

KALEIDOSCOPE

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Public Services at Local Government Level

1. Public Policy Issues

1.1. Definition of Local Public Service

According to the most widespread definition, public services serve public interests and are provided by the government. The state is often held accountable for these services. However, not all public sector services will be considered here. Some services, such as the police, the legal system, crisis management, etc. are not discussed by this study. These services are traditionally associated with the executive power of the state in Europe, although the American practice has successfully privatized some of them.

Public services can be classified as infrastructure and welfare services. The provision of welfare services is based on solidarity. In other words, the state balances the unequal effects of the market and ensures basic goods and services for those in need. Infrastructure services, such as postal and transport services, etc. often have great capital intensity and low profitability, and several other services, e.g. the maintenance of public places, roads, etc. are not lucrative either. Given the lack of private capital, the state began to provide them in response to the pressures of necessity.¹

Some public services seem more rational to be provided by local governments than at central level. Public services, such as the postal service, telecommunications, gas, electricity, railways, airways, and highways, are traditionally provided by central government authorities. These central public services are regarded

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¹ Bordás, M.: *A közszolgáltatások és az állam* (Public Services and the State). PhD Dissertation, Budapest, 1997. 23–24.

as state monopolies closely connected with the service functions of the state, however many of them have been liberalized in the last decades.

The argument for *shifting public services to the local level* is that local governments are more efficient at providing them.²

- Flexibility means that it is more advantageous to provide public services in a small area, because local governments can better adapt to changes in local needs.
- It instigates electors to get more involved in local initiatives, e.g. what public services they want, communicating that towards the local government, i.e. expressing their interests in the organization of public services.
- When local governments have the right to make their own decisions and regulate local affairs, they can easier meet the requirements of citizens. This dissolves the monopoly position of the central government.
- The provision of public services is more democratic, for the majority interest can be better manifested on the local level.
- Taxpayers can contribute to public services with local financial resources and as customers can better control provision of services.
- Elected boards of local governments can better supervise their administrative apparatus than a central public authority, in the preparation, implementation and monitoring stages of the provision of public services.
- The local management of public services offers a better opportunity for the transparent and open operation of local governments. Local governments thus become more accountable to the public.

However, devolution has not always resulted in a more democratic environment for decisions of local governments.³ It is observed by researchers that in countries with lower level political culture and less developed civil society, influential local “potentates” can monopolize rules of democracy.

Failure of localism can occur when laws are not deregulated in order to ensure the discretion of local governments. Acts of Parliament representing central government can limit localism. One way for violating the discretion of local governments is when a local task is heavily and strictly regulated by central laws.

The right to make decisions, however, is respected when the laws determine the main requirements of service provision for the local governments. Also,

² Horváth, M.T.: *A helyi közszolgáltatások* (Local Public Services). Budapest, 2000. 35–40.

³ Verebélyi, I.: A devolúció nemzetközi tapasztalatai, különös tekintettel a humán közszolgáltatásokra (International experiences of devolution, with special regard to human public services). In Fogarasi, J. (ed.): *Önkormányzati kézikönyv* (Local Government Handbook). Budapest, 2000. 25–38.

freedom to organize services on the local level is limited when a supervisory authority is allowed to strictly control activities of local governments. Instead, cooperation between central and local governments is advised.

The central government can limit the economic independence of local governments by providing targeted subsidies for them. Laws may prohibit local governments from imposing local taxes, or suppress their needs for credits.

In order to avoid these legal failures caused by legislation, constitutional regulations guarantee that certain rights of local governments should be respected by the Parliament. Rights of local governments, similarly to human rights, may not be violated by any law or government decision.

Many think that not all local public services can be provided in a small area.⁴ For example, hospitals cannot be efficiently organized in a fragmented local government system. Small local authorities do not often have the professional skill to manage special local public services.

The establishment of special regional public authorities is recommended to avoid the unwanted effects of small local governments. As another example, cooperation between local governments can be mentioned to manage complex local public services.

1.2. Public Policy in Developed Western Countries

1.2.1. Political and Administrative Environment

The provision of public services as a task for the state has been strongly influenced by public administration traditions. In Continental Europe, absolute monarchies first established centralized public administration systems. Later on state intervention was limited by laws, and public administration had to work under refined regulations. The theory of the “legal state” meant at that time that these laws bound the activities of public administration to prevent intervention in private affairs.

European theories have stressed that the public interest is better served when provision of public services is accepted as a state responsibility. The theory of “the provident state” meant that it was the responsibility of the state to ensure public services for the citizens. In Europe, public authorities are

⁴ Illner, M.: Territorial Decentralization: an Obstacle to Democratic Reform in Central and Eastern Europe? In: Kimball, J. D. (ed.): *The Transfer of Power—Decentralization in central and Eastern Europe*. The Local Government and Public Service Reform Initiative, Budapest, 1999. 7–42.

responsible for the provision of certain public services.⁵ Affairs of public services belonged to the public sector and were based on public law.

The American culture has always had an aversion to centralized power. This has encouraged the establishment of voluntary and charitable organizations. The individualist tradition stresses equal opportunities, which meant that it is the individual's responsibility to improve their situation by their own efforts. The provision of public services has been a matter of public policy, based on the needs and influence of various economic groups.

The American "New Public Management" emphasizes economic efficiency as a central value in the public sector. Public administration, similarly to the business sector, should be based on management principles. Instead of strict legal regulation, centralization, hierarchy and bureaucratic administration, "New Public Management" encourages private (business) administration of public services with public oversight. Public services are seen as practical tasks to be dealt with on the local level, rather than as a matter of public interest.

There is a persistent debate in Continental European literature on the question of whether the American public management approach can be applied in law-governed European administrative systems.⁶ Other pressing questions include whether the law-governed character of European public administration can provide adequate public services and whether such services will be maintained in the manner intended by law.⁷

Two basic public policies have developed in western countries, as a result of debates of 1980's.⁸

The "New Conservative Public Policy" reflects the interest of the American middle class that can buy public services in the market, but is unwilling to finance the welfare costs of the poor. This policy considers state withdrawal from the provision of public services and maintains minimum state intervention. Local governments have to establish a new relationship with the private sector, so that public services should be provided under business principles. Civil society, such as charitable and self-organizing organizations are involved by local governments in the provision of welfare services for the poor. This public policy decreases redistribution in the state budget.

