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Editors

Public and Social Services in Europe

From Public and Municipal to Private Sector
Provision

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From Municipalisation to Centralism: Changes to Local Public Service Delivery in Hungary

Tamás M. Horváth

13.1 INTRODUCTION

Over the last quarter of a century the system of local government in Hungary has passed through several phases, from ‘Goulash communism’, through radical system change, to crises and ‘illiberal democracy’. A cross-sector analysis of developments in Hungary may provide a relatively extreme example of recent trends in the development of local government and local services in Europe; countries are trying to implement clearly defined models, notwithstanding the obstacles they encounter. The basic research¹ underpinning this study is intended to provide a more or less complete account of developments in management of local services including public works and social services.

This chapter offers an account of policy in various sectors based on central and eastern European research on transition (Baldersheim et al. 1996). It also follows explanatory studies of the collapse of state communism and crisis studies (Hajnal 2014; Hajnal and Rosta 2014) of the

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recent turn in the development of the country. Additionally, it offers a special assessment of remunicipalisation (Hall 2012; Pigeon et al. 2012; Water Remunicipalisation Tracker 2013) and the re-emergence of municipal corporations (Wollmann and Marcou 2010).

13.2 STARTING CONDITIONS (PERIOD TO THE LATE 1980s)

During the 40 years of communist the state had a monopoly on the provision of public utilities and communal services in Hungary. Large national, urban or county council monopoly enterprises fulfilled these functions. The state operated utility services through public utility companies, which it both owned and ran (at national level for electricity; typically at regional level for water and sewage services and at local council level for solid waste services, district heating, park maintenance and public cleaning services). These firms had independent budgets. Council budgets contained only subsidies for their companies; however, public utility companies were under the strict control of the territorial committees of the Communist party, in the same way that local councils were. In this way, the administrative party hierarchy brought about the integration of communal political will.

Personal public services were provided by local budgetary institutions whose income and expenditure were incorporated into the local budget. The whole system was centrally financed. All citizens had a right to free education and healthcare; however, users had to pay after additional services. The relatively low prices led to excessive demand and permanent shortages at several levels of provision. Local responsibilities for primary and secondary education and healthcare were wide-ranging. Social care services, especially personal care services, were paid by the social security until 1984, after which they were centralised by the state administration. Local councils were involved in the administration of care for the elderly and childcare as they maintained the institutions providing these services. At the end of the 1980s there was a series of economic and political crises. In Hungary, in contrast with most eastern and central European countries (Horváth 2007), there was no distinction between political municipalisation and functional municipalisation during this period. The first free local elections were linked to the establishment of a genuinely new system of local self-government. Municipalities were handed much wider responsibilities and a new financial mechanism was established.

13.3 SYSTEM CHANGE (EARLY 1990s)

The new Local Government Act was one of the first laws passed by the freely elected parliament. Municipalities were given responsibility for a fairly wide range of services. Infrastructure services—the provision of drinking water, public lighting, solid waste management, the maintenance of roads and cemeteries—became an exclusively local responsibility. Urban local bodies were also made responsible for public transport, sewer systems and district heating. Municipalities were also made responsible for kindergarten education, primary education, basic healthcare and basic social services for the elderly. Cities had additional responsibilities, namely for secondary schools, basic hospitals and specified care homes for the elderly. The legal solution of discharging tasks ensured the equality of settlements. However, in spite of the fragmentation of small settlements, their functions were very wide and expensive. Initially budget instruments were to follow the breakdown of responsibilities stemming from the discharging of tasks.

At the same time there was a radical privatisation in the production and services sectors, led by the State Property Agency. The role of the counties was reduced significantly and most county-owned companies were sold to private investors.

In the 1990s various international programmes (PHARE, USAID, British Know How Fund, World Bank programmes, Soros Foundations OSI, and pre-accession EU support programmes such as ISPA and SAPARD) focused on the development of democracy or the provision of public services at the local level (Horváth 2007) were implemented. For instance, a countrywide network of integrated landfill sites for solid waste was established with the support of USAID and ISPA.

