

*IV. D. 2. Application of Administrative Law with Regard to Privatizations*

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## **Application of Administrative Law with Regard to Privatization: The Hungarian Case**

**Abstract.** The essay analyses the process of privatization in the transitional period. In the early 1990's, the privatization of the competitive sphere in Hungary meant the purchase of state-owned companies. Besides the legal background, the essay gives an overview on the political aspects of privatization. The next step was the privatization of public services in the middle of the 90's. The privatization of the sector of public services is peculiar as privatised public services remain under governmental control even after their privatization: public administration is responsible for the continuity of the service, for its general accessibility and its quality. The essay deals with the issues of the application of law in this respect. The privatization of the welfare sphere was primarily characterised by the retreat of the state without applying alternative methods like initiating the participation of non-profit organizations. In the analyses of the privatization of the welfare sphere, the essay deals with the principles of privatization, as well as the constitutional problems involved and the conflicts of the central government and the self-governments.

**Keywords:** privatization, competitive sphere, sector of public services, welfare services, supervision of competition, public health

### **1. Privatization of the Competition Sphere**

In developed Western countries privatization formed part of the neoliberal economic policy that occurred from the 1980-s. This type of privatization focused on the *decrease of the public sector's scope*, which meant the state's withdrawal from the public services and at the same time the extension of market mechanisms in this field. Similarly to other Central and Eastern European countries, the first aim of Hungarian privatization was to *transform 90% of the state property in the sphere of competition to private ownership*.

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So, the privatization of the countries in transition from communism has a *different function and meaning* at the beginning of the privatization processes. In Hungary the *new economic administrative law* concentrated on refining the administrative system from its old bureaucratic characteristics and elaborating market institutions which had been in existence before the transition. The *aim of this chapter* is to analyse the new functions and activities of administrative law that have played a role in shaping privatization.

### *1.1. Characteristics of the Bureaucratic Economic Administrative System*

In Hungary the privatization process in the sphere of competition happened in a special way compared with other Central and Eastern European countries. The reason was the special features of Hungarian economic administration system which had the greatest effect on the methods of privatization. That is, from the 1960-s a *special economic administration system* had developed in Hungary as a result of economic reforms. The main characteristic of this so called “*neither planned nor market economy*” was that the legal regulations aimed to create market institutions, although in fact a high level of state intervention still existed.

In order to accelerate the disintegration of the traditional planned economy the most essential step was the *division of executive and proprietary administrative power* which was executed in 1984. It meant that most proprietary rights belonged to the administrative organs before being handed over to the state-owned enterprises, and came to be exercised by self governing bodies within the state owned enterprises. The administrative authority that had established the state owned enterprises *supervised its operation from the point of view of legality, and could not intervene by economic decisions*.

In 1968 another organization reform had already *remodelled the central economic administration* by eliminating the scope of the sectoral ministries in the execution of the central state plan. Instead, a *special directional method*—that of the *economic regulators*—typified the connection between the ministries and the enterprises. Economic regulators were legal norms, but in fact represented economic means, such as financial, price, wages, and employment factors in the direction of state enterprises.

This indirect directional method represented a looser connection between the central public authorities and the state enterprises, than the directives aimed to execute the central economic plan. The so called “*functional*”

*ministries* and central administrative authorities were entitled to pass economic regulators and the *sectoral ministries* were responsible for a sector of the economy, such as industry, commerce, agriculture etc.

Nevertheless this new direction showed the limitation of the public administration's intervention, but at the same time was capable of maintaining the enterprises' financial and political dependence in another form. Consequently this looser economic-administrative intervention allowed *market mechanisms and institutions* to develop and most of them seemed as a basis for the new administrative system.

### 1.2. Development of the Privatization Process

If the privatization is implemented by the transformation of ownership, it has generally two forms: the securities of the company can be issued on the Stock Exchange, or the shares are sold by tenders.

The money and security market being less developed in Hungary, the only possible means of state enterprises' privatization in the competition sphere was to invite tender for selling. Partly because of this fact, and partly for other reasons, *selling by inviting tender* remained the main form of privatization in the competition sphere.

The first form of privatization, the so called "*spontaneous privatization*" had already taken place during the rule of the last socialist government at the end of the 1980-s. By that time it was obvious, that although the self governing enterprises were more efficient and better organized than the previous organs of the planned economy, state ownership *could not be reformed in this way*.

Theoretical attempts to analyse this type of state ownership, could not answer the real nature of exercising property rights. The reason was that these enterprises did not operate in the form of commercial companies, but in public corporations. Secondly, in the lack of any real ownership the functions of the owner, the managers and representative organizations were interwoven and were exercised by the self governing body consisting of the employees.

Consequently, public corporations could not represent real business interests in any form. Legal regulations were passed in 1989, giving the enterprises an opportunity to become to *commercial companies*, in which the property rights were exercised by the former self governing bodies. In order to obtain capital investment and decrease the companies' debts the self governing bodies *sold some of its shares to foreign investors and banks*. In most cases the *managers* themselves also *bought shares*.

One of the advantages of this form of privatization is that being based on the company's decision it could adapt fairly well, increase the capital, decrease the debts and income was generated for development.

The first democratic government stated that it had to defend state property from this "wild privatization", and exerted *strong administrative control* on each step of the process of *privatization*. This defensive attitude displayed the characteristics of the old administrative culture which tried to strengthen its power by widening its proprietary functions.

But this change was also related to other political interests too: the government needed the income generated by privatization in order to finance the budget deficit and pay off state debts. Besides, the government intended to appoint its own supporters to the most important economic positions, so the populist wing accused the former élite of trying to salvage its political power in the form of economic power.

By that time more interest groups, such as the employees, local governments, claimants of reprivatization, etc., also declared their claims to state property, but these interests were not successful.

As a result of this economic policy the total "*renationalization*" of the *state owned enterprises* took place.

The *State Property Agency* which had merely been an advisory body earlier, now became an administrative organ under the government's direct control. The State Property Agency put the state enterprises under its administrative control and exercised property rights without censure and publicity. Actually, this organization was not based on its executive powers but on ownership. It meant that it was not possible to contest its decisions either by administrative or juridical means.

Furthermore, the State Property Agency, as an administrative organization was not capable of making business decisions properly and did not have enough professional administration to deal with the huge number of state enterprises. In fact this form of privatization was an *unrestricted political privatization*, which meant, that economic points of view were subordinated to political interests.

The process of privatization took place in two steps: the public corporations were obliged to become to limited companies, and the shares were sold without inviting tender. After some years it increasingly became obvious, that the process of privatization *had slowed down*, had become *bureaucratic*, a "*hotbed*" of *corruption*, although there were attempts initiated by the Governments to reform the privatization system.

So, besides selling, other legal forms of privatization, such as leasing contracts and *utilising contracts* were introduced. The reason was, that by that time, it was obvious, that privatization by selling contracts was not

realistic, because domestic capital investment was lacking. Besides, selling for foreign investors was not always acceptable because of the fear of the dominating influence of foreign capital.

The *State Property Managing Share Company* as a super holding company in state ownership was also established in order to run those bodies which were intended to remain in state ownership for a long time.

As a reaction to the inefficiency of the privatization process, public and political opinion increasingly stated the necessity of “*the privatization of privatization*” which meant the *decentralization and democratization of privatization*. In other words, the conditions *must be based on legal regulations*, and other groups, such as the employees, claimants of reprivatization, public foundations, and public bodies *must also have an opportunity to take part in privatization*.

Sharing the income of privatization between the state budget and the privatized companies was also among the claims.