⁵ Lőrincz, L.: *A közigazgatás kutatásának tudományos irányzatai* (Aspects of Research on Public Administration). Budapest, 1976. 78–80.

⁶ Konig, K.: Public Administration—Post-Industrial, Post-Modern, Post-Bureaucratic. Paper. *EGPA Conference*, Budapest, 1996. 2–3.

⁷ Waldo, D.: *The Administrative State*. New York, London, 1984. 153–154.

⁸ Horváth, M.T.: *A helyi közszolgáltatások szervezése a modern államban* (Management of Local Public Services in Modern State). Unpublished Doctoral Dissertation, Budapest, 1999. 95.

The “New Left Wing Public Policy” maintains a centralized administrative system, which influences the provision of local public services. Local governments are obliged by law to provide certain local public services. The central government subsidizes local governments from the state budget by using a financial regulatory system. The level of redistribution is high in this system, which is a guarantee for the assurance of solidarity in the provision of welfare services. Other preferences, such as a regional financial system and regional development of the central government can be achieved as well.

1.2.2. Local Government Environment

Delegated model

The provision of public services is also influenced by the character of local governments. In the delegated model local governments are a part of the government system, in terms of not having their own, rather a delegated scope that is given them by the central government. The scope of local governments is often heavily regulated by laws, too, in this system. In other words, laws strictly determine the activities of local governments, so local governments can act only if laws entitle them to do so.

In the delegated model the central government controls local governments by limiting their financial accountability. To achieve this goal, the state subsidizes local public services with targeted and addressed grants from the state budget. Local governments have little freedom to make decisions on the provision of public services based on local needs. A central financial regulatory system aims to balance any inequality of local governments by giving grants from centralized appropriations for specific purposes.

Political issues are not emphasized in the delegated model, because local governments have less political power in this system. Instead, the servicing function of local governments is strengthened by the extension of local public services to be provided by local governments.

The delegated model of local governments has in most cases evolved in the centralized, law-governed public administration systems. This model is typified by the bureaucratic organization of local governments. Organization of local governments is based on hierarchy: local public services are provided by local government institutions as a part of the organization of local governments.

Decentralized model

In the decentralized model local governments are regarded as local political power with their own scope to decide on certain local issues. Local governments have their own financial responsibility, too, which means that they have the

right to acquire financial resources by imposing local taxes and having other income, such as business-like activities, privatization, etc.

The central government encourages local governments to learn alternative ways of providing local public services in this system. This means involving the civil and the business sectors into the provision of local public services and the establishment of an interactive relationship with them. The emphasis is laid on management principles in the decentralized model, which implies the requirement of efficiency in the provision of local public services.

Economic efficiency should be achieved when public services are managed by local governments. Managers of local governments are accountable to the citizens as taxpayers to efficiently use public money. Local governments are often expected to cut their budget and staff in order to decrease local taxes to be paid for local public services. Citizens, self-organizing bodies have a strong incentive to participate in the decision-making process of local governments.

Taxpayers are regarded as customers and local public services as goods. Local governments are expected to provide local public services at the lowest price and the best quality. Customer choice should also be assured by providing differentiated services. General availability of the services has less importance than in the delegated model, but the emphasis is on customer satisfaction.⁹

Local public services are typically organized by local governments, and provided by business firms, non-profit or charitable organizations. Market principles, such as competition, invitation of public tenders, market prices, profit-oriented firms, etc. are often used in the decentralized model. Local governments operating in this system are minimally regulated by laws, which specify exactly how and in what manner local public services ought to be provided. Although, public policy has high expectations of local governments to find the best way for meeting the requirements of citizens.

1.3. Public Policy in the Post Communist Countries

1.3.1. Changes of Local Public Services

The Communist states aimed to equally care about the needs of citizens, regardless of their contributions. This is called the “paternalist” philosophy of the communist state. During the Communist era, public services in Eastern European countries served as part of the wealth redistribution system of the state controlled

⁹ Osborn, D.–Gaebler, T.: *Reinventing Government. How the Entrepreneurial Spirit is Transforming the Public Sector*. Budapest, 1994.

economy. The Communist state ensured the welfare of citizens by dictating how certain goods and services were to be provided to the general population.

Not only were welfare services provided free of charge, but below-market prices for goods such as foods, flats, and utility services were also established and subsidized by the central government.

Communist budgets served the interest of production more directly than the interest of welfare. For example, they often subsidized loss-making state-owned enterprises. Until the 1960s the so-called “bureaucratic redistribution”¹⁰ based on a macro-economic plan meant that markets existed only on the periphery of the economy. Central planning, state investments, and bureaucratic allocations prevailed. Starting in the 1960s, however, market allocations gained precedence.

When that system disintegrated after the transition in 1990, a small portion of the society became wealthy, but most became increasingly poorer. This special market produced a new entrepreneurial class that has obtained great wealth and a political elite that has achieved great power. The interests of these two elites are often able to suppress what remains of the bureaucratic state redistribution system.

Recently, groups whose incomes were provided historically by the state bureaucracy have found themselves at tremendous economic disadvantage. The guarantee of low incomes and subsidized basic goods and services, such as food, homes, utilities and health care under communism have disappeared.

With the privatization of state-owned enterprises and the creation of open market institutions in the post-Communist era, a “grey economy” prevails and the state budget is under great pressure.

In post-Communist economies there is a pronounced pattern among the entrepreneurial class of successfully avoiding the payment of taxes and social insurance. As a result, the state budget is further depressed. The reaction of the government is to further increase fees and taxes, which, ironically, even more encourage people to avoid paying them.

The political elite and “newly rich” argue that costs of certain public services shouldered by the state in the former Communist regimes are far beyond the state’s ability to pay for them. In many Eastern European countries since the collapse of communism there has been tangible movement toward the withdrawal of the state from public services.

¹⁰ Kornai, J.: *A hiány* (The Shortage). Budapest, 1982.