The transformation of the utility sector (Fleischer 1993) began in the early 1990s. The first step was the restructuring of state monopolies. This meant that the companies providing monopoly services were audited then transferred from state ownership to local government ownership. At this point the former budgetary companies were transformed; they were made subject to company law although all their shares remained the property of municipalities. At this stage there was also a division of assets; some were sold (fully privatised), but in some cases it was considered more beneficial to retain them in public ownership and in these cases a minority stake would be sold (partially privatised), or the asset would remain wholly publicly owned.

In Hungary there was extensive fragmentation of former state-owned water companies. During 1991-1992 around 400 local government service organisations and five state-owned regional companies replaced the previous five national and 28 regional companies. In contrast solid waste management services were integrated on a scale which produced entities capable of operating services economically. In the case of district heating services, 290 local heat generation and distribution companies were transferred to 103 urban local governments (Horváth and Péteri 2004). The restructuring process included the establishment of semi-independent regulatory authorities for the energy sector (gas, electricity, district heating). In other services central state offices or municipalities were responsible for operational oversight and had some powers to regulate the prices charged to users.

There was a far-reaching decentralisation of personal public services. The main features of the process were as follows:

- (i) The role of the non-governmental organisation (NGO) sector in the provision of social services increased.
- (ii) Churches and private charitable organisations once again became providers of social care, secondary schools and to a lesser extent, initially, elementary schools.
- (iii) The terms of operation of state-owned and municipal institutions were also changed, allowing for the spread of sector-neutral financing and quasi-market practices.

After this preparatory phase the liberalisation process was extended and intensified. This phase started around the middle of the 1990s. In the public utility sector it led to privatisation. In the area of electricity, after restructuring the industry and service delivery relationships of ownership became different. It means that productivity, maintenance of the distribution network and service provision were divided. The Hungarian Electricity Board became a commercial company (MVM) but remained state-owned. Shares in the six regional electricity trade companies were sold to three big investors, the German companies RWE and E.on and the French company EDF. By law the state retained 25% of shares plus one vote in gas distribution companies. The Budapest Gas Works, traditionally linked to the capital, remained partially owned by the Budapest city government after the transition.

Personal public services, especially care for the elderly, were increasingly outsourced to not-for-profit organisations. There was a dramatic increase in the number of civil sector organisations during the transition; in 1997 there were 430 civil organisations per million inhabitants in Hungary; the Czech Republic had the second highest figure for the east-central European region, with 400 (Civic Atlas 1997).²

13.4 FURTHER TRANSITION (MID-1990s TO MID-2000s)

By the middle of the 1990s the transfer of state-owned core assets to local governments was complete. This was followed by two parallel developments. A proportion of the transformed companies were privatised. There were at least three good reasons behind the decision to seek to privatise public companies. Firstly, privately owned companies seemed to be more efficient than public sector organisations. Secondly, a price competition arose due to the privatisation tender (which includes consumers' pricing formulae for a longer time period). Thirdly, private providers became operators of that services for which local authorities were responsible. On the other hand, in the 1990s and 2000s large western European energy, water, and waste companies were ready to enter the newly open, regulated markets. In general, these companies acted in their own interests and ultimately their shareholders' interests. The whole EU pre-accession process very much supported this process.

Other companies were not privatised and the reasons for this 'failure' were varied. The most commonly mentioned main reasons for not pursuing privatisation were as follows: First, the fees paid by consumers did not cover costs, and subsidies were not defined clearly and normatively in advance. Second, privatisation would have involved selling the infrastructure as well as the right to operate the service. The strategy of separating maintenance of network infrastructure and operation of the service was intended to motivate service providers to improve efficiency. The companies which remained in public hands were nevertheless radically reorganised to improve their effectiveness and efficiency.

It is hard to say that high or low level of privatisation is concentrated on one type of service or another type. Indeed, the particular model depended on municipality policy. In the water sector different local governments pursued very different policies. Some of them even sold off core

local assets, such as pipe networks, whereas others retained ownership of infrastructure and regulated the activities of service providers, including setting prices. There are also cases where there was a shift in local strategy after the failure of privatisation. In the city of Szeged outsourcing of water supply initially led to dramatic increases in the cost to consumers creating a scandal, and the municipality was compelled to re-commission the service on a completely different basis. Under the new contract the service was much more tightly regulated by the municipality than it had been before.