This *new conception of privatization* came into being only after the coming to power of the socialist-liberal government in 1994. The main aim of the reforms was to implement the privatization as soon as possible, because the companies under state ownership were making serious losses because of the way they were run by the State Property Agency.

Although the Act on Privatization of 1995 regulates the opportunity for other groups to share in the privatization, such as the claimants of reprivatization, the managers, the employees, domestic investors and social insurance companies, *privilege is given to the foreign investors*. The reason is, that only this group of buyers can pay in cash, which is needed to cover the state debts and to decrease the privatized companies’ capital for development.

The privatization process must always be published, which means, that *openly published tenders* must be invited and the points of view of the decision also must be written in a memorandum. The *principles of privatization* that must be followed during the decision making are also regulated in the Act on Privatization of 1995.

While in the former regulation several public authorities, such as the State Property Agency, the State Property Managing Company and Ministries took part in the privatization, the Act on Privatization of 1995 placed all the companies in state ownership under the *State Privatization and Share Holding Company*.

The main aim of the State Privatization and Share Holding Company is to sell these companies, not to run them. If the selling by invited tender was not successful, or the company is intended to be maintained under state ownership, the State Privatization and Share Holding Company has to *make utilising*

*contracts* with private companies for the treatment. Those companies which are intended to remain as state property, such as central utilities, must be selected by the *Parliament* and enumerated in the Act on Privatization of 1995.

Considering the *legal status* of the State Privatization and Share Holding Company, special importance was given to the several kinds of *control* over it. The Parliament and the Audit Office have the right to supervise the activity of the State Privatization and Share Holding Company. Besides, the Parliament's approval is needed for the Government's most important privatization decisions. The privatization minister appointed by the Government has the rights to exercise property rights. The members of the Board of Directors are appointed by the Government and they have legal responsibility for their decisions. The Directors of the Board of the Supervision are drawn from candidates of the six political parties represented in the Parliament.

## **2. Privatization in the Field of Public Utility Services**

### *2.1. Public Administration's Supervision over Public Utility Services*

Before the 19th century the *provision of public services by the state was rather unusual*, and it was only after the industrial and demographic revolutions that it became more widespread. This period of time saw certain social changes notably an increasing urban population from which social problems, such as poverty, and poor public health arose.

From the 1980s in Western European countries and in the USA political, economic and social observers were *generally sceptical about intervention by the state*. These critics encouraged most governments to rethink their own economic policy. The previously positive attitude towards the state provision of public and welfare services came under increasing criticism.

Theories led to the conclusion that the role of the state in directing the economy must be queried. *Neoliberal economic policy* unequivocally held the increasing state intervention and the considerable state property responsible for inflation and the growing budget expenditure. Liberal economic thinking along these lines recommends an economic remedy for economic problems, *promoting the extension of market mechanism, instead of etatism*.

This was expressed in several economic policy programs, such as liberalism, deregulation, privatization, etc. Nevertheless privatization is perhaps the program which has had the greatest effect.

There are many ways to *define and interpret privatization*: in the most narrow sense privatization means the reduction of state property by selling

state owned enterprises. In a *wider sense* it is considered as a *decrease in the scope of the public sector*, the limitation of its function and generally the weakening of its influence, at the expense of an increase in private influence.

The new liberal economic policy presented a system of arguments on more levels for the approval of privatization: privatization was accepted favorably because it can give individual entrepreneurs the freedom to initiate undertakings in those areas which had hitherto belonged to monopolies, and as a consequence the differentiation of public services widens the customer's options.

The economic advantage of privatization is that it is capable of dissolving those monopolies which are not natural monopolies and which negate healthy market competition. Furthermore, the elimination of state property and the state's bureaucratic and administrative direction of public enterprises would give way to private companies which are much more able to adapt to market conditions.

Privatization of public utility services has special features compared with the enterprises of the competition sphere. The main characteristic is, that *public administration maintains its control over the privatized enterprises* so that continuity, general availability and quality of the services should be guaranteed. The main forms of public administration's control over the utility services are *price regulation* and the *supervision of their operation*.

The reason of maintaining of these types of administrative control is, that public utility services are monopolies in two senses: state monopolies and natural monopolies. Public utility services are often declared as *state service monopolies*, that public authorities have to provide. *Natural monopoly* is considered to provide the most effective service if only one firm is in the market.

*Special contracts* are made in implementing privatization of public services, in which there is a special relationship between the public authority and the private firm. Contracts, such as franchise, concession and contracting out, are generally applied.

Public authorities often maintain their right of ownership in these contracts, and only the *economic functions* of the public service *are assumed by the private firm*. Public services are in the public interest, so public administration has to shoulder its responsibility, maintain its control, although these services are operated by private firms. The right of public authorities' supervision can be stipulated in the contract or regulated by legal rules. Inviting tender for the operation of public services also serves public interest, because that private firm will get the right for the operation of the service, which has offered the lowest prices and the best quality.

If the public services are *provided by state owned enterprises*, utility services are in most cases connected with welfare, and profitability is of no significance.

In this case the state gives financial support to the enterprises if they are running of a loss. Secondly, although the utility services are maintained by public authorities they have an economic, not an executive character.

If the public utility services are privatized, the conflict of *public and private interest* emerges. If the utility is operated by the private firm, the public authority gives an exclusive right of the operation to the private firm, so that the profit should be guaranteed. Consequently, the public authority establishes and recognizes a *private monopoly* instead of state monopoly. Being in a monopoly position, the private firm operating the utility service can increase its prices, because it is not subject to competition.

On the other hand, the interest of the customers requires a lower price and better quality of the service, which should be guaranteed by the state. In this case the public interest of the state and the profit interests of the private firms are always contradictory.

For this reason, the most problematic point of these contracts is the *way of determining the service's price*. In other words, these contracts are long term ones, and because of the changing economic circumstances, the prices can not be determined in a fixed way. Instead, the prices charged by privatized utility service enterprises are generally determined by means of *price regulation*.

It is generally accepted, that the role of price regulation must *substitute for competition* in those areas, where natural monopolies exist, and are operated by private firms. It means, that price regulation must perform the function of the *income allocation of the competition*: the service's best duality for the lowest price, and the guarantee of the private firm's profit.

The greatest problem of price regulation is that while the competition has perfect regulatory effects, price regulation is a *legal method*, which can not substitute competition in the same way. For example, application of price regulation is always based on the legislators' decision, and there has not been uniform agreement on prices.

Secondly, the process of price regulation is generally long and complicated, compared to the automatic effects of competition. Furthermore, the *principles of the prices* have not been elaborated in a sufficient way, although differentiated methods of price regulation have developed.

The institutions of price regulation—the *regulatory bodies*—are always independent from the governmental and political organizations, which is guaranteed by legal rules. It means, that only the Parliament has the right to regulate the framework of the prices, appoint the heads of the regulatory bodies, and supervise their activities. The decisions of the regulatory bodies can be contested in the courts. The regulatory bodies are public authorities



with professional staff. Their main tasks are to pass decrees regulating prices, decide in legal discussions between the customers and the private firms, supervise the budget of the firms, etc.

Former opinions emphasized, that price regulation is inevitable, because it must substitute competition. But regarding the inefficiency of the price regulations, more standpoints admit, that *price regulation* is less *effective, than competition supervision*. That is, one of the functions of competition supervision is to limit the abuses deriving from the monopoly. For this reason, the basic dilemma of the public service sector is whether the price regulation or the conditions of competition supervision must be applied.

