations where their liabilities do not exceed the extent of their material contribution. Act CXCV of 2011 on the economic stability of Hungary stipulates that a local authority may only enter into affairs generating local authority debts only with the preliminary acquiescence of the government and may take up only liquid credits for its operation, which also means that planned deficiencies in the operational budget may not be financed from outside (credit) sources and can be covered from internal sources (e.g. surplus accumulated during earlier years) only. And from 2013 the new act stipulates the operational deficiencies may not be planned at all. Another decision forming the basis for prudent operation was law CLXXXIX of 2011 on the local authorities of Hungary, which declared that settlements with fewer than 2000 inhabitants within one district are obliged to form joint local authority offices and former county institutions, health institutions and hospitals maintained by the Local Authority of the Capital, local authorities of settlements go over in the hands of the state in 2012.

Owing to the measured withdrawal of tasks, within own revenues it was the revenues deriving from local taxes that became more and more prominent and so local authorities are taking pains to increase their tax revenues by imposing new taxes or increasing current tax brackets. Imposing local taxes, however, has never been limitless since it is the law that defines what kind of and how much taxes can be imposed, what the limit of its extent is and what allowances and exemptions can be made use of (Bordás, 2015.). Accordingly, a local authority may only decide about imposing or not imposing some kind of tax.⁷ At the same time the possibilities to increase local taxes are limited by several economic and political conditions that mutually reinforce one another. The tax burden on potential taxpayers

⁷Meaning: Closed-listed imposition of local taxes. In more detail: Kecsó, 2013.

(businesses and private individuals) is also influenced by central taxes, unemployment the increases in the number of inactive persons and decreases in real incomes. Even when certain local taxes are introduced, these conditions force local authorities to make serious considerations in the selection of taxpayers (entrepreneurs and/or residents) as regards the determination of the extent of the tax, allowances and exemptions (Lóránt, 2008, p. 651.). Beginning from 1st January 2015 local authorities are entitled to introduce not only local taxes but settlement taxes as well provided these are not prohibited by other laws, such as the land tax and furthermore vehicle tax, a high building tax, dog tax, road tax, etc.

Nevertheless, local authorities decided to introduce several classic taxes (local taxes) as settlement taxes. There are several reasons for this. On the one hand local authorities were not prepared to abide by and administer opportunities and on the other hand the revenue generated from settlement taxes can only be used to finance social provisions and settlement development, so the revenue coming from these taxes is only favourable for local authorities that do not possess enough resources to finance these tasks. In opposition to settlement taxes, local taxes were freely utilizable and thus also provided a kind of flexibility for local authorities. Following 1st January 2015, revenues coming from local capital stock taxes may only be used to finance the provision of social services and the expenditure on wages for officials and from 2017 their contributions to the central budget are mostly covered from these.

The pressure to solve the spiralling instability beginning in the 90s has placed the current government in the role of stabilizer. In 2011 the debt stocks of county self-governments were assumed and in 2012 and 2013 decisions were made as regards the full expropriation of the debt stocks of local authorities. The assumption of the maintenance of institutions providing public services (schools, institutions providing specific services, hospitals and health institutions providing ambulatory services) also came under the authority of the state, so stabilizing the provision of services and their financing of the local authorities.

The dark side of the consolidation process

There is no doubt whatever as regards the efficiency and success but at the same time mention must be made of local authorities that can be regarded “losers” of the process. Every year Parliament passes the estimate of costs for the following year, in which the rules of calculation for the supplementation of the funds for “losing” local authorities and decreasing

the subsidies for “winning” local authorities are detailed. Appendix No 2 to the currently effective Act Lof 2018 on the central cost calculation of Hungary has the stipulations on the operational subsidies of local authorities. Point f) of this Appendix details how the parameters for inclusion and supplementation are set. In the case of local authorities where the tax-power potential shapes favourably hat is revenues from capital stock taxes shape favourably in relation to the number of inhabitants, state subsidies provided for performing the compulsory tasks of local authorities may be decreased or withdrawn and where the revenue from capital stock taxes is unfavourable the subsidies may be increased. Practically, in this system, local authorities with considerable revenues from capital stock taxes indirectly finance the central budget through their solidarity contributions after passing the Finance Act of 2017.⁸The effects on the economic and sociological aspects of this process fall beyond the scope of the current study and may be dealt with separately. The table for the effective law on parameters of subsidy increases and decreases is as follows (HUF):⁹

No.	Categories according to the per inhabitant tax power potential (HUF)		The extent of decreases of subsidies in percentage of the calculated revenue		The extent of supplementation in percentage of the basis for supplementation	
	lower limit	upper limit	minimum	maximum	maximum	minimum
	a	b	c	d	e	f
1.	1	7 000	0	0	50	45
2.	7 001	10 000	0	0	25	20
3.	10 001	12 500	0	0	0	0
4.	12 501	22 500	20	80	0	0
5.	22 501	42 000	80	105	0	0
6.	42 001	110 000	105	120	0	0
7.	110 001	536 000	120	125	0	0