But this withdrawal often occurs without either well-defined political concepts or elaborated theories. The post-communist countries are often called as “premature welfare states”¹¹

Although laws in the post-Communist countries still emphasize the state’s responsibility, this tendency by the state to withdraw from public services is increasing. Moreover, with constitutional and administrative regulations emphasizing that the state has a high-level of responsibility to support certain public services, how can the withdrawal of political support and funding for public services be justified from a legal standpoint?

A main purpose of this study is to shed light on whether changes in the provision of public services since the transition are more heavily influenced by American or Western European traditions.

1.3.2. Local Governments during the Transition

Territorial governments in the communist regime were established on the so-called “democratic centralism” of the soviet model.¹² This system was neither democratic, nor did it represent real local interests.

Territorial governments were put under dual subordination: subordination to higher territorial governments and their own elected council.. Election of the members of the council was formal, due to the lack of competing candidates. The Communist political party nominated the members of the council and appointed the executive board or the administrative apparatus. Hegemony of the communist party prevailed in the affairs of territorial governments.

Issues of territorial governments were heavily regulated by central laws, or decided by central public authorities. Territorial governments did not have the right to decide about local matters, but were obligated to implement central tasks. Instead, decentralization, which means a devolution of functions of state to autonomous territorial governments, and deconcentration were widespread. This latter terminology implies shifting governmental functions to the local level within the hierarchical system of state bureaucracy.

Structure of territorial governments were based on sectorial administrative means. Local tasks were performed by the enterprises owned and closely controlled by the territorial governments. Territorial governments were administered by the executive board of the higher territorial government, the last resort in the sectorial ministry.

¹¹ Kornai, J.: *Az egészségügy reformjáról* (Reform of Health Care). Budapest, 1988.

¹² Illner, M.: *op. cit.* 7–42.

Local finances were a part of the state budget, in a restricted finance system. Territorial governments did not own property, but merely handled state-owned assets.

The bureaucratic system of vertical subordination in territorial government degenerated into a system of networking where personal political relationships played an important role. In other words, contributions to local services were negotiated informally between the territorial governments and high level political administrators.

Autonomous local government systems were established in the Post-communist countries at the beginning of the transition, due to a high expectation of the public toward democracy and localism. In this system local governments are required to organize local public services in their own scope. Local governments are the local political power with the right to decide in local matters.

However, a tendency toward maintaining some degree of centralism or even one toward centralization can be observed. Central governments intend to maintain their control over territorial political and economic development. A question is, whether constitutional and other legal regulations can give a guarantee to the decentralized power of local governments.

2. Privatization Issues

2.1. Privatization Conceptions

2.1.1. Conservative Way for Privatization

Conservative theories for privatization hold that local governments began shouldering more public services than they could effectively manage.¹³ In this view the principle of free choice is violated, because services are provided by local governments and not the marketplace.

This privatization theory maintains that only market values, such as competition, profit-orientation, private participation, etc. can enforce economic efficiency. Another public interest, i.e. customer-oriented public services can be better served, too, when public services are put under market-based operation.

¹³ Savas, E. S.: *Privatization—the Key to a Better Government*. London, 1987. 47–49.

This theory holds that local governments should provide better quality public services from decreased taxes. High redistribution is thought to be unjust. Free choice and efficiency due to competition reduce costs.

Privatization is thought to be able to be implemented only if the tasks of local governments are in fact decreased.

To achieve these goals, local governments should cut their budget by withdrawing from public services and encourage business firms to provide them. When competition is established, and monopoly positions are diminished in the market of public services, competition supervision, price regulation and quality control of local governments will not be needed. This results in a cost reduction in the budget of local governments.

When privatizing public services, local governments should establish a new relationship, the so-called “public-private partnership” with the business sector. That implies an interactive relationship for cooperation, in which local governments hold responsibility for the provision of public services, while utilizing the initiative and creativity of private firms. Local governments will be responsible directly to the customers, when public services are subject to market principles.

This style of privatization may not mean transferring public services entirely to the private sector. Instead it results in shifting to a so-called “regulated market” where local governments, as organizers, can assign the operation of services to private enterprises, as providers. In other words, the public services market is under the oversight of local governments, so that the accountability of local governments can be maintained.

The general opinion in the US is that local governments shouldering the provision of public services is an unfavourable political decision. With few exceptions, services can be provided by business firms in a competitive environment. When a fee for the services can be charged, privatization is avoidable. Only payment for the services can assure rational consumption. There are tax-based services, such as public lighting for which a fee cannot be charged. Opportunities for privatizing these services are more limited, but are possible by contracting out.

If most public services are provided under market conditions, the poor are excluded from their consumption. However, social welfare issues cannot be a reason why local governments should provide free of charge or low price services. Social welfare policy can be executed by other means, such as subsidies, social aids, vouchers, or charity, etc.

US social policy never intended to provide more than a few governmentally administered welfare programs. This is in line with the belief of many that poverty is in many ways the fault of the individual, not the result of social

inequality. The Constitution acknowledges the political, not social or welfare rights of citizens. With few exceptions, local governments are not bound by law to provide welfare services.

2.1.2. Left Wing Privatization Policies

As opposed to conservative theories, left wing policies for privatization consider that local governments must assure the public interest, by meeting not only requirements of quality and continuity, but the general availability of public services, as well. Local governments are a type of public authority based on hierarchy in the government system, for their operation is inconsistent with entrepreneurial principles. Besides, local governments are closely connected with politics, and less dependent on customer decisions.

Local governments have to shoulder the provision of those public services, too, that are not profitable. In most public services, for example, non-competition is unavoidable. For example, institutions for the homeless people, or public lighting cannot be easily shifted to a competitive environment or performed on a fee basis. Local governments must exercise control over quality and costs.

In Continental Europe, public interest is the reason cited for the state's responsibility to shoulder welfare programs. Social rights are mandated in many national constitutions, and European Union treaties. Under public law, welfare belongs to the public sector. It aims to assist the poor.

In contrast to US conservative theories, left wing policy claims that there is justice in providing welfare services because these services are based on fair redistribution. Application of business principles in welfare services is inconsistent with solidarity. To this way of thinking, freedom means recognition of social citizenship, including the rights of individuals to be protected from inequality brought about by the market.