Recently, developing technical requirements allowed market competition to be created in those areas, which had previously been natural monopolies. As a result, there is a tendency towards putting public utility enterprises under competition supervision instead of price regulation. These *deregulation programmes* intended, that the prices of the deregulated sectors must be determined by competition. But deregulation can not be implemented for every utilities, or in all the activities of the deregulated utilities. Consequently, the elements of competition law and the price regulation are interwoven, and it is not easy to decide in concrete cases, which one must be applied.

## 2.2. *Price Regulation and Competition Supervision over Public Utility Services in Hungary*

Privatization of public utility services was implemented in 1996 in Hungary. Earlier, public service enterprises were placed under *direct administrative control*, even after the economic administrative reforms of the 1960-s. At the beginning of the transition most of them were transformed to *commercial companies* and the property rights were exercised by the State Property Agency or the local self governments.

The 1990 *Act on Price Regulation* declared, that in the new economic system prices are to be determined by *market competition* and the intervention of the government in this field can happen only in *exceptional cases*. These exceptional fields are enumerated by the Act, when the means of the *competition supervision are insufficient* to prevent abuses deriving from the position of monopoly.

Almost all public utility services are included among these activities, and put under price regulation. Price regulation means, that the sectoral minister or the local governments are obliged to *pass a decree or by-law to determine the maximum level of the utilities' prices* to be applied.

Obviously, the reason for placing these utility services under price regulation is, that they are *natural monopolies and are not subject to the effects of competition*. In this case the legal rule determines the prices directly, and the provisions of *competition law are not applied*. The reason is, that price regulation instead of competition is responsible for determining the “right” price. Secondly, the price is regulated in legal rules which can not be revised either by the civil court or the Office of Competition. Certainly, if the utility services are not under price regulation, the price is stipulated by the parties of the concession contract, and the competition law can be applied, if the utility charges a monopoly price.

Although the traditional means of price regulation was adjusted to the requirements of the market mechanisms, it was *modelled to the state owned utility enterprises*. In another words, this system of price regulation does not meet the *profit interest* of the private firms and the *customers’ interest*. The reason is, that although the Act declares that the profit must be guaranteed, does not regulate the *methods and principles* of the regulated price. It means, that the public authority is entitled to regulate prices and may exercise *discretion* in choosing the method.

The private company operating the utility only has the right to make proposals, which are not obligatory for the public authority. Being a legal rule, the regulated price could theoretically be contested only in the Constitutional Court, if it does not cover the profit for the private company. But in fact it is obviously not the task of the Constitutional Court. Furthermore, the sectoral ministers are *dependent from the government*, and represent its interests in determining prices. Besides, the local governments’ staff do not have the necessary professional skills to regulate the prices.

Suffice to say, this *bureaucratic regulatory system* does not meet the requirements for the regulatory bodies’ independence, the procedural guarantees and differentiated regulatory methods. Naturally, the privatization of public utility services could not have been implemented on the basis of this regulatory system. For this reason, *other solutions were sought to ensure the profit interest* of the private companies participating in the privatization.

Firstly, *regulatory bodies* were established by the legislation in those areas, where privatization had been performed. These bodies represent more modern principles of price regulation, such as professionalism, independence, participation of the companies in applying prices, the representation of the customers, the function of balancing several interests, etc.

Secondly, the methods of price regulation are regulated in *Government resolutions*, which mean, that if the decree or the by-law contradict the resolution, they can be challenged in the Constitutional Court. That is, in

this case the decree or the by-law violates the principle of the hierarchy of legal rules.

In other cases the contracting parties stipulated the methods of the prices to be applied in the *concession contract*. The minister or the local government obliged themselves, not to pass a decree or by-law regulating the utility's prices which contradicts the agreement of the contract. The problem is, that when the minister or the local government make the concession contract, they represent proprietary function, and can not oblige themselves as the executive powers.

On the basis of these analyses it can be proved, that the system of price regulation is fairly *contradictory* and *confused*. There could be two possible solutions. One of them is the creation of the regulatory bodies and procedures that represent *modern principles*. But many experts are unsure, whether it is possible without traditions and whether its costs could be financed.

The other possibility is the *extension of competition supervision*. In this case the Office of Competition would become a "*quasi*" *regulatory body*, which means that public authorities would determine only the methods of prices and the Office would have the scope to decide in the case of abuse of prices. But the Office of Competition declared in its decisions many times, that it is not the task of the Office to determine the "right" price of the utilities. That is, not all utilities are under price regulation, and in these cases the Office has the right to decide if the abuse of prices has occurred. But the practice of the Office shows that it tried to avoid investigating prices, and so the costs of the companies operating the utilities.

### 2.3. Privatizing Public Utility Services in Hungary

In Hungary before 1990 almost all the public services were state monopolies with a few exceptions, which were allowed to operate privately as individuals or companies. After 1990 the liberalization of state monopolies was completed.

The Constitution makes it obligatory for monopolies to be regulated by acts of Parliament. Besides the Concession Act several acts contain the regulation of state monopolies, e.g. the Civil Code, the Post Act, the Bank Act. Some of these may not be operated by private persons, but are the exclusive monopoly and property of the state.

The listed state monopolies in the *Concession Act* are transferable to the private sphere only by concession. The Concession Act was created as a framework act containing the general rules of concession, and the detailed conditions are regulated in clauses.

Among the detailed activities listed in the Concession Act only a few belong to the field of public services, (the maintenance of public roads, railways, rivers, ports, airports, and public utilities, public transport, telecommunications, postal services) others are regarded as policy monopolies (the production of nuclear energy, and the production of drugs), and a third group of monopolies are regarded as financial monopolies (mining, state lottery).

*Concession* means those privileges, licenses, or advantages which were given by the state to persons or organizations for those activities which the state is obliged to perform. According to this interpretation concession is a license given by the state for executing public tasks by private persons. Concession is therefore often considered to be a form of privatization of public duties.

*Licensing*, the practice of a state monopoly for a private party is often identified as concession. The main difference between concession and licence is derived from the two divergent positions of the administrative organ: when granting a licence the administrative organ acts as an administrative authority, but when awarding a concession it decides to enter into a contract, as an owner.

Another difference between them is that the conditions of the license are determined onesidedly by the state. If the applicant suits all the legal requirements he or she will have the right to obtain the license. However, the awarding of concession is always the decision of the administrative organ, as well the selection of the person entitled to the concession also depends on it. Conditions of practice of concession are determined by the mutual agreement of the parties.

The subject of concession may be the granting of a monopoly by the state, or the permission to utilize state owned property. By granting concession on state owned property the state intends to keep its right of control by maintaining the right of the ownership of its own property.

The *concession contract* is faced with the contradictory elements of private and public law. This conflict is caused by the existence of a civil law contract representing entrepreneurial activity and of administrative control enforcing the public interest.

This dilemma is revealed in the question, as to whether the concession contract can be classified as a civil law contract, or as a separate category. However, no explanation has been given as to whether the state can legitimately be regarded as an equal party in the contract, despite the state maintaining rights as the bearer of executive power.

Concession contract consists of the preclusion of competition and assurance of *monopoly* for the party entitled to the concession. Obviously there are cases when the competition would anyway be excluded because of the character of the activity: e.g. the building of roads and motorways. But

generally the award of a monopoly is itself diametrically opposed to the principles of competition. The question is, what kind of solutions may be offered to eliminate this situation?

The Treaty of Rome tried to outline an alternative: EEC countries have to ensure that enterprises should not be awarded exclusive rights which would contradict the law of competition as laid down by the Treaty of Rome. At the same time the Treaty allows for exceptions: those enterprises providing public service are allowed to depart from these rules if they are limited in performing their tasks. But any departure should not be in conflict with the public interest.