On the basis of the table in the case of local authorities with tax-power potentials exceeding per capita HUF 12500, a decrease in subsidies is to be executed applying a defined proportionality of the capital stock tax for 2017:

$TCS = IA * [c + (AE - a)/(b - a) * (d - c)] / 100$, rounded to a full figure, where:

TCS = s the amount of the decrease in subsidies,

IA = is0.55% of the capital stock tax for 2017-a

⁸In detail: Law XC of 2016 on the budget estimate of Hungary for 2017

⁹Annex 2, Law L of 2018 on the budget estimate of Hungary for 2019

AE = the per inhabitant tax-power potential of the local authority, on the basis of which the appropriate line of the parameter table is to be applied in calculating extents of subsidy decreases and supplementation.

To the extent of one example let us return to the calculation of the state subsidies for the settlement of Visonta. If the annual capital stock tax revenue in 2018 of the settlement of 1250 inhabitants is HUF 352 000 000, the per capita tax-power potential is HUF 281 600 meaning that it is to be classified as category 7. Calculating with the above formula its solidarity contribution is HUF 2 371 000 and thus it is not entitled to state subsidies. Another unfavourable condition is that the new law on local authorities requires that neighbouring settlement with population under 2000 inhabitants are requested to establish joint local authority offices and this is true for Visonta as well. Currently the settlement is the centre of the Atkár-Detk-Pálosvörösmart-Visontajoint local authority and under law CLXXXIX of 2011 the other three settlements do not receive state subsidies either and all the four settlements have to finance certain obligatory state task from their own resources. Although it is a considerable burden, at present the settlement is able to meet both obligatory and assumed task as well. For the very young there is a crèche in the village and the education of the older ones is conducted in a high-level day nursery and school, which also has a new gymnasium. The health centre houses the panel doctor together with the dentist, the district nurse and the pharmacy but there is also a salt chamber and a room for recreation waiting for those wishing to be cured. The community centre, the library, the youth and the pensioners' clubs serve the recreation of those living in the village. By making use of the opportunities provided by submitting project proposals the management of the village build and improve the environment and develop the settlement.

The situation is not so lucky everywhere. Following the nationalization of schools it became clear for the government that their maintenance cannot be managed from the amounts withdrawn from local governments and so in law XC of 2016 on the estimate of costs for 2017 it decided on further withdrawals from local authorities with higher local capital stock taxes (HIPA). Accordingly, several local authorities had to pay considerable sums in 2017 – Győr (industrial park) close to HUF 5 billion, Tiszaújváros (TVK ErőműKft, MOL PetrolkémiaZrt.) HUF 1.7 billion, Székesfehérvár (Videoton industrial park) HUF 1.5 Billion, Budaörs HUF 2.1 billion.

In the case of Budaörs this burden is out of proportion and in addition it receives less from the state in exchange for fulfilling its local authority tasks and so has to make payments to the central budget at the expense of its own revenues. This, however, is contrary to the two thirds law on local authorities, according to which the community has full disposal of its own revenues. With reference to this the local authority launched a lawsuit against the state of Hungary, which carries a number of interesting issues. On the one hand the unlawfulness of a law can only be declared by the Constitutional Court, although since 2010 the number of bodies or persons that can move such has been highly restricted. If the Constitutional Court declares (public law decision) that the budgetary act concerned is illegal, action for compensation (civil law) can be submitted based on this decision only. On the other hand, Parliament enjoys sovereignty in making law but is not a legal entity so the state is obliged to pay for the damage caused, provided civil law enforced. The claim submitted by the town was favourably affirmed by the Law Court of the Capital but the Court of Appeal of the Capital dismissed it on appeal on the grounds that until the constitutional supervision of the law the town is obliged to pay the solidarity contribution. So the town appealed to the Constitutional Court and although there is no time limit for it to make a decision, its decision is going to be crucial as it can put an end to the attribute of the budgetary autonomy of local authorities.

Increasing the productivity of the state and local authorities through the use of cloud services

The above economic and budgetary processes strongly determined the participation of local authorities in the e-administration as well. The digital development of the past year –be it online services, big (open) data, social media or cloud-based computer technology – widen the scope of opportunities for improving public administration.

Storing and accessing data with the help of clouds offer opportunities for the state and local administrations to drastically improve their efficiency. The acceptance of clouds, as such, increases rapidly but while cloud-based computer technology, storage and applications are more frequent than a few years ago, there are still difficulties. Infocommunicational infrastructure was considered as one of the most important indicators of a given country's preparedness for introducing e-administration and so has a relatively high weight in present public administration indices. If, however, the infrastructure is stored in a cloud, the local authority will not have to spend on hardware, software, specialist resources or operation any more. Thus, infocommunicational infrastructure as a component of the index, is expected to lose some of its weight (Varga, 2018.).The advantages are, of course, also clear to the

Hungarian system of local administration but the liberalization-inclined, crisis-laden and then stabilizing processes of the past early thirty years coupled with technical backwardness and distrust to novelties, resulted in considerable time lag.