2.2. *Privatization Means*

2.2.1. Spontaneous Privatization

Spontaneous privatization takes place, when local governments entirely withdraw from the provision of certain services. The withdrawal of local governments gives way for business enterprises and charitable organizations to provide these services. Local governments may encourage citizens' voluntary organizations to provide public services, or individuals to manage the services on their own. This way to privatization is supported by conservative theories, rather than by left wing policies.

2.2.2. Dissolving State/Local Government Monopolies

In conservative theories privatization is completed when competition is established in the area of a former monopoly. Business firms are considered to provide the best quality service at the lowest price, due to the profit motive. Profit orientation can allocate financial resources in the most effective way.

When competition cannot be established and profit-oriented firms cannot be employed, competition can be imitated in the following way:

- Some local public services, such as drinking water supply, for example, are natural monopolies, where competition would contradict economic rationality. Public tender is invited by local governments in these cases. The right for the operation of the local public service will be awarded to that applicant giving the best offer: lowest price and best quality. Inviting public tender can assure equal opportunities and hinders corruption.
- When a market-based fee cannot be charged for a particular service (as is the case for services for drug addicts, or maintenance of public roads) local governments have to subsidize the provider of the service. The price of the service is regulated by local governments, or stipulated in the contract made between the local government and the provider. The regulated or contracted price should guarantee reasonable profit and prevent monopoly pricing.

2.2.3. Non-profit Enterprises

Local governments often assist non-profit enterprises in providing public services for several reasons. Non-profit enterprises are encouraged to provide public services, when privatization policy holds welfare as inconsistent with business-like activity. Many Americans consider non-profit organizations to be more reliable than for-profit businesses, especially when customers cannot judge and choose the quality of services. Consumers of non-profit services can benefit from qualities such as flexibility, autonomy, customer-oriented services and satisfaction of special needs.

2.2.4. Application of Contracts

Local public services can be contracted out, as a way of establishing public-private partnerships. Local governments entitle private enterprises to operate those public services which were previously local government monopolies in franchise or concession contracts. Contracting parties stipulate the most important conditions of the provision of the local public services, such as quality

requirements, continuity, general availability of the services, supervision by the local government, termination, compensation, duration, etc.

Contracts are used for keeping local government supervision over the privatized service, so that interests of the public may be maintained. In some cases local governments tend to have the majority of the business shares in the business firm to which the right to provide the service has been awarded. In law-governed administrative systems laws often regulate privatization conditions as obligatory elements of the contracts for the local governments.

2.2.5. Regulated Market

Health care is a special field of local public services in terms of having three members in its provision. Finances of health services are based on insurance principles everywhere. Insurance can be private (as is the case in the US, or the additional insurance in the publicly financed systems) or public (as is the case in the national health insurance or the state budget systems).

According to the American practice, health services are one of the most marketable services. Even in this business oriented health system, health services are not provided entirely under market principles. Social welfare issues, or other market failures, such as externalities: epidemic, lack of insurance, are to be avoided by regulations.

For this reason, the governments provide free health services for the poor and elderly. The poor cannot afford to pay the market price for health insurance. The elderly should pay expensive health insurance, because they constitute a high risk and cost for the business-oriented insurance companies. Some health services, such as vaccination, are obligatory when epidemic needs to be avoided.

State intervention is applied to health care in order to solve market failures. However, state regulations in the market of health care can occur in many ways.

In the US, health care providers are obliged by law to provide free health services for poor and elderly people. The price of these free health services is regulated and paid by the government. This government intervention represents welfare issues. Any national health insurance system based on citizens' mandatory contribution would limit customer choice and increase taxes.

Health services in Europe are local public services, but financed by a national insurance-based system. Economic efficiency is also a most important issue of the privatization here. Several variations of market mechanisms vs. state regulations can be developed as a result of privatization.

However, the privatization of health care is unlikely to alter the public finance systems in Europe. This is because central and local governments have to respect health services as a universal constitutional right when organizing

health care. Solidarity as a public interest which privatization policies have to observe implies that health services should be generally available for all citizens. Mandatory contribution of citizens to health care should be retained.

Opportunities for privatization are limited in European health care. A regulated market can be established in the three segments of health care: regulation, finance and service.

Competition can be established between health providers for acquiring financial resources from the national health insurance. Insurance companies purchase health services of providers on the basis of the quality of the services. Both health providers and health insurance companies compete for clients, which certainly results in a better quality of health services.

Health care providers may operate in the form of privately-owned business associations or non-profit organizations. Without the direct control of local governments, health care providers can make more rational economic decisions.

Prices of health services are often regulated in the public finance systems, due to the requirement of global cost containment. Prices of health services are based on complex incentives in order for health care providers to be able to provide health services of the best quality and most efficiency.

2.3. Privatization Tendencies in the Post-Communist Countries

Reflecting the policy of developed Western countries, former political elites in post-Communist countries have attempted to develop a so-called “premature welfare state” theory. The communist government promised much more welfare than it was capable of realizing. Welfare kept at the level of early communist states was unrealistic in the 1990s.

This circumstance gave impetus to the political elite to withdraw from public services. However, the “premature welfare state” theory misinterprets “non-intervention” of privatization policies. Non-intervention does not mean the radical withdrawal of the state from public services.

Some post-Communist authorities have attempted to decentralize and privatize public services in order to modernize the system. Welfare services are insufficiently provided by local governments. But replacement of state-welfare services by so-called self-organizing institutions has not taken place: instead, serious deterioration of welfare has occurred. Welfare privatization in the post-Communist countries has been fairly limited. The civil sector is not sufficiently developed to allow the state to withdraw from providing welfare services.

Due to a lack of state funding, some welfare services have been shifted to business firms. Market conditions have been created, but there are relatively few private initiatives in the field of welfare, since the majority of citizens do

not earn enough to pay for them. In the wake of transition, social policy depending on privatization is not an attractive prospective for the near future.

During the communist era, infrastructural local services operated under strict administrative supervision in the form of state-owned enterprises. The prices of services were low or free of charge, due to the “paternalist” philosophy of the communist state. Profitability was not an issue in the system, because the state subsidized the losses of its state enterprises.