13.5 THE EFFECT OF CRISES (2005–2010)

In 2005–2006 Hungary faced a severe financial crisis. Restrictions on overspending on social services became clearly visible to the public. Decentralisation of school maintenance for every settlement including the very small ones seemed to be unsustainable. Some hospitals operated by smaller town authorities had to be closed in spite of demonstrations by local residents. In addition although 63% of care homes for the elderly were maintained by local government institutions, 17% by churches and 20% by NGOs, the previous arrangements for sector-neutral financing and regulation were changed. Experts have been talking about the re-emergence of state dominance in service provision (Gyekiczky 2009) since this period. Budgetary institutions under state direction have been given exclusive contracts to deliver public services at the expense of NGOs and commercial bodies.

An approach to coping with the financial crises which was specific to larger, urban municipalities was the establishment of integrated institutions to provide personal public services. Similarly, municipally owned companies were reorganised as holding companies. Some remunicipalisation took place in the early stages of this period. The effect of financial crises was the integration of public service provision in order to save money.

From 2010 a clear trend towards greater public control over services was evident. First, larger municipalities and then the central government started to buy back shares in the privatised companies providing public services. The motivations for doing this were to control the increase in costs to service users directly and to limit investors' profits.

Municipal owners started to transform the companies that were still in public hands into multi-utility companies. Multi-utility holding companies were established from single utility-based municipal companies to exploit the potential for synergies. At the same time 'in-sourcing' emerged

as an alternative to the universal preference for outsourcing which had previously prevailed. This development was not independent of the changes in the EU legislation on the provision of general economic (and non-economic) services. The changes to municipal corporate governance which are occurring in Hungary (Grossi and Reichard 2008; Grossi and Thomason 2011) appear to be similar to increase municipal proportion in some of the other European countries. However, one difference is that the legal environment changed in a more radical way. The stages in the development of companies which were originally under municipal ownership are shown in Fig. 13.1.

At first, in Hungary the privatised public service providers tended to be owned by foreign investors, that is, western European groups of monopolistic providing companies, such as the German companies RWE, E.on, EnBW, the French companies GDF and EDF and the Italian company ENEL in the energy sector; RWE, BerlinWasser (German companies), SUEZ, Veolia (French companies) in the water sector and ASA (Austrian company) in waste services. There are crucial differences between remu-

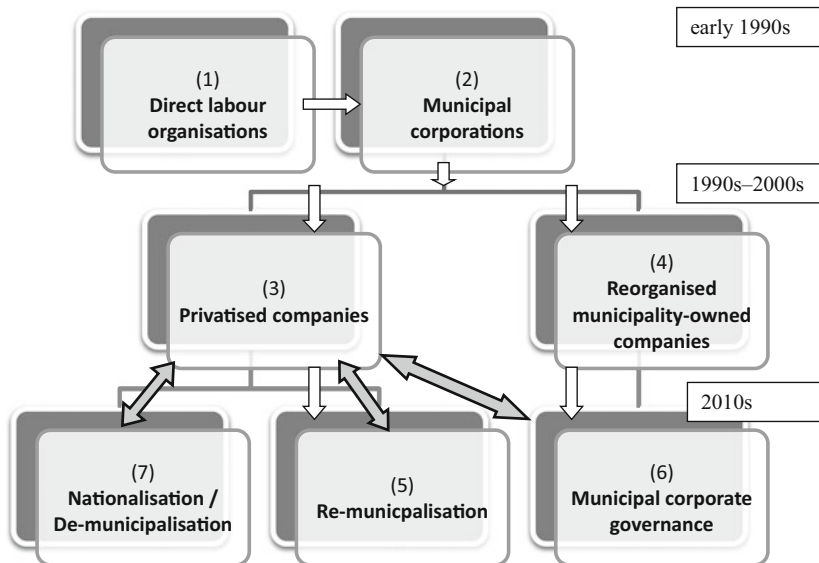


Fig. 13.1 Development scheme of municipality-owned companies in ECE (Source: Author)

nicipalisation and nationalisation. The Hungarian government from 2010 placed focused on the change of ownership structure. Developments in Hungary, which represent a rather extreme approach to addressing the challenges facing Europe, may illustrate the key challenges. The main characteristic of developments in the 2010s was the emergence of governmental opposition to privatisation. This is illustrated in Fig. 13.1 by bidirectional arrows (\Leftrightarrow).