Another specific feature of the concession agreement is that in most cases concession occurs in areas typified by high capital intensity and low rentability. The public administration has to guarantee benefits for the contracting party to attract private capital. The measure of the benefits of concession activity depends on the concession fee and the price of the service. As the concession contract is a long term one, the contract may only be modified by mutual agreement. In the event of poor calculations or inflation the enterprise may make losses, and it would result in the bankruptcy of the enterprise and at the same time the public would lose its services.

More variations are applied in determining the *price* of the public services. On one hand the enterprise should be entitled to raise its prices in the event of inflation, on the other hand the right to do so may justifiably be limited because the activities of such enterprises are not conducted under market conditions which would force them to reduce the prices. In most cases the price of the services are determined in legal rules by the authorities.

The most specific character of the concession contract is the public element. The object of the concession is always connected with *public property* or *public money*. For this reason it has become necessary to oversee the making of these contracts to safeguard against corruption, and ensure equal opportunities. This rule makes it binding for the administrative organ to announce its offer of contract and to judge it by way of public tender.

The first step towards concession is to invite *public tender* which is an obligatory condition of concession. Public tender may be initiated by the state, a ministry department, or the local government. The right to invite public tender is always determined by the bearer of property, or governed by the clauses within the Act. The right to select the candidate for the concession follows from the right to invite the tender.

Concession contracts will be made with whoever submits the most favorable offer for the concession. According to the interpretation of this provision it is not obligatory for the state to enter into a concession contract if the

administrative organ has declared the public tender invalid. If the public tender is declared valid the concession contract may only be made with the winning candidate.

The other reason why the administrative elements exist in concession contracts is the responsibility of public administration for the *continuity* and *quality of public service*. After the transfer of public services the public administration may not refuse responsibility. That is why public organs have the right to modify some provisions of the concession contract one sidedly.

Another departure compared to the civil law contract is the right of the administrative organ to *nationalize* the enterprise in the event of breach of contract. Immediate termination of a contract as a sanction of civil law would not suit the demand for continuity. As a consequence of being responsible for the continuity of services, the public administration has wide rights in *supervising* the enterprise, which may occur in three forms: the state may keep the majority of shares in the enterprise, thereby maintaining the right of control as the owner.

The state can also create opportunities for controlling the enterprise by *legal rules* or may entitle the ministry or government department to supervise it. Finally, the contracting parties may stipulate the right to control the enterprise by the state.

Concession contacts are made for a definite time to avoid the indefinite transfer of state monopolies. The maximum period of the contract is 35 years although there was an exceptional contract made for 47 years.

In the concession contract on one hand the state's obligation is the transfer of the right of the operation of the public service, on the other hand the contracting party's obligation is to pay the *concession fee*. During the existence of the contract the state is not allowed to change monopoly position disadvantageously for the party entitled to the concession, i.e. the administrative organ is not permitted to invite another tender, or to establish any new state owned enterprise in that field of public service. This regulation is necessary to guarantee benefit to the company.

After making the concession contract it is obligatory to establish a *business association*, and to obtain the *licenses* which are necessary for the practice of the public service activity.

### **3. Privatization in the Banking System**

After the aforementioned process of economic liberalization had taken place in the 1960s the *banking system* had to be adjusted to the changed

circumstances. Previously, all the banks performed the same functions and came under the state budget control. The lack of scope meant that the banks' functions were limited to the *execution of the central state plan* and the *financing of state investments*.

The indirect economic administrative system needed a banking system which could promote the *development of a capital based market*. In this case the role of the banking system would have been to influence the market processes by economic regulators on the basis of the central economic policy.

For this reason the *division of the functions of the central and credit banks* occurred by the end of the 1980-s. The *central bank* (National Bank of Hungary) as the part of the administrative organization system performed only the *monetary regulatory functions*, but *5 state owned commercial banks* were separated from the central bank. Although the central bank was empowered with monetary regulatory rights, its *close dependence on the government* was maintained.

The government appointed the president of the central bank and it was empowered to set credit and monetary policy. Furthermore, legal rules set by the government and the finance ministry were obligatory for the activities of the central bank. But the *budget policy* had the greatest influence on the central bank's operations: the deficit of the budget was financed by the central bank's credits, and the amount was not limited by any legal rule.

The legal regulations of the transition *stated the independence of the central bank* from the Government in 1991. That is, the Act on the National Bank declares, that the *Government can not control* the activities of the National Bank. The role of the Government relating to monetary policy was narrowed down to an advising capacity and *representation* by a minister in the Bank's meetings. The *Minister of Finance* only has the right to *reconcile* the monetary policy and the finance of the budget deficit with the National Bank. Besides, the president and vice president of the National Bank are appointed by the president of the Hungarian Republic. The directors of the Board of Supervision are appointed by Parliament.

The National Bank is a share holding company under state ownership, but it is also "*quasi*" *public authority entitled with executive power*. That is, the National Bank has the rights to *pass decrees* which are obligatory for the commercial banks and which provide monetary regulations. The other executive task of the National Bank is the *supervision of the commercial banks* as to whether they operate according to the provisions of its decrees.

However the intervention of public administration began to prevail once more which *adversely affected the operation of the capital market*.

Although the Act limited the amount of credit to be given to the budget by the central bank, the budget can pressurize the central bank to issue government securities. So the *budget's financial demands still affect the capital market* and squeeze credit out of the commercial banks and increase inflation in the economy.

The *state monopoly* of banking activity was dissolved, and as a reaction, new banks were established, primarily by foreign investors.

The *Office of Banking Supervision* was established in 1991 under the Government's direction. The main function of the banking supervision is to *guarantee the interests of the investors*. The Office gives the *licences* needed for their establishment. Besides the technical, financial and personnel requirements, the Office has to investigate, whether the bank's business plan serves the interests of the investors.

The *supervision* of the Office is extended to the commercial bank's activity from the aspects of *legality* and *safety of investment*. The Office has the right to apply *several sanctions* in cases of abuse, such as to oblige the bank to take the necessary measures, impose fines, withdraw licences and relieve managers from their office.

*Obligatory privatization* was also legislated in order to decrease the scope of public administration in this sphere. But in reality an *opposite tendency* appears. The state owned credit banks made heavy losses partly because they had many unpayable claims in the state owned enterprises, and partly because of the old management. Therefore the state saved them from bankruptcy with an increase of capital subsidy and consolidation of credit. As a consequence, the *proportion of state ownership has increased* by 70% in the banking sphere.

The property rights were exercised by the State property Agency, and later by the Ministry of Finance. Obviously, these administrative organizations can not have business interests in the banks' activities which fed—among others—to banking scandals in many cases.

The *conclusion can be made that public administration can not assume many different divergent functions (supervisory, monetary and proprietary) at the same time*. The National Bank saves the state owned credit banks from bankruptcy with refinancing credits, and the Office of Banking Supervision performs a lenient supervisory activity over them. Furthermore, the National Bank determines high reserve rates for the credit bank's in order to balance the budget. Consequently, the saving of state enterprises from bankruptcy, hinders the proprietary state's monetary and supervisory functions. The state thus finds itself in a contradictory position.



## 4. Privatization of the Welfare Sector

### 4.1. *State-Responsibility in Welfare*

The provision of welfare services as a task for the state has been strongly influenced by the European welfare traditions. European governments continue to treat welfare services as activities that cannot be adequately supplied by the market alone and that must receive state subsidies. In recent years, however, U.S. policies have increasingly been based on the idea that only the market can assure the quality of welfare services and that the state therefore should incorporate market principles in welfare policy.