Some of the infrastructural local services were put under market-based operation as a result of privatization. Supervision of local governments over the privatized service should be maintained. There is a conflict between the profit interest of the private firm and the public interest of local governments. Public interest is identified as good quality, low price, the continuity and availability of services. The interest of the private firm is to achieve the highest possible profit.

When public service providers are in a monopoly position, they are also in a position to increase the price of services, while decreasing their quality. Abuse of the monopoly position can be controlled by competition, the supervision of which is exercised by a central administrative authority. In the absence of competition supervision, local governments should regulate prices and control the quality of services. Local governments, however, do not have sufficient management skills to balance between public and private interests.

When privatizing infrastructural local services, local governments have to impose new local taxes, or increase the price of services, so that the profitability of the business enterprise is ensured. Citizens are in most cases unwilling to pay more for better-quality service. Local governments are more interested in maintaining the status quo, i.e. local public services at low price and bad quality, than in managing political tensions caused by higher taxes or prices.

As a result, the privatization of local infrastructural services is insufficient in post-communist countries, due to the lack of management skills and funds. Most of local infrastructural services are still insufficiently provided by local government-owned enterprises.

3. The Hungarian Case

3.1. Questions of Autonomy in the Legal Regulations

The first issue to be explored if local governments have autonomy in the legal regulations to organize local public services.

Optional local public services

Act LXV of 1990 on Local Governments determines local public services that municipal local governments provide. They are as follows:

settlement development and management, environmental protection, housing, canalization, maintenance of cemeteries, local public roads and public places, local public transportation, public sanitation, fire protection, public safety, energy supply, employment management, primary education, health care, welfare services, children and youth care, public education, sport, public health.

It is up to municipal local governments if they should shoulder the aforementioned tasks or not, and if so, how and in what manner. Municipal local governments should respect local needs and take their financial possibilities into account, when making decisions on the provision of local public services.

Compulsory local public services

Act LXV of 1990 on Local Governments identifies compulsory local public services as follows: drinking water supply, primary education, primary health care, primary welfare services, public lighting, maintenance of cemeteries, local public roads

Municipal local governments are obliged by Act LXV of 1990 on Local Governments to provide the aforementioned services. However, this act does not say how and in what manner. It is left to the discretion of municipal local governments, unless another act regulates the provision of these services. However, each of these compulsory local public services is regulated by sectorial acts. Sectorial acts regulate in detail the quality and fees of the service, applied contracts, supervision of the provider, etc.

Moreover, Act LXV of 1990 on Local Governments entitles acts to determine other compulsory local public services. Only a few local public services, such as public sanitation, can be mentioned, when another act other than Act LXV of 1990 on Local Governments obliges municipal local governments to provide a local public service.

The extent of the settlement, its population and other specifics should be taken into account when a local public service is declared compulsory. In other words, local governments are equal when exercising rights, but differentiated when laws determine obligations for them.

Act LXV of 1990 on Local Governments obliges the county local governments to provide local public services, when municipal local governments are not obliged by laws, or are unwilling to provide them. Municipal and county local governments should make an agreement regarding which one of them will provide local public services.

Act LXV of 1990 on Local Governments lists compulsory local public services for the county local governments as follows: secondary education, public education, sport, child care, sport, secondary health care, secondary welfare services, environmental protection, employment management.

Conclusions

The conclusion based on the relevant legal regulations can be made regarding the autonomy of local governments that local governments *have little freedom to choose which local public services to provide*.

Local public services to be provided by local governments are listed by Act LXV of 1990 on Local Governments or other acts. Almost all of them are declared compulsory. Some of them are compulsory for municipal governments, and others are subject to agreement between municipal and county governments, as to which one will provide them.

Local governments have *more freedom to decide how and in what manner they provide local public services*. The minimum quality and types of some local public services, such as health care, child care, welfare services, drinking water supply, education, are heavily regulated by sectorial acts. Other local public services are typically not strictly regulated by laws, or if so, it is optional for local governments whether they follow these rules, or not.

3.2. Constitutional Protection for Local Government Rights

Constitutional rights of local governments relevant on the provision of local public services are as follows:

- Right to make decisions in regulation and management. Local governments have the right to pass decrees and resolutions in local government affairs. Their decisions can be supervised only regarding legality.
- Right to exercise property rights, such as pursuing business-like activities, discretion in using income, selling, buying, leasing their own property, etc.
- Right to have financial resources proportional to tasks. Local governments have the right to impose local taxes, and receive state subsidies.
- Right to form organization and operation of local governments.
- Right to association with other local governments.

The Constitution entitles the Parliament to detail the aforementioned rights in Act LXV of 1990 on Local Governments. *The main rights of local governments for providing local services are:*

- Offering to provide voluntary local public services, if they are not declared by law as the responsibility of some other public authority.
- Cooperating with the civil sector in performing local tasks.

- Establishing local government institutions, business associations, and nonprofit organizations to provide local public services. The director of the organization shall be appointed by the local government.

The legal method for enforcing the constitutional rights of local governments is that the Constitution prohibits the Parliament from violating those rights listed in the Constitution and Act LXV of 1990 on Local Government when passing acts.

As mentioned earlier, sectorial acts often regulate in minute detail how local public services should be provided. When these acts determine quality, technical, and other requirements, the withdrawal of the right to make decisions by the local governments does not arise.

Violation of autonomy is more problematic, when an act regulates privatization issues. The local governments exercise all the rights to make decisions, when establishing a local governmental institution to provide local public services, appoint and recall its director, finance and closely control its activities. When privatization happens, the connection between local governments and providers necessarily becomes loose.

This is because privatization, as a way of modernization, contradicts the traditional bureaucratic administrative means. Market principles, such as competition, business-like activity, incentive, etc. cannot be manifested in the operation of the local government institutions. Local governments are expected to establish a new relationship with the business and civil sectors when privatizing local public services, too.

If local governments exercised all the rights of decision making in the provision of public services, the implementation of privatization would be impossible. For this reason, the central government tends to keep the rights to vindicate its preferences when regulating privatization issues by acts.