13.6 AN ILLIBERAL TURN

A factor specific to Hungary is that in 2010 and 2014 national-conservatives won the elections, gaining a two-thirds majority in both the national parliament and most of the city assemblies. Prime Minister Viktor Orbán argued that private companies had abused their dominant position by overcharging for their services and stated that the conservative government wanted to buy back their shares. This was one of the key motivations for changing the political system (Hajnal 2014) and market relations, including public service provision. Paradoxically the national-conservative ideology includes a preference for state-centred solutions to all social and economic problems. The market-oriented strategy of previous governments shifted to a state-centred defence of what the national-conservatives considered the national interest.

The process of democratisation was restricted under the national-conservative government from 2010. The electoral system was changed at both national and local level in order to make it easier for governing parties to win a majority. The new regimes neglected the need for a balancing of powers. The majority of members of the constitutional court and ombudsmen were replaced. The judicial system was reorganised in order to fire leading judges. Quite a few of the laws passed were applied retrospectively.

A law was passed which fundamentally changed the constitutional settlement in Hungary and affected the institutions of liberal democracy. It was quickly amended on several occasions to suit the majority party. Power has been concentrated in the hands of the executive, by weakening the constitutional court and the ombudsmen and by firing the leaders of the higher courts throughout the country. Freedom of religion and the activities of non-historical churches have been restricted. Most of the results of the decentralisation that took place during the transition process have since been eliminated. According to Orbán, an ‘illiberal democracy’ is to

be established. The term was taken from a symposium in the July issue of the *Journal of Democracy* (Hajnal and Rosta 2014: 3). According to international observers this so-called ‘illiberal democracy’ is based on violations of the rule of law and basic democratic values (Tavares 2012).

The local government system has become extremely centralised. County government offices have been strengthened and newly established district offices are now subordinate to them. Some important public services are provided at this level, such as basic and secondary education. Maintenance of public schools used to be a municipal statutory obligation, but now it is not. There is in fact no mechanism of civil control over the education system. County governments have lost their remaining service-provision functions. The institutions which they used to maintain—social care homes, hospitals, and specialist schools—have been brought under central government control. Regional development has also been centralised. District administrative offices have taken over most of the bureaucratic work of mayors’ offices. By 1 January 2013 the average urban government had lost one-third of its public servants; these workers have become ‘state servants’ and the infrastructure and equipment they used (rooms, computers, office furniture) became central government property.

In general, central government plays a very active role in determining the economic framework for public utility service provision in Hungary. From 2010 onwards several measures were taken to centralise profits from the energy, water and waste sectors and other public utility sectors (funeral services, park maintenance, chimney-sweeping services). Providers are now burdened with a central tax levied on public utility networks. They are required to cut the prices charged to users and a new supervisory fee has been introduced to fund an administrative regulatory authority. Originally, municipal utilities were exempted from some of the taxes, but this is no longer the case and the financial burden on municipal utilities is now heavier.

Recent parliamentary acts relating to service provision clearly state that newly built infrastructure must become the property of municipalities or the state, although private companies may be given the right to operate services. It is central government policy to buy back shares in companies. However, the banks believe that the risks in these transactions are too high and they are reluctant to participate in such credit agreements. This means that in practice the municipalities have to pay, and hope to recover the cost from expected future profits. The cost of maintaining infrastructure should be covered from user charges although tariffs are set directly

by parliament and the government notwithstanding real cost calculation. National legislation has been crucial to remunicipalisation. The aim of the national government seems to be to transform public utilities into not-for-profit services. The role of municipalities in this process has not yet been determined.

13.7 CHANGES IN PUBLIC SERVICE PROVISION

For reasons specific to Hungary there is currently a movement by towns towards establishment of unified companies as municipal holdings in order to gain more direct power over the operation of public services and infrastructure. Although the early experiments with this model took place a relatively long time ago, their popularity increased after the recent period of international crises and especially under the present government. Today, corporations of this type are operating in half the large- and medium-sized cities. They are municipally owned conglomerates (holding companies) controlling diverse service-provision companies. Their governance structure belongs to one of two different types, strategic or operational holding companies, depending on activities and rights to influence. The governance structure also has implications for human resources, internal structure, and so on.