There is a persistent debate in the Continental European political literature on the question of whether American public administration, which is based on a public management approach, has established a new relationship between the public and private sectors and whether such approaches can be applied to law-governed European systems. This question is especially important in the field of welfare, because in Europe the *welfare rights of citizens* are specified in national constitutions and the welfare responsibilities of the state are detailed in public law.

Other pressing questions include whether the law-governed character of European public administration can provide adequate welfare services and whether such services will be maintained in the manner intended by law.

Western European theories traditionally have stressed that the *public interest* is better served when providing welfare services is accepted as a state responsibility. However, this has become somewhat muddy as a result of the neoliberal tendencies of the 1980s.

From a comparative viewpoint, the United States has provided only a minimum level of welfare service. The *individualist tradition* stresses equal opportunity. It is the responsibility of individuals to improve their situation by their own efforts. The Constitution declares political, not social or welfare, rights of citizens. The provision of welfare has been a matter of public policy, based on the needs and influence of different economic groups.

However, American culture has always had an aversion to centralized power. This has encouraged the establishment of voluntary and charitable organizations. In lieu of strict regulation, public policy often encourages private administration of welfare services with public oversight.

Excluding the Great Depression, U.S. social policy never intended to provide more than a few *governmentally administered welfare programs*. This follows the belief of many that poverty is in many ways the fault of the individual, not the result of social inequality. For this reason, social

welfare allocations are provided on a case-by-case basis for people in need. Awarding welfare is always based on discretion. It is the duty of clients to prove their financial condition warrants assistance. And provision of welfare allocations also depends on whether clients observe behavioral rules established by public authorities. With unemployment in the United States at relatively low levels in recent years, most Americans believe they should no longer finance welfare services for poor people.

Europeans view the American welfare system as *stigmatizing* because it does not focus on the social conditions that lead to poverty, but instead emphasizes treatment of the symptoms of those conditions. In Continental Europe, the public interest is the reason cited for the state's responsibility to shoulder welfare programs. *Social rights are mandated in many national constitutions.*

Distinctions between the welfare services of the public and private sectors are reflected in the differences between applied public and private law. *Under public law, welfare belongs to the public sector.* It aims to promote the poor, and the state must intervene to compensate for unequal market mechanisms. For this reason, European approaches regard the application of business principles in welfare services as inconsistent with the public interest.

#### 4.2. Privatization of Welfare Services

Conservative U.S. economic theory holds that because of the New Deal, public administration began shouldering more public tasks than it could effectively manage, thus interfering with economic development. In this view the principle of *free choice is violated*, because welfare services are provided by the state and not the marketplace.

This theory of privatization often is criticized in Europe, where it is widely held that providing welfare is fundamental to the public interest. In contrast to the U.S., European theories claim that there is justice in providing welfare services because these services are based on fair redistribution. In the European way of thinking, freedom means *recognition of social citizenship*, including the right of individuals to be protected from inequality brought about by the market. Welfare services based on market principles are regarded as being inconsistent with state responsibility.

However, American style privatization may not mean transferring welfare services entirely to the private sector. Instead it may mean shifting to a so-called "*regulated market*" where government maintains the responsibility but it can assign the operation of welfare services to private enterprise. Social policy is also expressed in the U.S. by other means, such as subsidies

and vouchers. In American government redistribution of wealth is contrary to market mechanisms. Rather, individuals in society should accept responsibility for their own welfare.

Free choice and efficiency due to competition reduces costs and encourages partnerships between the private and public sectors.

The European approach attempts to maintain a boundary between the two sectors. But once privatization emerges, the dichotomy of public-private law was no longer clear. The public interest that earlier determined what kinds of welfare services the state should provide has now become a vague, intractably political principle.

Under U.S. policy, public administration's role is to maintain the *quality of welfare services*. When non-competition is unavoidable, government must regulate the price of services. For example, institutions for the homeless cannot be easily shifted to a competitive environment or performed on a fee basis. Government must exercise near or at least distant control over quality and costs.

In the United States, some welfare services have been privatized by *contracting out*. When a fee cannot be charged for a particular welfare service (as is the case for services for drug addicts), the public authority often assists non-profit enterprises in providing services. While competition is often not possible in these fields, costs can be reduced by contracting for the best quality service at the lowest cost.

U.S. privatization occurs if the enterprise providing the welfare service is a profit or non-profit organization operating under market conditions. Free-of-charge services are regarded as impractical, because only fees can assure reasonable consumption. Direct assistance to the needy provided by vouchers enable the exercise of choice and at the same time provides benefits to individuals who are in need.

Typically, European approaches do not embrace this form of privatization. Vouchers are issued directly by public authorities. Privatization of welfare to non-profit (and for profit organizations) is rare. Moreover, this approach is not likely to displace centralized state systems.

Many Americans consider nonprofit organizations to be more reliable than for-profit businesses, especially when customers cannot judge and choose the quality of service. Further, where these organizations operate in a competitive environment, public authorities can reduce price supervision over them.

Consumers of *nonprofit* services can benefit from advantages such as flexibility, autonomy, customer-oriented services, and satisfaction of special needs. These public-nonprofit partnerships meet the requirements of the American public. But there are those in the United States who fear that

nonprofit organizations risk losing their identities as their quasi-state role expands.

The U.S. practice of incorporating competition in providing welfare services could well serve as a model for Europe. The state's role in providing welfare services continues to be dominated by a monopolistic, centralized system.

#### *4.3. Privatizing Welfare Services in Hungary*

In Hungary since the demise of Communism, welfare has been provided by both the public and the private sector. There is a tangible movement toward *withdrawal of the state from welfare services*. But this drawback is occurring without benefit of either well-defined political concepts or elaborated theory. The "public interest" in welfare must be redefined.

The question is as to whether change in the welfare systems in Hungary since the transitions are more heavily influenced by American or Western European traditions? Is the central challenge to welfare systems meeting legal requirements, or is it to provide a loose safety net? Moreover, with constitutional and administrative regulations emphasizing that the state has a high-level responsibility to support welfare, how can the withdrawal of political support and funding for welfare be justified from a legal standpoint?

During the Communist era, welfare in Hungary served as part of the wealth redistribution system of the state-controlled economy. The Communist state *assured the welfare of citizens* by dictating how certain goods and services were provided to the general population. Not only were welfare services provided free of charge, but below-market prices for goods such as flats, foods, and utility services were established and subsidized by the central government.

Communist budgets served the interests of production more directly than the interest of welfare. For example, they often subsidize money-losing state-owned enterprises. Until the 1960s, the so-called "*bureaucratic redistribution*" 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 1990 transition, a small portion of the society became wealthy but most became poorer and poorer. This special market produced a new entrepreneurial class that have 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, and utilities under Communism has disappeared.

With the privatization of state-owned enterprises and creation of open market institutions in the post-Communist era, a “*gray economy*” prevails and the state budget is under great pressure. The percentage of the state budget devoted to welfare is higher in post-Communist countries than in developed Western nations. The political elite and “new rich” argue that welfare costs shouldered by the state in the former Communist regimes are far beyond the state’s ability to pay for them. These circumstances have forced the state to further withdraw from many welfare services. As a result, the current system can be viewed as a mechanism for maintaining a permanent economic underclass. Social policy continues to reflect the interests of the new political and entrepreneurial elite, whose members are economically independent from the state welfare system and are not interested in addressing the growing poverty which could eventually jeopardize their own economic success.

