

**Directorate for Financial, Fiscal and Enterprise Affairs  
Fiscal Affairs**

---

**Fiscal Design Across Levels of Government**

---

**The OECD 1999 Survey on Fiscal Design Across Levels of Government**

**Country Report: Hungary**

**Final**

*The Ministry of Finance, Hungary, has prepared the report by filling in a test questionnaire developed by Fiscal Affairs. The chapters in the report correspond directly to the questionnaire.*

*The FDI has funded the assistance from local experts.*



## TABLE OF CONTENTS

2. Public finance and its sub-systems. Classifications of levels of government.....	
2.1 Central Budget.....	
2.2 Segregated state funds.....	
2.3 Social security sub-system.....	
2.4 Structure of local governments. Duties and authorities.....	
3. Current expenditure.....	
3.1 Expenditure assignment – Actual status of the legal framework.....	
3.2 Gross current expenditure of the public finance system by subsystem and function.....	
3.3 Total expenditure by economic category.....	
3.4 Decision-making authority of local governments during the performance of duties .....	
3.5 Method of providing public services.....	
3.6 Macro-economic control of local governments, budgetary co-operation between government levels.....	
4. Tax revenue .....	
4.1 Classification of tax revenue at local governments - 1996 - (HUF millions).....	
4.2 Independence of local decision-making – tax administration and relation with central government.....	
5. Non-tax revenue.....	
5.1 Non-tax revenue by legal title of local government.....	
5.2 Non-tax revenues of local governments, by function, for 1996.....	
6. Local government current grants originating from the central budget.....	
6.1 Development of the grant system.....	
6.2 State contributions and grants.....	
7. Capital expenditure and capital revenue.....	
7.1 Capital expenditure, capital revenue and capital borrowing by local governments for 1996. ....	
7.2 Capital accounts of local governments by function, for 1996 .....	

## **2. Public finance and its sub-systems. Classifications of levels of government**

In Hungary, public finance is divided up into four sub-systems regarding both the public duties and the sources. The following sub-systems constitute public finance: central budget, social security, segregated funds, local governments.

Public finance is divided into central and local budgets, in which the individual levels possess relative independence, own revenue and expenditure.

The division between central and local budgets for public duties is based on the principle that each task must be allocated to the fiscal level where it can best be implemented. The fundamental criterion for this is that the performer of the task be as close to the affected population as possible. Political deliberations between the different levels of public finance of course influence the division of duties. The autonomy of local governments can be described as medium. The central or local allocation of authority necessary for the performance of the duty shall be presented in detail further on.

The management in the individual sub-systems of public finance must be pursued on an annual budgetary basis. The budget of the sub-systems is a financial plan or financial fund which contains the approved expenditure and the expected revenue for performing the tasks, during the period of validity, either as an estimate or as an estimate implementation. The budgetary year is the same as the calendar year. Every financial movement in the sub-systems must be accounted for, every item of revenue and expenditure forms part of their budget.

Separate acts prescribe the content and requirements of state duties. The sub-systems contribute to defined extents and in defined ways to their budget for the provision of state duties. The state duty related to the public finance sphere is performed by the state in part or in full through budgetary bodies, and directly or indirectly provides the financial cover for this, in part or in full.

### ***Data distributed at one level: local governments***

Under the Hungarian local government system, the community, county, and metropolitan governments differ in their **obligatory** tasks. Town governments with county rights constitute an exception in that they carry out obligatory county tasks within their own administrative areas.

As explained in the material, community governments can voluntarily perform tasks that are obligatory for county governments (high schools, vocational schools, student dormitories, social institutions, and hospitals). There is separate information on every local government in our information database. In principle, data is available on the expenditures and revenues of the functional approach for the two specific types of local government. That, however, would not cover the consolidated expenditures spent on the obligatory tasks of county and metropolitan governments and governments

Annex B - Country Report: Hungary  
of towns with county rights, as expenditures on such tasks are included among the expenditures of small town and even village governments. For this reason, data are not disaggregated further than the “local government” level.