Does municipal corporate governance matter compared with remunicipalisation? Yes it does, because the former is an extended form of company governance for non-privatised local service providers. Its position was stabilised when it was granted exclusive rights to provide public services in a particular municipality or area.

In the second stage of the whole service management transformation process, central government started to take ownership of utility companies formerly owned by private investors or municipalities with the aim of establishing a huge, state-dominated, non-profit-making organisation to provide some of the public network service functions, such as waste management, central heating and gas and electricity services.

Centrally ordered cuts in tariffs for household energy, solid waste and similar services are about 25% on average. Direct regulation of user fees for utility services has been one of the key policies of the Orbán government. This popular policy (according to the government, it 'decreases the burdens on families') also became a central feature of the manifesto for the 2014 elections and was highly successful in winning support for the nationalist right-wing in the general EU and local elections.

13.8 ADMINISTRATIVE CHANGES IN THE DELIVERY OF WELFARE SERVICES

There was also administrative change in all the main fields of welfare provision in Hungary. Initially, a very decentralised system emerged following the transition from socialism. Since then signs of a gradual return to a more centralist, bureaucratic model of control have emerged, mainly due to under-funding. However, the centralisation of social care, education, and health in the 2010s also brought about radical changes at the level of the providing institutions. The contrast between the current regime and the regime of 1990 is extreme.

In social care services the decentralised model which emerged after 1990 meant that local governments had wide responsibilities in the fields of personal social care and social benefits. As a whole, of course, it was a mixed system. Social insurance and unemployment benefits were administered by centrally managed agencies. Municipalities were responsible for means-tested benefits, child protection and personal social care. In the 1990s a block grant system was introduced; this was later replaced by a model in which more and more funding was earmarked for specific purposes. The sphere of central government responsibilities was widened by the public administration reforms of 2011-2013. The use of earmarked grants has spread and this has reduced the role of alternative (non-state) forms of service delivery.

As Table 13.1 shows, the operation of residential care homes has been centralised since the beginning of 2012. The proportion of places managed by local governments decreased from two thirds to one third. Apart from the central government, churches, especially the so-called historic churches, were well placed to benefit from these reforms. Historic churches such as the Catholic and Protestant churches have better positions from the point of view of budgetary grants. Institutions managed by churches have an advantage over care homes managed by other providers. These rules were formalised in the electoral term which began in 2010.

Basic and secondary public education was transferred to the central government in Hungary at the beginning of 2013. A huge budgetary institution has been established to act as a maintenance centre for schools. Municipalities have lost their influence over schools. Schools operated and controlled by the central government have lost their organisational and budgetary independence; the school directors do not have influence over human resource management or economic rights. The central institution

Table 13.1 Places in residential care homes in Hungary, 2006–2012

<i>Operated by Year</i>	<i>Total [figure (%)]</i>	<i>Local government</i>	<i>Church</i>	<i>Non-profit</i>	<i>For- profit+others</i>	<i>Central government</i>
2006	87,479 (100%)	59,091 (68%)	9,078 (10%)	17,996	97+50	1,167
2008	89,771 (100%)	58,802 (66%)	12,167 (14%)	17,573	107	1,122
2011	93,079 (100%)	56,566 (61%)	16,916 (18%)	18,223	307	1,067 (1%)
2012	93,436 (100%)	30,720 (33%)	17,358 (19%)	18,278	217	26,863 (29%)

Source: Szilágyi (2014: 264), based on KSH (Central Statistics Office)

has a staff of around 130.000 (KLIK 2014) involving an overwhelming majority of teachers and other employees in state sector education. The maintenance of almost 3,000 schools has been centralised. Municipalities remain responsible for maintenance of buildings in schools with a catchment area population of over 3,000, but in smaller municipalities even this option is restricted. Of the non-state players only historic churches have increased their maintaining position from 21% of grammar schools in 2003 to 37% in 2013.