Central governments in most cases cannot give up control of the privatization processes of local governments, because the Constitution makes the central government responsible for certain local public services. This is the case when the Constitution regulates the right to health and welfare as constitutional rights, and obligates the central government to guarantee these rights for the citizens through organizing the health care system, national insurance and institutions as a safety net.

When the central government decentralizes certain public services to the local level, it does not mean that it can totally give up accountability for these services. Control over local public services by the central government can occur only by legal regulations. The tendency of the central government to influence local matters through legal regulations is closely related to the

centralized and law-governed character of the Continental European public administration, as well.

Constitutional rights of local governments can be violated by an act on privatizing local public services in two ways:

The act withdraws the right to decision-making from the local governments

A privatization act often determines the legal form, i.e. business association, not-for-profit company, etc., of the local public services provider, based on the preferences of the central government. It may be thought, for example, that economic efficiency of certain local public services can be assured only in the operation of a profit-oriented company. Or, on the contrary, only a not-for-profit nature of the local public service provider can guarantee welfare issues.

Conditions of the privatization contract to be made between the local government and the local service provider can be regulated by acts, too. Contracts are an important applied privatization means, which give the opportunity for the local government to keep supervision over the privatized service. Central legal regulations often establish obligatory elements, such as the fees for services, general availability, exclusive rights of operation in a given area, procedure for public tenders, etc. to be stipulated by the contracted parties.

The right to operate local public services is in most cases a monopoly of the local government, which can be exercised by a private firm only by concession or license. Getting the right to operate may be the condition for acquiring state financial resources. To choose the private firm to be awarded is evidently left to the discretion of the local government, although the central government may establish incompatibility in the activity of the private firm: e.g. the pharmaceutical industry cannot buy business shares in hospitals.

The act violates the right to property of the local governments

When local public services are privatized, the property of the local government has less relevance, because the emphasis is on awarding the right for the operation to the private firm. Local public services are generally not connected to public property of high value, like the energy supply, telecommunications or the highways, for example, so sale of the publicly-owned property less frequently occurs. Health care, water supply and housing may be mentioned as exceptions.

The privatization policy of the central government may aim to decrease private property in the field of a local public service, e.g. sell the local-government owned flats to the tenants. It is possible that the central government intends to establish favorable conditions for the purchasers, e.g. low interest credits in long term or low price for doctors to buy business shares in health institutions.

Local governments may be required by government policy to lease the building free of charge, where the local public service is provided.

The acts on finance affairs do not assure sufficient financial resources for the local governments to provide local public services

The act on the annual state budget may decrease general or targeted grants to be generated for local governments. In many cases, local public services are financed partly by the state budget, or the national insurance, and partly by local governments. Local governments are often not entitled by acts, either, to impose local tax sufficient to finance local public services.

Acts on privatization passed by the central government were in some cases challenged before the Constitutional Court, referring to the violation of the rights of local governments. The Constitutional Court has to balance its decision on the basis of rationality between two interests: the autonomy of the local governments and the influence of the central government to perform certain reforms.

The Constitutional Court stated in its decisions that the autonomy of local governments is not absolute and unlimited. Acts passed by the Parliament cannot withdraw local government rights or limit them in a manner so that they lose their inherent meaning. This means the legal provisions protecting the autonomy of local governments from the central government.

A local government right is not only manifested in the single right to decision-making. Instead, it entails a complex array of points, including the right to make decisions. When some of the decision-making rights are withdrawn, but the local governments have enough leeway remaining to make decisions that hold responsibility contingent on the performance of their tasks, the constitutional rights of local governments are not violated. The Constitutional Court should case by case consider if right to decision of local governments is in fact violated.

Local governments' right to property may be limited if it is related to an important local public service. The public policy of the central government to improve local public services is an important public interest serving as a base for the limitation of the right to property. However, the act can not oblige the local government to sell its property, because that would mean an entire withdrawal of the right. When property rights are limited, local governments should receive compensation in proportion to the limitation.

The Constitutional Court states in its decisions that it is up to the discretion of the central government to establish a finance system for the local governments, provided it is in the form of Parliamentary act. If ministries or other public authorities, such as the national insurance, decide case by case about the grants to be generated for local public services, the autonomy of the local

governments is violated. This is, however, a formal, not a content, requirement for the legislation.

It is vague to judge from a legal point of view if the funds available for local governments are sufficient to finance local public services. It seems to be the constant interpretation of the Constitutional Court that it should be up to the financial possibilities of the state budget to determine in which manner local public services will be financed by the state. Along this line, the Constitutional Court made the conclusion, too, that it is a professional, rather than a legal issue, that what kind of finance system is created by the state to subsidize local public services.

Only in extreme cases do finance affairs become constitutional issues: if local public services cease to exist, due to insufficient financial resources. Regardless of the insufficient finances issue, local governments remain responsible for the provision of local public services. It is involved in the interpretation of the Constitutional Court, that decreasing grants to be generated for local public services by the state budget does not mean the violation of the right to sufficient fund of the local governments.

Conclusions

There is a tendency by the legislation to centralize local issues by passing privatization acts that withdraw local governments' rights. Local governments try to keep their autonomy from the central government when acts violate their rights. The Constitutional Court tends to protect the rights of local governments on decisions and property in its interpretation, but much less readily admits their right to sufficient income to provide local public services.

As a result, the central government is not legally liable to decrease the funds to be generated for the carrying-out of local tasks. Local governments have relative freedom to decide how they organize local public services. There is a tangible tension between the central and local governments due to the efforts of the central government to implement its preferences by urging reforms in the field of local public services. Financial resources for local tasks, however, are more and more in short supply.

3.3. Financial Autonomy of Local Governments to Provide Local Public Services

Three issues of financing local public services should be answered:

- Whether local governments are autonomous in their financial decisions when managing local public services. To judge this requirement, the proportion of local governments' own revenues against their entire revenues

should be compared. Local taxes in the own revenues are also important to consider. The proportion between normative versus special grants is not randomly established.

- Whether local governments possess sufficient funds to provide a wide range of local public services dictated by local needs. This is a complex issue, which needs to take into account not only local governments' share in GDP, or the characteristic proportion of local government revenues, but the level of decentralization and local tasks, as well. Whether local governments depend too much on the state budget, which can decrease grants needs to be considered.
- Whether the finance system assures efficiency and good quality of local public services. Finance systems should be based on incentives. For example, if the local government system is fragmented, or finance is targeted at differentiated tasks, funds cannot be used efficiently (spill over effects) The promotion of market principles, such as competition, the involvement of the business and civil sectors is the best way to assure high quality service.