## **2.1 Central Budget**

The central government budget constitutes the central level of public finance, except for the social security and its segregated state fund budgets which operate as separate sub-systems.

The central budget is divided into chapters. The budgetary chapter is the sum total of the estimates and bodies supervised, managed and supported independently from the point of view of budgetary planning, implementation and accounting.

Parliament creates an act on the central budget and its implementation. The budgetary act defines the fund budgets per fund, and the revenue and expenditure per legal title.

In the budgetary act, Parliament determines each local government’s share of the centrally regulated taxes and duties, the normative central budget contribution titles and amounts of the local governments and the local minority governments, the allocations, appropriated and other subsidies for the local governments and the local minority governments, as well as the allocation and payment system of grants due to the local minority governments, (net) financed including the obligations in respect of the public finance sub-systems.

## **2.2 Segregated state funds**

The segregated state fund is a fund financing certain state tasks, partly from sources outside public finance, which due to the nature of its operation, necessitates segregated financing within public finance.

A fund can be established by law for which the purpose, sources of revenue, sphere of feasible expenditure and the minister responsible for its utilisation must be determined. A fund can only be established if the sources outside public finance for providing the task can be prescribed for it, i.e. tax payments, penalties, contributions.

The fund can also obtain credit to be debited to future revenue. The sources of the fund can only be used for defined objectives. Companies and private individuals can also support the different funds on a voluntary basis – free from regular income tax and corporate tax.

The funds can perform economic tasks and can realise concrete public objectives, too. Today, in Hungary, there are two segregated state funds in operation: the Labour Market Fund and the Nuclear Fund.

## Annex B - Country Report: Hungary

### 2.3 *Social security sub-system*

The social security system constituting part of public finance is a compulsory insurance system for society based on mutual risk assumption, operating on insurance and solidarity principles. The budgets of the Superannuation Insurance Fund and the Health Insurance Fund constitute the sub-system of the public finance social security.

The social security sub-system finances and performs the obligatory tasks defined in the act on social security. Parliament creates an act on the budget for the social security financial funds and on its implementation.

The main source of revenue for social security is the contributions paid by employees and employers, which are payments in proportion to earnings. The employer deducts the contribution and pays it to the social security body. The state undertakes a guarantee for the social security services. In certain cases, the social security bodies carry out the payment of grants financed from the central budget. Social security also has capital revenue, the permanently or temporarily free liquid assets can be invested for the purpose of increasing the standard of services or for covering operational costs. In addition to this, in the event a company going bankrupt, social security can also receive a share of the assets distributed, in lieu of any unpaid employer contributions.

The main services of the social security are the following: old-age and disability pension, health care provision, sick pay, maternity and child-care benefit, and unemployment benefit.

### 2.4 *Structure of local governments. Duties and authorities*

Full money circulation is connected to the public finance part of the local government sub-system budget. The local government budget is separate from the state budget, although state grants and other budgetary connections are linked to it.

The current structure of the Hungarian local government system evolved within the framework of the change in political systems in 1990. The Constitution provides the highest guarantee for the local government system. Act LXV of 1990 (Ötv) on Local Governments contains the fundamental rights, types of local government, compulsory duties and the economic bases for their operation.

With the termination of the council system in Hungary a one-level local government system was established. With regard to the types of local government, they can be categorised into local (community, town, capital and district) and county local governments. There is no subordination between them, namely, the distributive function of the former county councils within the counties has been discontinued. This means that the activity of the smallest settlements is directly linked to the highest level bodies of state administration, i.e. with the ministries and other bodies with national jurisdiction, even with Parliament.