In 2012 specialist healthcare (inpatient, integrated outpatient, and independent outpatient specialist care) became a state responsibility. Legislation was passed making hospitals and outpatient care institutions owned by county governments and the healthcare institutions operated by the Budapest municipal government as property of the state. Then the state took over inpatient and outpatient specialist care institutions owned by municipal governments. Hospitals managed by the municipalities were also brought under a central administrative organisation in the same year. Only 12 out of 112 municipal and county hospitals remained as local budgetary institutions. The total number of hospitals in Hungary is 174. The official explanation for the reorganisation was a lack of financial resources. A model based on state-owned providers is expected to respond better to patients' needs and ensure that the healthcare system is financially sustainable. The original aim of the reforms was to manage patient pathways much more efficiently, something which has not been achieved yet.

13.9 CONCLUSION

Several policy initiatives currently being implemented in Europe are likely to result in remunicipalisation and municipal corporate governance. One is public (based on local democratic control and/or social control), the other is central administrative (bureaucratic). Figure 13.2 depicts the stages described in Sects. 13.5, 13.6 and 13.7, namely

- remunicipalisation: returning services to municipality control in a public or administrative, bureaucratic way;
- re-emergence of municipal corporations in a public or administrative, bureaucratic way.

The relatively extreme Hungarian case from 2010 means something special in this process, namely quite a strong campaign against private organisations being given responsibility for the provision of public services. It means not only sector policies, but direct political measures influencing the market of public utility services. Some of the measures which have been implemented in Hungary—specific taxes, central administrative regulation of prices and legislation to compel providers to cut

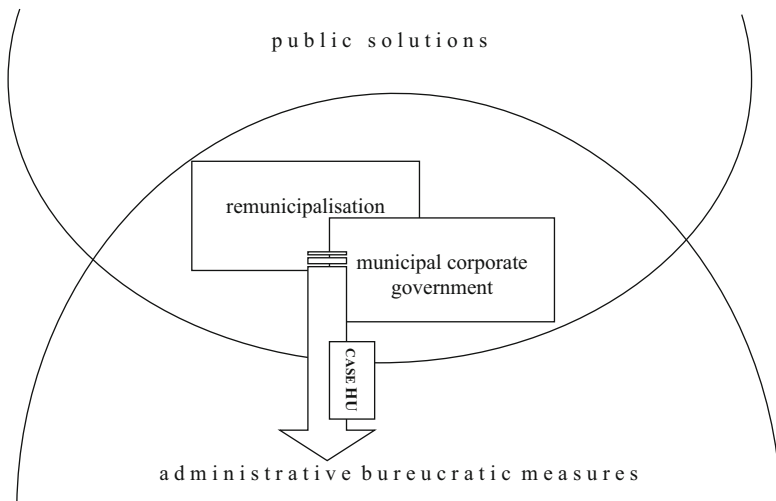


Fig. 13.2 Basic types of recent public service management initiative and their movement in the case of Hungary in 2010s (*Source:* Author)

prices—run completely counter to the regulatory principles and instruments permitted in a contemporary liberalised market. Developments in Hungary provide an example of overemphasis on administrative-bureaucratic problem-solving focused on de-municipalisation rather than simply remunicipalisation.

In summary, remunicipalisation (returning responsibility for service provision to public hands) and municipal corporate governance (municipalities hold a controlling stake in private provider companies) have both a public and a more administrative meaning. The Hungarian case represents an extreme example of particular interest-based voluntarism, because in Hungary there has been a move towards massive state intervention at the expense of public civic solutions. It is not yet clear what the final goal of the current policy is, whether there will be further nationalisation or directed re-privatisation. Very radical centralisation has taken place in Hungary, destroying the relatively liberal system of local government which was established in 1990. However, the motivation for this policy seems to be different in infrastructure services and personal social services. Developments in infrastructure services seem to have been determined mainly by economic factors, whereas the changes in education and social care were driven to a greater extent by ideology.

NOTES

1. In the framework of the MTA–DE Public Service Research Group. The study is also sponsored by project OTKA no. K 101147.
2. The corresponding figures for other European countries are 470 (Germany), 380 (Spain), 1070 (Austria), 1210 (France) and 1940 (Sweden).

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