3.3.1. Rights to Economic and Financial Autonomy

Act LXV of 1990 on Local Governments declares that local governments shall provide local public services. In order to manage them, local governments:

- Dispose their own property, administer their budgetary revenues and expenditures. They are entitled to independently manage their own economic administration in the framework of finance laws.
- May choose how they maintain their own budgetary organization (local government institutions) support private entities (business associations, non-profit organizations) purchase services by any other means.
- Have the right to their own revenues, shared taxes and support from the state budget. The budget of the local governments is part of the public finances. In other words, this budget is distinct from the state budget, but is linked to state subsidies and other budgetary ties.

On the basis of the provisions of the Act, local governments are fairly free to administer their economic activity and choose ways of providing local public services.

The question is whether local governments have real financial autonomy in the current public finances to provide sufficient local public services set by laws and local needs.

3.3.2. Assets of Local Governments

State-owned assets of local public services, such as some of the utilities, health care and welfare institutions, schools, etc. were transferred to local governments at the beginning of the 1990s. The assets of local governments may be real estates and financial assets (shares).

Assets related to local public services are primary assets of local governments. Some of the primary assets, such as local roads, public parks and squares, are completely unsalable. Partially salable assets are the utilities, public buildings, and local government institutions.

The selling of negotiable assets of local governments or providing them as contributions in cash to business associations may be limited by local governmental decrees. Otherwise local governments have the right to exercise property rights, similarly to private persons.

3.3.3. Own Revenues

Local governments have the right:

- To pursue business-like activities with their assets and can have profits, dividends, interests and leasing fees deriving from this. However, business-like activities may not jeopardize the provision of local public services. The accountability of local governments in business associations may not exceed their contribution in cash. Local governments may raise loans and issue bonds, too.

These afore mentioned capital revenues have increased from 4% to 16% in the total local budget during the last 10 years.

- To levy their own taxes, fees, and environmental fines. Local governments are empowered to decide which types of local taxes to levy in the framework of available local taxes regulated by Act C of 1990 on Local Taxes. Rates of local taxes can be determined within legal limits. These revenues have increased from 16% to 24% in the total local budget, due to the increase of local taxes.
- To have shared revenues with the state, including shares from individual income and vehicle tax. The percentage of shared revenues has not changed.

3.3.4. Grants from the State Budget

- Normative grants form the major part (70%) of all subsidies from the state budget. The annual act on state budget fixes the amount of normative grants each year. The allocation of normative grants is based on need-based (local

unit expenditure) and per capita-based (number of inhabitants and defined age cohorts) measures.

Normative grants, however, are not based on actual costs, in terms of contributing just a part of the actual costs. One type of the normative (population-based) grants may be allocated to any local public service, such as the maintenance of health institutions, communal services, etc. The other type of normative (per capita based) grants may be allocated only for specified purposes, such as each social welfare service and educational institution.

- Targeted and addressed grants are specified by Act LXXXIX of 1992 on Targeted and Addressed Grants. Targeted grants are established for important public goals, such as solid waste disposal, or medical instruments, for example, and will be given if the applicant local governments meet the conditions.

Addressed grants are discretionary and support specific investments with high capital intensity, such as the reconstruction of hospitals.

- Poorer and less developed local governments with unbalanced budgets resulting from external factors receive special state grants.

The normative and specific grants have decreased from 50% to 30% of the total local budget, due to the decrease of normative grants. This decrease is from 20% to 13% in the state budget.

3.3.5. Transfers from other Public Authorities

Funds are obtained through transfers from other public organizations, i.e. National Health Insurance, for the management of health services. Reform conceptions in Hungary agreed that solidarity in health care should be maintained. In other words, health services should be available for all citizens and contribution to health care should be proportional to their income, while health care provision is equal, regardless of contribution.

To achieve this goal of solidarity, instead of the former state budget system, national health insurance was established.¹⁴ The national health insurance fund is formally independent of the state budget, but in fact the act on the annual state budget determines its sub-areas, such as medicine, primary, secondary health services, preventive healthcare, etc. The state budget subsidizes the national health insurance fund, too, when it makes a loss.

¹⁴ National Health Insurance is preferred in the Continental Europe. This is because it is clearer for the customers how their contributions will be spent on health care, if the national health insurance is separated from the state budget, than if it is up to day-to-day political decisions as to how health care will be financed from the state budget.

Health care providers are under dual finance in the current finance system: Their maintenance is financed by local governments, whereas their services by the National Health Insurance Fund. Local governments are obligated to provide buildings free of charge to health care providers, even if the health care providers are privatized. Local governments receive population-based normative grants from the state budget for the maintenance of health institutions. Addressed and targeted grants are also available for this aim.

Conclusions

Conclusions that can be drawn from the financial autonomy of local governments to provide sufficient local public services are as follows: financial autonomy is much less assured in the current finance system than where the decentralization of local public services is determined by legal regulations.

- Normative grants dramatically (by 40%) decreased, although capital revenues increased by 400%, and local taxes have become more important. (150% increase) These latter increases of own revenues compensated for the decrease in normative grants.
- Local governments are still fairly dependent on the state budget. The percentage of grants of the state budget in the total local budget is still high (30%). Furthermore, the state has an unlimited right to decrease it year by year in the annual state budget. Measures of normative grants are not differentially calculated and are not adjusted to the real local needs.
- The percentage of local taxes is still low (9%) in the revenues of local governments. Fees for local services are not typical, (1,5% at present) due to the paternalist traditions of the communist era. Increasing capital revenues (15% at present) is not supported by public policies, since it is local governments that are considered to have the responsibility to serve as public authorities rather than entrepreneurs.
- 50% of state grants are targeted and addressed grants. Normative grants are based on types of local tasks, too. This does not give local governments freedom to decide on how and in what manner they manage local tasks. The principle of “one service–one provider” is the rule: finance is based on the type of services, which does not encourage the establishment of providers providing complex services.
- The efficient allocation of funds by local governments to manage local public services is not an issue in the current finance system. Using business principles as a way towards efficient local public services is not supported. Collecting fees for local services, especially for welfare services, which could assure reasonable consumption, is not accepted by the public.