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, further encourages people to avoid paying them.

The consequences of fiscal duress are well illustrated in Hungary, where the *contradiction* between, on one hand, the constitutional requirements regarding social rights and, on the other, major reductions in welfare services has resulted in legal challenges in the Constitutional Court. The Court has been forced to interpret welfare rights within the framework of today’s more restrictive financial reality. As a result, it has enabled the legal reduction of welfare services. There was an attempt to amend the Constitution to eliminate some mandated welfare requirements. However, this attempt failed.

Although laws in the post-Communist countries still emphasize the state’s responsibility, this tendency by the state to withdraw from welfare services is increasing. The sharp difference between legal requirements and reality in Hungary and other post-Communist countries would be better served by administrative innovation and adaptation rather than intervention by the court.

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. However, the “premature welfare state” theory misinterprets “non-intervention.” Non-intervention does not mean the radical withdrawal of the state from welfare.

Hungary has attempted to decentralize and privatize social welfare services in order to modernize the system. But replacement of state-welfare services by so-called self-organizing institutions has not taken place; instead, serious deterioration of welfare services has occurred.

Welfare privatization in Hungary has been fairly limited. The private sector is not sufficiently developed to allow the state to withdraw from providing welfare services. Due to a lack of state funding, few, if any, welfare services have been shifted to nonprofit organizations. 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 welfare services. In the wake of transition, social policy depending on privatization is not an attractive proposition for the near future.

## **5. Privatizing Health Care**

### *5.1. Privatization Policies in Health Care*

The aim of this chapter is to introduce privatization concepts of health care from a comparative approach. Privatization issues of Hungarian health care will be examined in the post-communist political-administrative environment. The paper will also briefly look at some principles and trends in the privatization of health care in the US and Western Europe.

Health care in Western Europe has been provided in the public sector as an important public service. Even in the US, where the provision of health care is largely based on private participation in a competitive environment, the government plays an important regulatory role.

More examples can be mentioned as to how traditions of public administration have affected reforms in health care. Reforms aimed at establishing general access to health care in the US failed. Such health care reform would require a central health authority, which is not realistic in the decentralized, business-oriented US public administration. Any national health insurance system, based on citizens’ mandatory contribution, would limit customer choice and increase taxes in the US. The European practice of public financing of health care is inconsistent with American traditions.

The privatization of health care is unlikely to alter public finance systems in Europe. This is because authorities have to respect health services as a universal constitutional right when organizing health care. Instead, reduced subsidization and increased cost sharing, as a result of privatization, signals state withdrawal from health care. The privatization of health care has not always resulted in an extension of market mechanisms in Europe, but heavier state intervention and regulation. The aforementioned limitations of privatization are closely related to the nature of the centralized and law-governed European public administrations.

Several variations of market mechanisms vs. state regulations have developed in health care. Health care is probably the area of the economy in which public vs. private elements in finance, regulation and services have interwoven in the most complex way. Privatization in the widest sense means reduction of the public sector, but several forms of privatization can take place in practical reality.

Health care in the US, similar to other services, is a business activity, and privatization policies aim to achieve even more efficient health services by using business principles. Health care services in the Scandinavian countries, as opposed to the American practice, are provided by the state based on social welfare principles.

It is important to define the public purpose which privatization policy has to follow in health care, as privatization will determine the roles of the state, market and civil sectors.

While the possibilities and limitations of privatization in health care are clearly seen in developed western countries, privatization is an unpredictable issue in post-communist Europe. The need for privatizing health care is evident, but it is difficult to predict exactly which kind of health care model may evolve in these countries.

*Hungary* has created a public law system based on the continental European model, but bureaucratic administrative traditions from the communist state remain. The premise of this chapter is that these *communist attitudes have effected health care reforms and developed a different form of practice for privatization than in Western Europe*. For this reason, health care reforms in Hungary are fairly vague.

## 5.2. *Public Interest in Health Care*

European health care policies have followed two main areas of public interest since the 2nd World War, named *solidarity* and *efficiency*.

*Solidarity* means that services are available for all citizens and contribution to health care should be proportional to their income. This is a main principle of health care everywhere in Europe.

National governments are obliged by federal laws to provide free health services for poor and elderly people in the US. Medicare and Medicaid obviously represent welfare issues, but are exceptional, rather than a general commitment on the part of the government. Solidarity has not developed in the individualistic American society. The ideology of customer choice represents the interest of the American middle class which can obtain health services at market prices, but is unwilling to contribute to health care for the poor.

*Efficiency* in health care in the widest sense means that funds generated for health care should provide the best outcome, such as quality of services, customer satisfaction, health conditions for the population, etc. It also includes the improvement of other factors outside health care, such as preventive programs.

American theories, not accidentally, have established a most differentiated way of efficiency and effectiveness in health care. This is due to American administrative traditions. Not only health care, but all public administration has always been based on business principles in the US.

The privatization policy in Europe was expected to assure more efficient health services from reduced financial resources. Privatization of health care did not merely mean withdrawal of the state, but an increase in the role of market mechanisms, such as competition, deregulation, additional private insurance, etc. This way of privatization is called “regulated market” in health care.

Opportunities for privatization are limited in European health care. Solidarity has been protected by constitutional regulations as citizens’ universal right to health services. Regulated prices or bureaucratic financial rules still prevail here, due to the requirement of global cost containment in public finance, too.

Privatization practices in Europe cannot evidently prove that privatization has resulted in greater economic efficiency in health care, or just transformed financial resources by altering contributions.

The most important difference between a regulated or free market in health care is the public and private character of the finance system. The percentage of public finance is low in American health care (only Medicare and Medicaid) but dominant in Europe. Only one example can be mentioned as to regulation limiting market mechanisms in the US: the regulated prices of Medicare



and Medicaid. Due to the influence of the medical business lobby, the requirement of global cost containment has less relevance there than in Europe.

*Privatizing health care is problematic in Hungary, because neither solidarity nor efficiency can be enforced.*

The Hungarian Constitution declares that everybody has the right to the best health care which should be guaranteed by the state through its health care system. This kind of regulation obviously contradicts the increased state withdrawal from health care: universal access to health care is still guaranteed by law, but provision is inadequate. The sharp difference between constitutional regulation and practical reality is a basic characteristic of the so-called "premature welfare state".

*Redistribution that has recently developed in the Hungarian health care system does not insure reasonable contribution from citizens to the health services.*

Theoretically, national health insurance is an insurance-based system, which means that citizens have to contribute after their incomes. National health insurance in fact assures the universal right of health care to citizens. So, the costs of the health care of the growing number of unemployed and pensioners should be financed by citizens' contributions.

At the same time, the budget for national health insurance has been decreased by half in the last ten years, due to the lack of proportionate sharing in contributions. Business associations are unwilling to pay contributions to health care, and can successfully avoid doing so. Wealthier people can afford private health-care services, or pay under-the-table money for better state health services.

People with lower incomes, such as civil servants and the employed, contribute the most to the budget of the national health insurance. As a result, the percentage of private finance is increasing, but *public finance is proportionally* decreasing in the total cost of health care.

According to general opinion, increasing contribution of citizens to health care is not realistic in the current system. Additional Financial resources could be drawn in the following way: a) Imposing tax on unhealthy products, such as alcohol, tobacco, etc., and transferring it to health care. b) Establishing additional health insurance using private insurance companies. c) Compulsory co-payment for health services d) Selling state/local government owned health institutions.

No single government has to date made any plan for drawing financial resources from anything other than citizens' contributions.