At the same time it has to be made clear that despite tightening conditions the Hungarian state recognized the opportunities inherent in technological development. The role of the cloud in the operation of the government is increasing partly because it is a tool that enables a new framework of operation and on the other hand, the cloud may enhance efficiency by allowing better cooperation and the timely access to data. It is also considered to be a key strategy to support remote employees, which is a considerable advantage in improving mobility and creating flexible job opportunities. The importance of this is included in the involvement of younger employees in public service. On the other hand several administration officials still do not know all the available potentials, which means that cloud-based application are likely to increase in the future. Institutions linked to the Government cloud may close down their inefficient computer rooms and server rooms and thus the “carbon footprint” of the institution will decrease. The peculiarity of the system established is that the unused resources might as well be put up for sale and used right away. If there is a demand the servers may be resized and only as many physical resources may be used as needed at any given moment.

In Hungary, in 2014 the government decided that a data centre, which is also able to provide cloud-based should be installed as soon as possible. The data centre project is to be implemented within KÖFOP (Public administration and services development operative project) and so informatics background systems that can operate without breakdowns and problems became strategically important for the government and public administration. This demand can mostly be met fully with a state-owned informatics environment which is also able to serve special demands, is well-regulated and has a high capacity. According to government regulation 467/2017. (XII. 28.) the government cloud is the total of a calculation and storage capacity providing cloud technology-based informatics infrastructure services operated by NISZ (National Infocommunication Providing closed Stock company).The implementation of electronic public administration is also a government strategic objective and it has also realized that this can be implemented only by supporting the administrative operation of local authorities with tools of informatics and unifying the provision of the tasks.

In the local administration sector, the open office usually appears at the level of home pages of settlements and open data services are only used to publish decrees on the budget and closing accounts. With most local authorities e-public administration solutions are practically

used to create an own home page and these usually meet only the basic level of e-public services and thus it might be possible to download a form but with small local authorities it is impossible to submit the downloaded form electronically. In the domestic local administration system the cloud-based operation is carried out via the local authority ASP (Application Service Provider) system thus ensuring a direct connection with the central budget. Kovács (2017) summarized the most important aspects of ASP in his article. The legal basis for the compulsory application of the local authority ASP was created with the amendment of § 114 of Möt. by law LIV of 1916 amending law CLXXXIX of 2011. The law delegates the way of joining ASP, the final date of joining, the technical systems of the local authority ASP, the organisation operating the data storage, the sources of the data in the archive and downloading, data summarizing and supplying data to the level of a government decree. Government decree 257/2016. (VIII. 31.) on the local authority ASP system provides two opportunities for joining :

- a) linking to the system (in order to support its tasks the local authority makes use of the appropriate technical system of the local authority ASP)
- b) linking through an interface (besides keeping the informatics system of the local authority it carries out upgrading in the system on the basis of which certain data, defined in the appendix to the government decree, are submitted to the local authority data storage via a linking surface – a so-called interface.

In the sense of the government decree referred to there were three linking stages. From the 1st January 2017 1673 local authorities had to join the local authority ASP system – more exactly its tax and management technical systems. Most local authorities that had not joined before, joined the full system on 1st January 2018 and so did the remaining local authorities, which had been specifically defined in the amended government decree and the ones that had been given permission for the so called interface connection. The local authority task-support extension with the help of the ASP technology was implemented in two stages.

In the first stage – in the project entitled “Setting up the ASP centre” the developments were carried out with EU support. The aim of the project was the development of the ASP system, to which local authorities may have joined voluntarily. The system, completed by 2015, which consists of a system shell and technical system services, is operated by the Hungarian Treasury. In the first half of 2015 55 local authorities joined, which received European Union funds to assist the required preparation. After the closing of the project another 44 local

authorities joined the services on 1st January 2016. As a consequence of voluntariness joining was made possible also by not making use of the full service portfolio and it happened that not all the member of joint local authorities maintaining one office joined the local authority ASP system. In the second stage, on the bases of the contents of government decree 1004/2016. (I. 18.) on the establishment of the annual development framework of the Public Administration and public Services development operative program there was a national extension of the system. In this framework new technical systems were implemented – the electronic administration portal system, including providing a service of electronic forms, an inheritance inventory system as well as the development of ensuring, supporting a national extension and the development of existing technical systems.