Unions of local governments, which could compensate the fragmented local government system in the provision of local public services, is not promoted by the finance system, either.

Health care is the only local public service where the lack of efficiency and quality of the services has been the most apparent and has led to serious political tensions, such as demonstrations, a main subject of elections, etc. Although the public finance of health care in the GDP has decreased only by 1% of the GDP (from 5,9% to 4,9%) during the last 10 years, citizens experience a dramatically worsened quality of services.¹⁵ Health care is considered under-financed and wasteful at the same time.

3.4. Problems of Regionalism and Fragmentation

Regionalism has not developed in the Hungarian public administration yet, but the local government system still operates in the traditional structure. This local government system is considered fragmented in terms of being insufficient when local public services are provided.

Attempts at reforming the local government structure have been so unsuccessful, because the local government act can only be amended by an act adopted by the qualified majority vote of parliament, for which a consensus between the government and opposition parties has not even once been created.

In 2006 a government decree referred public administration offices to the county level, altering their classification as county capital. In 2007 though that government decree was annulled by the Constitutional Court.

European Union directives, however, require the creation of the regional level between the central and territorial ones. The region is not only a public administration unit, but also a new territorial unit of economic development. European Union grants are often bound to region development.

In the Hungarian public administration system – without the emergence of a constitutional problem, only units on the regional level, such as e.g. region development councils could be created which were not local government bodies, i.e. were not delegated a public authority's scope of responsibility and are not local representation bodies.

¹⁵ The total costs of health care (public and private finance) decreased only by 0,7% due to the increase of private distribution (0,5%), such as under-the-table money, medicines, private clinics, etc. Citizens increasingly have to contribute to their health care from their private resources. The percentage of both the public finance and the total costs in the GDP is very low compared to OECD countries.

In the present local government system in past years, two new public administration entities have emerged: the small region and the district centre. These two public administration entities are not regulated by a unified law, furthermore even an amendment of the local government act has not occurred, only certain sectorial acts confer public authority responsibilities onto this level. In these cases acts also stipulate, with a taxative enumeration of municipalities what territories small regions or district centres extend to.

Municipalities operate in each settlement, such as villages, towns, cities, and in the counties and the capital of Hungary. The local governments of counties and the capital serve as superior administrative authorities to decide administrative cases, when administrative decisions from the first level are appealed.

Local governments of the counties and the capital have their own tasks to provide local public services, too. This is the case when the local public service requires special professional specifications, such as hospitals and secondary schools, for example. The local governments of the counties and the capital are obligated by the act to provide certain local public services, when local governments of smaller villages or towns do not provide or are not capable of providing them.

This system is not sufficient when dividing tasks between the local and county level, because it does not take into account the territory where public services are provided. It does actually occur that people living in the territory of a local government consume a public service provided by a county local government, without contributing to that service through their local government. (spill over effects)

Act LXV of 1990 on Local Governments declares freedom of association for local governments and regulates the cooperation of local governments in the following way:

- The position of a common notary can be established when the population of the neighbouring settlements is below 1000–2000.
- Local governments may establish associations in order to implement their common task more efficiently and sufficiently.
- Local governments may establish supervisory associations for the foundation, maintenance and development of a common organization. Local governments make an agreement in which they stipulate the legal form of the organization, their financial contributions, types of the services the association will provide, and other rights and obligations.

The local government associations are regulated by the act, for it is a generally accepted view that local governments of small settlements are not capable of providing most of the local public services. However, when local governments

associate, they can better perform development programs of the given area, more easily acquire financial resources through tenders, or from the state budget. Also the provision of local public services, such as water supply and waste water management, cannot be sufficiently adapted to the territories of local governments.

Nevertheless, Act LXV of 1990 on Local Governments does provide opportunities to local governments to cooperate with each other in the provision of local public services. Although the management of small areas has little tradition yet. The association of local governments is less frequently applied for providing local public services than it would be expected.

3.5. Management Values and Bureaucratic Structure

Management values are not assured in the structure of local governments. Instead, legal regulations emphasize the implementation of the tasks of local governments set up by laws. The tasks of local governments can be classified as legislative (to pass decrees in the framework of superior acts), jurisdiction (to apply laws when deciding administrative cases), and servicing (when providing local public services.)

When implementing this latter task, the representative body of the local government passes a resolution in which it orders the establishment of an institution or firm to provide the local public service. Also, the representative body is entitled to decide on whether to privatise a local public service or not, or if so, how and under what conditions.

It is the duty of the notary and the office of the mayor to organize the local public service based on the resolution of the representative body. When the local public service is provided by a local government institution it is supervised by a public servant of the office of the mayor. The notary assures only the legality, not the efficiency of the operation.

The only guarantee for efficient operation is that if consumers complain to the representative body at public hearings and the representative body orders the improvement of the service. This feedback, however, does not work well in practice.

Local governments have committees elected from the members of the representative body to deal with special fields, such as health care, welfare, economic, financial issues, etc. Members of these committees are politically appointed, but not experts in the field.

Public servants of local governments are in most cases not trained as managers, either. They consider it more important to keep legal regulations related to the local public service, such as complicated financial rules, technical require-

ments, etc., than efficiency, quality and customer oriented services. This is due to the bureaucratic traditions of public administration and the lack of management values.

Local governments are careful when deciding to privatize a local public service. This is because they do not know how to keep sufficient control over the privatized services.

Privatization has less risk when the local public service is privatized for non-profit organizations, which is the case in the welfare services. Laws determine in minute detail how welfare services should be provided by non-profit organizations.

However, laws do not detail how to supervise a privatized for-profit private firm. A business-oriented private firm is motivated by the profit, not public goals, such as quality, continuity and general availability of the service. Local governments do not have sufficient management skills to balance between these private and public interests. They can easily lose control over the business firms, which may make the customers unsatisfied.

Central government's example of privatizing some infrastructure public services does not encourage local governments to privatize most other infrastructure local services.