*Greater economic efficiency of health care has not been achieved in Hungary, either.* This is especially difficult because many bureaucratic

features of the former economic administrative system still prevail, and have led to a waste of the decreasing financial resources for health care.

Health care under communism was funded from the state budget in a bureaucratic, centralized system. The funding of various health services was determined by political decisions. The provision of health services was a state monopoly and health care institutions were owned and closely controlled by the state. As in the case of state enterprises, health care institutions were financed by the state, no matter how inefficient they were. Informal bargains between politicians and the directors of health care institutions determined how financial resources were transferred to health care.

Many think that the failures of the health care system are caused by the influence of bureaucratic coordination and an unregulated market. Alongside the existing bureaucratic coordination, there has developed an unregulated market, such as the pharmaceutical and medical equipment industry, private clinics, etc. The government controls the health system by traditional bureaucratic means, or lets it remain uncontrolled.

### *5.3. Health Care Policies in the Politico-Administrative Environment*

Health care policy in *Western Europe* is determined by political consensus. In other words, ad hoc or regular organizations representing several groups of health care, such as health authorities, providers, patients, etc., are established to negotiate health care policy. Health care policy in Europe means no more than an informal consensus-based political decision that should be regulated by laws. Political decisions on health care reforms are made in a democratic way, although the public administration system entrusted to regulate them has been centralized.

*The Americans* are adverse to any centralized power, and believe that only decentralized public administration and a wide civil sector can guarantee democracy. Health care matters are not extensively regulated by public laws there. Neither federal nor state laws determine accountability for health departments with regard to health services, with only a few exceptions, such as AIDS, health care for the poor, etc. Public laws deal with the quality of health services or other technical issues, but typically do not determine tasks for health authorities.

In the absence of intense legal regulations, nonprofit organizations in the US have more freedom to influence health care policy. This is also due to the traditions of self-governance. The lobby (pressure group), for example a medical association, is a kind of nonprofit organization which represents an interest group. Lobbies are not informal, but legally regulated and registered

organizations in the US. Lobbying activities are a most important guarantee to American democracy.

Nonprofit organizations are in no way limited to deal with public matters in the US. This is because there are no public issues that only public authorities are entitled to deal with. Consequently, health care policy is primarily developed by nonprofit organizations, rather than government authorities. Health care policy, similar to other public policies in the US, is in fact an applied practice.

*The Hungarian government has not yet established a clear health care policy.* Instead, it is left to day-to-day political goals as to how health care issues are regulated. Steps toward health care reforms that have been seen during the last ten years can be concluded only on the basis of legal rules, not on health care policy, because government decisions on health care are often kept in secret, and made behind the scenes.

The process of legislation is governed by law in Hungary. It is the task of the Ministry of Health Care to elaborate a proposal for laws on health care. The minister who is accountable for the operation of the ministry is appointed by, and can be recalled by, the prime minister. Acts on health care are passed by the Parliament, where political parties in power have a majority. Therefore, both the preferences of the minister of health care and the strongest political party currently in power prevail, when health care issues are enacted.

There are “checks and balances” in the legislation, with varying degrees of impact. The president of the Hungarian Republic has not exercised his right to veto when it comes to health care issues, but more acts on health care have been attacked before the Constitutional Court. The Constitutional Court has refused to decide in those cases where health care policy was debated.

Health care pressure groups also influence legislation. Government is legally obliged to withdraw representative organizations from the codification of health care. However, laws do not state clearly which lobbies (consultative, opinionative, etc.) should be withdrawn, nor how to do so.

Under communism, representative organizations were established by state order. The role of these “artificial” representative organizations was to demonstrate to the public that the communist state was democratic. This type of tradition still prevails when government authorities do not take pressure groups’ opinions into account and consider that only the government is competent to make important decisions. Government authorities often violate acts in the process of legislation, wherein they exclude publicity and arrive at informal political bargains.

Health care is declared by law to be a public issue which only government authorities can deal with. The state is accountable for providing

health care. Health care policy, however, should be based on a consensus between both state and civil sectors, including physicians, citizens, health employees, etc. Only a consensus-based health care policy has any chance of modernizing health care.

Lacking consensus, inadequate government decisions are implemented regarding health care. This is generally because government authorities cannot represent public interests in health care, such as solidarity and efficiency; rather, these authorities reflect the personal interests of their leaders. Political parties in power choose to share the benefits of privatization through means of corruption and via the acquisition of the property of health care institutions.

The modernization of health care, on the other hand, would hurt the interests of certain social groups, and not result in any political benefit for the government. Business firms, for example, which share extra profits with the management of health institutions for providing diagnostic services and senior physicians, who receive most of the under-the-table money from patients, are interested in maintaining the status quo, but manifestly have no interest in modernizing. The public would most likely be against additional health insurance, seeing as people would see an increasingly narrower state health services in such a reform.

#### *5.4. Efficiency of Health Care in Developed Countries*

It is well-known that health care providers are interested in extending services in order to achieve higher income. Customers do not have enough information to judge if health services are really necessary. This is called “asymmetrical information” in the market relations of health care. Not only are health services typified by “asymmetrical information,” but as being healthy is the most important value for individuals, demand for health services is less limited than that for other goods.

All financial regulations *in Europe* which have tried to limit the costs of health services at the level of health care providers, while assuring the quality of services, have failed. All of the applied incentives have disadvantages. The system of “global budgeting” encourages providers to provide less service, but does not guarantee quality. Providers are interested in serving more patients in the “fee-for-service” or “day system”. The most widespread method is the DRG (Diagnosis-related groups) system, which incites efficient service, but only in the case of one patient, not many.

Insurance companies in the *American* private insurance system can transfer higher costs to customers by increasing insurance fees, although competition between insurance companies forces them to be prudent. The

price for health services and insurance is stipulated by contracting parties, such as health care providers, insurance companies and patients. Only the prices of Medicare and Medicaid are regulated in the US.

Transferring higher costs to customers is not possible in the European publicly financed system, because the measure of contributions to health care is determined by law. Therefore, financial rules must meet the requirements of global cost containment. In case of loss, the state subsidizes health care from the state budget, rather than increasing contributions from citizens. Such a subsidy is not well received by the economic policy.

American health insurance companies control the costs of providers by using differentiated means for cost-effectiveness. Cost-effectiveness is enforced by competition between health providers, customers and insurance companies. There is a belief in the US that only market mechanisms, such as competition, private ownership and profit-motive, can enforce the quality and efficiency of services. Regulated prices and transfer of capacity are the rule in European publicly financed systems.

Health providers, both for- and nonprofit, are interested in profit in the US, although in a different way. Communities often establish nonprofit hospitals. The nonprofit character of hospitals has a different meaning than in Europe. Nonprofit hospitals in Europe can not pursue business-like activities, nor make a profit. Nonprofit hospitals are normally financed by the state or the national health insurance plan so that social welfare issues in the provision of health services can be maintained.

The community, as the owner of nonprofit hospitals, can not directly share in the profits, but can generate it for publicly beneficial investments. Nonprofit hospitals in the US are a special legal form of business associations. Nonprofit hospitals in the European sense are exceptional in the US, because they are thought to be inefficient, and a waste of taxpayers' money. Scandinavian examples, on the other hand, show that state-owned health institutions can provide efficient and high-quality services.

According to American practice, health services are one of the most marketable services. Only the technical requirements of health services should be regulated by laws. According to American privatization theories, European governments provide services as public goods, because these services are thought so important for the public that the government guarantees them, regardless of whether consumers can pay for them or not. These services are directly provided by public-owned institutions or simply subsidized by central or local government authorities. Demand for these services necessarily increases due to the low price, which leads to a waste of financial resources.