Annex B - Country Report: Hungary

- It should be noted here that the county and regional councils for regional development, which were established by Act XXI of 1996 on Regional Development and Regional Planning, are in command of the allocation of liquid assets – particularly for development objectives -, although these delegated (not elected) bodies do not constitute part of the local government sub-system.
- The exception confirming the rule is the capital city, where the Capital Local Government was authorised by law to allocate certain sources originating from the central budget and part of local taxes (for example, business tax) to the districts.

It is, therefore, a fact that an overly dissected, subdivided local government system was established in 1990. A total of 3 115 local governments, independent in every settlement, took the place of the 1 600 councils (700 of which were joint councils containing 2 200 settlements). In recent years, with the separation of settlements, the number of local governments has increased further, and this process still continues today. On 31 August, 1997, there were 3 170 local governments in operation, broken down as follows:

**Box 2.1 Breakdown of local governments by (settlement) type:**

Community	2 687
Large community	223
Town	195
Town with county rights	22
County	19
Capital (with districts)	24

**Box 2.2 Breakdown of local governments by number of inhabitants:**

Community under 200 people	282
Community between 200-499 people	699
Community between 500-999 people	692
(Large) community between 1000-4999 people	1 158
Town between 1000-4999 people	21
(Large) community between 5000-9999 people	70
Town between 5000-9999 people	66
Large community over 10,000 people	9
Town (with capital districts) over 10,000 people	154

For almost half of the 3 200 local governments the number of inhabitants does not reach 1 000 people, and for more than 280, the number does not even reach 200 people. Thus, in respect of the population for one local government – 3 300 people – Hungary is in the lower-middle section in Europe.

With the sub-divided structure of local governments they all have an exceptionally wide sphere of duties and authority. Although local government rights and duties are mostly the same in all local governments, with many settlements, the number of inhabitants and financial strength of a

## Annex B - Country Report: Hungary

settlement are not sufficient from the point of view of meeting the population's demands for public services efficiently, professionally and economically.

In 1990, when the councils were discontinued and the local governments were formed, the spheres of duties and authority were not organised anew and in accordance with the system. Thus, most of the local governments are today still performing those duties which are no longer compulsory (in particular area duties) which were developed under a different political, economic, organisational and management structure and whose financial terms and decision-making mechanisms were entirely different in comparison to the present situation.

### ***Principal compulsory duties of the local governments:***

- nursery education,
- primary school education,
- public education, provision of library services,
- support of local sport,
- basic health provision,
- basic social provision,
- upkeep of public cemeteries,
- liquid waste disposal
- upkeep of public areas (cleaning),
- settlement development,
- environmental protection (protection of important local, natural sites, the air, etc.),
- water supply, drainage, drainage of rain water, water damage prevention,
- maintenance of public roads,
- public lighting,
- disposal of dead animals,
- organisation of field guard duty,
- professional, local government fire brigade (only in towns),
- local defence and civil defence duties,
- co-operation with national and ethnic-minority local governments.

Besides these, many small local governments maintain secondary education institutes and hospitals, although this is not a compulsory duty. They have the possibility of transferring these to the county local governments which have the authority to maintain these institutions, however, not every local government does this.

### ***Duties of county local governments***

## Annex B - Country Report: Hungary

Part of the compulsory duties of county local governments include, in particular, the following:

- the provision of secondary schools, vocational schools and colleges; the collection, preservation and scientific processing of natural and social museum relics, and historical documents, that exist in the county; the provision of county library services, professional pedagogic and public education consulting and services; duties related to the enforcement of physical training, sports organisation, child and youth rights in the county;
- the education of children under lengthy treatment in health-care institutions, education, upbringing and care of handicapped children who cannot be taught with the other pupils; health care provision exceeding basic health care, and provision of child and juvenile protection; area harmonisation of specialised social services, and certain duties belonging to the sphere of specialised provision;
- harmonisation of duties related to the protection of the man-made and natural environment and to area regional planning, development of county tourist sites, collaboration in harmonising the area employment duties and training, as well as participation in the development of the area information system.

Town local governments with county rights have been established as specific types of local government in towns with between 22 000 and 50 000 inhabitants, which perform both county and local functions.