The tax technical system ensures the recording, accounting and handling of central and local taxes belonging to the portfolios of local authorities, taxes and dues to be collected as taxes, levies, as well as substitutions, fines as well as administrative procedural duties. It allows the electronic administration of cases linked to the fulfilment of tax liabilities. The management technical system supports the economic activities of local authorities and economic activities of publicly financed institutions that in the lack of independent economic organizations keep their books in the office of the local authority. The fulfilment of tasks are assisted by five other technical systems – the property cadastre technical system, the industrial and commercial technical subsystem, the folder management technical system, the portal system (settlement portal, ELÜGY, portal electronic form supply) and the inheritance inventory system. A new element is the Data repository development, which serves the extensive analysis of data and so serves the preliminary assessment of government and local authority decisions. It collects its data from information accumulated in ASP technical systems and data transferred via interfaces of local authorities that did not join the ASP as well as from information available in the systems of the Treasury on local authorities. Other local authorities are to join continuously from 1st January 2018 and 1st January 2019.

By now it has become extremely important for the government that possible anomalies of task financing should come to the surface and that the commencement of the indebtedness of local authorities could be recognized and prevented, which requires the continuous monitoring of making use of public funds, financing tasks and the liquidity status. Accordingly, the data repository is useful for local authorities as well. On the one hand it creates an opportunity to audit the data quality burden of local authorities, the disclosure of parallel activities, replacing certain reference services and so rationalizing the burden of the data providing obligation on

local authorities and so freeing local authorities from certain burdens. On the other hand it provides management information and operational decision support for local authorities since by analysing own data of local authorities, an up to-date Management Information System can be provided, through which fact-based decision making may become part of the organizational culture of local authority organisations. The operational decision-making may be assisted by the fact that by the collective analysis of data kept separately in technical subsystems cross-checks can be made, on the basis of which lists containing risky cases may be produced. By publishing statistical statements of different ways of breaking down local authorities are provided with opportunities to make sense of their own situation in the whole of the system and make use of this in preparing and monitoring their own developmental and operational policies. The supportive intent of the state cannot be questioned but the use of the local authority ASP system is not yet general and its adaptation – due to the differences in informatics, human resources and technical preparedness is still left to the future, since the implementation of the system is very recent analysable data are not yet available.

While public intervention and IT developments are unquestionable, a central funding and information system that is equitable and adaptable to all local governments is needed. Further research in these areas is well-founded.

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Summary

In the creation of modern local authorities in Hungary following the social transformation the country made efforts to delegate the possibly widest range of powers to local authorities, for the execution of which it ensured a wide-ranging economic independence and thus local authorities emerged as a kind of a fourth power. Each and every settlement regardless of its size and location was awarded the right to local administration and the rights linked to regulating local public affairs and conducting an independent operation.

In allocating tasks and powers the differentiation of tasks was omitted, and the definition of compulsory tasks and powers could often be followed with difficulty even in a legal sense and in a lot of cases even local authorities interpreted the differently. In the years following the social transformation wished to follow the model of the model of the local authority with an entrepreneurial spirit but they were unprepared for it either economically or personally and so fought with liquidity and management difficulties and embarked on the process of indebtedness.

Since local authorities were unable to manage their financial bankruptcies, by 2011 it became evident that the settlement of the debts of local authorities could only be solved with the involvement of the state. The government tackled the debt consolidation of local authorities in three stages and in parallel to the consolidation several restrictions were introduced as regards the economic autonomy of local authorities. Act CXCIV of 2011 and Act CLXXXIX of 2011 as well as from 2013 onwards the new Act on local authorities set several brakes regarding management, task execution and financial frameworks. In parallel, in the Finances Act, after 2013 the government determines the contribution liabilities to the central budget on the basis of solidarity of local authorities that possess outstanding revenues and thus exposed them to the local authority management risks.

From 2014 onwards, in the interest of the operation of local authorities, the government implemented several developments in order to make up for time-lags of over twenty years by providing IKT technologies. By establishing the government backbone network it provided opportunities for local authorities to be linked up and then with the local authority ASP system it also made the uniform task execution and the background support of the effective operation possible. With the Data repository service of the ASP system the government provided real time monitoring, decision preparation and managerial information system for local authorities.

Abstract

This study the briefly summarizes the processes involved in the liberalization of local authorities, economic independence-related errors after 1990 and then give an insight in the major milestones of the necessary state intervention. It presents the wrong practices that led to the indebtedness and liquidity problems of local authorities as well as the state responses that, although under tight condition, but normalized the operation of local authorities. It also briefly touches upon the winners of the period of liberalization and the dark sides of the process of consolidation. In addition to the economic and financial consolidation it also presents the IKT efforts made by the government to make local authority task execution, operation and opportunities for the supervision by the state more efficient. Through giving an insight into the ASP system it demonstrates the possible operational framework of local authorities in the future.

Key words

Local authorities, liberalization, inability to operate, stability, local authority ASP