However, Europeans consider the American health care inefficient in terms of insufficient global cost containment. Americans argue that the reason why the US spends a higher proportion of GDP for health care is not the ineffective provision of health care, but a better quality of service based on a higher level of medical techniques and research. Higher global costs of health care are also a result of customer choice. In the US, the customer decides how much to spend on health care.

### *5.5. Spontaneous and Regulated Privatization in Hungary*

*Spontaneous* privatization of health care happens when local governments, without any relevant legal regulations, initiate privatization of their health institutions. When *privatization is regulated*, legal rules, determining basic principles and requirements, serve as a framework for privatization.

Health institutions were under state ownership during communism, but at the beginning of the 1990s they were handed over to local governments. Local governments, with few exceptions, such as national clinics and medical universities, own health institutions in Hungary.

Constitutions declare general state-accountability for health care, but it is the responsibility of local governments to provide health services in their administrative areas. Financial resources for this task are assured by the state budget, but not at the necessary level.

Health institutions operate in a dual financial system: local governments are obligated by law to provide the building and medical equipment for their health institutions, but the national health insurance finances services in a DRG system. Financial laws do not say in what manner local governments have to maintain the building of the clinic and assure medical equipment. Local government can not afford to pay much for their health institutions.

Local governments are entitled by the act on local government to decide important issues of their health institutions. These rights of local governments, like the rights to autonomy and ownership, are protected by the Constitution, as well. Actually, it is the right of local governments to sell, lease, or transform their health institutions into business associations. *Any proposal for acts on privatizing health care can not violate these constitutional rights.*

All physicians were public servants before 1990. Laws entitled family doctors to provide primary health services in the form of business associations. Local governments must contract with them to supervise their activity from the point of view of continuity and general availability of services.

*Family doctors legally received the right to praxis in 2000.* Right to praxis is an exclusive right to provide primary health services in a given area determined by the local government. The owner of the right to praxis can sell and inherit his or her praxis. Family doctors often buy the clinic and medical equipment from the local government, too. Privatization of the primary health system has almost been completed in Hungary.

*Spontaneous privatization has to some extent taken place in the secondary health care system.* Private firms have invested in medical diagnostic equipment and own and operate them in health institutions. Due to their lobbying activity, national health insurance finances diagnostic services to such a high level that extra profit can be achieved. Paradoxically, health institutions are often loss-making and close to bankruptcy, thanks to the insufficient finances of the national health insurance and the poor maintenance of local governments.

Another way for spontaneous privatization of the secondary health system is when local government gives the right of operation to a private firm. The private firm will have the right to buy or use the property, such as the building and medical equipment, and to reorganize health institutions. This kind of privatization can theoretically be justified with better professional skills on the part of the private firm which can operate health institutions more efficiently than the bureaucratic local government authorities.

The practical reality shows that in most cases members of the political elite are the beneficiaries of this kind of privatization. Local governments are not required by law to invite a tender open to the public. There are no professional or other requirements for privatization, either.

*Neither quality nor efficiency of services can be guaranteed, nor can the accountability of local governments be enforced in this system.* The private firm can not be controlled if it generates financial resources of its own, but not for public benefit. This path to privatization can *easily become the hotbed of corruption, as well.*

*Privatization of secondary health care systems should be regulated by laws.* Legal regulations have to define some principles of privatization, such as *democracy* and *legacy*, in order to guarantee incentives for better quality and efficiency.

### 5.6. *Efficiency in Hungarian Health Care*

It is generally accepted in continental Europe that national health insurance can serve efficiency better than if health care is financed from the state budget. The reason is that 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 and owns the funds, than if it is up to day-to-day political decisions as to how health care will be financed from the state budget.

Continental European countries traditionally organize health care by national health insurance. Funding of the national health insurance is collected from the compulsory contributions of citizens. The contribution is proportional to income, which serves social policy. (Wealthier people pay the costs of the poor and the chronically ill.) Health care provision is equal in national health insurance, regardless of contribution.

When national health insurance (NHI) was established in 1990 in Hungary, it was thought to be a step toward a more efficient health system. However, the government's idea was to shake off responsibility for health care as the most problematic area of welfare. It could be seen at that time that the income of the health care budget would decrease due to the black economy. The recent government centralized the NHI fund under government control again in 1998.

The NHI was governed by a body represented by government authorities, health care providers and customers, and lost its right to determine its financial issues in 1998. Instead, it is the right of the government to make important decisions about the fund of the national health insurance. The NHI is actually a part of the state budget in the recent system. Losses of the NHI can be compensated from the state budget, as well.

We can see that the government has a conflict of interest when the NHI is formally separate from the state budget, while the government still maintains control by keeping the right to determine its budget. The fund of the NHI is decreasing and wasted, due to the insufficient finance system. It does not serve efficiency, either, if the state subsidizes the losses of the NHI. The government keeps the right in this way to make a cost/benefit trade-off, depending on the current political situation.

Laws determine 20 sub-areas of the health care budget, such as operational costs, medicine, primary and secondary health care, etc. The Ministry of Health Care calculates how many hospital-beds can be financed in each county. Then the Office of the NHI makes an agreement on bed-capacity in each county. These agreements are in fact administrative decisions made by the Office of the NHI. The Office of the NHI is a public authority, not a purchaser, when it comes to distributing capacity, which circumstance basically determines these agreements.

*The current health finance system is still characterized by a communist-type planned economy, wherein a central plan has been broken down into a number of steps to a group of state enterprises.*



It would serve economic efficiency, if, instead of a public authority, the legal form of the national health insurance were either regional not-for-profit companies, or business associations in the country. It would be important to transfer capacities to these insurance companies so that they as purchasers could buy health services in a finance system based on financial incentives, and sufficient quality control. Health care providers would sell their health services, and compete both for financial resources and patients.

*Health care providers, similarly to the former state enterprises, are still not entitled to make their own economic decisions, such as investments, making and using profit.*

Local governments, as the owners of health care institutions, can afford to spend much on maintaining buildings and buying medical equipment. Health care providers sell their health services in a market, where the Office of NHI is in a monopoly position and prices are regulated to be low, due to the pressure of the state budget. Furthermore, health care providers are purchasers when buying medicine at market prices. The pharmaceutical and medical equipment industries having been privatized and deregulated, charge monopoly prices.

Health care providers are forced to broaden their services in order to avoid bankruptcy. The Office of NHI is not sufficiently interested in checking these exaggerated services. The more services are provided on global level, the lower prices will be determined to be by the Office of NHI. Paradoxically, those health institutions that provide adequate services are operating at a loss.

*This tendency does not serve efficiency on the global level but is instead a waste of financial resources.*

Incentives should promote the requirement for "service on an adequate level." It is a general tendency in the Hungarian health system that physicians treat patients in hospitals, even if it is not necessary, so that hospitals receive a higher income, and physicians more under-the-table money. The requirement of "service on an adequate level" can be achieved by dividing in- and outpatient systems. Physicians will be interested in treating patients in an outpatient system if they get the right to praxis and finance in a DRG system.

Health institutions would undoubtedly be more efficient were they to operate in the traditional business manner. Business is regulated by corporate law in a refined way so that sufficient economic decisions and financial accountability can be assured. Health institutions are closely controlled by local government. Limiting the autonomy of health institutions does not aid in rational economic activity. Health institutions should compete for financial resources in a system that allows the national health insurance scheme to buy higher quality, more efficient services.