### ***Duties of the capital city local government***

Separate rules apply to the capital city. The capital local government performs those compulsory and voluntary duties which affect the whole of the capital or an area exceeding one district, and those which, in the capital and in the country, are related to a particular situation (sphere of action).

Duties concerning the whole of the capital city are those related to urban development, urban planning, housing management, disaster prevention, water, gas and distance heating services, sewage and rainwater drainage, sewage cleansing, public lighting, flood protection, public sanitation, public cemeteries, public transport, tourism, environmental protection, employment, secondary school education, health care provision, specialised social provision, child and juvenile protection and public collection business. In the event that the given duty or provision affects more than one district – for example, public education, national and ethnic-minority education, performance of pedagogical and cultural duties, general education, sport, child and juvenile activities - then its harmonisation is the task of the capital local government.

Annex B - Country Report: Hungary

The **district local government** is obliged to attend to nursery schooling, primary school education, basic health care and social provision, as well as provide healthy drinking water, maintain local public roads, and assert national and ethnic-minority rights.

*The dysfunction of the sphere of duties and authority system*

The cause of the largest problem in the Hungarian local government system is the fact that the transfer of public service regional or (small) area duties was not regulated clearly. Some settlements still “carry” such duties performed before the change in the political system, although the operation of the inherited institutional structure is increasingly burdensome for the settlement.

Transfer of the duties to small-area level (reachable within one day’s walk) is missing from the Hungarian local government system. This does not produce efficient solutions, particularly because the economic willingness to associate is low, and the Hungarian legal system today does not recognise compulsory association. However, both international and domestic experience prove that comprehensive associations are not established merely voluntarily or of one’s own free will.

A further problem is that the settlements can unilaterally transfer the institutions performing the local duties to the county local governments, who are obliged to take them on and run them. There was no clear regulation which would group the institutions which provide the local service to the county local governments providing the local functions – as a regulated exception to the town with county rights – along with their assets and other operational background. The latter, namely, that the asset ownership rights follow the movement of the duty, has not been resolved in the local government sphere (those who became owners then are only obliged to transfer the utilisation rights to the party maintaining the new institution).

### 3. Current expenditure

Following the presentation in Chapter 2 on the distribution of duties and responsibilities within the different subcategories of local government, Table 3.1 summarises the overall distribution of expenditure responsibilities across levels of the total public sector.

#### 3.1 Expenditure assignment – Actual status of the legal framework

Function	Central government	Local government
1. General public services	**	*
1.1 Bodies preparing and implementing laws	**	*
1.2 Financial and budgetary activities and services	**	*
2. Defence	**	*
3. Public order and safety	**	*
4. Education	*	**
4.1 Preparatory and basic education for school		**
4.2 Secondary school education		**
4.3 Other education	**	
5. Health	*	**
5.1 Hospital activities and services	*	**
5.2 Family doctor and family paediatrician provision		**
5.3 Provision of other medical and dental surgeries		**
5.4 Public hygiene activities and services	**	
Other health care matters		**
6. Social security and welfare	**	*
7. Housing and community amenities		**
8. Recreational, cultural and religious affairs	**	*
8.1 Sport and leisure activities and services	**	*
8.2 Cultural activities and services	**	*
8.3 Broadcasting and publication activities	**	*
Other public and entertainment activities	**	*
9. Fuel and energy	**	
10. Agriculture, forestry, fishing and hunting	**	
11. Mining, manufacturing and construction, except fuel and energy	**	
12. Transportation and communication	**	*
12.1 Public transport	*	**
12.2 Telecommunications	**	
Other transport and transportation	**	
13. Other economic affairs	**	
14. Other functions		

Key: \* Divided responsibility  
 \*\* Main responsibility

Annex B - Country Report: Hungary

*Local expenditure by function and economic category*

In Table 3.2, local expenditure is shown as a proportion of overall public expenditure, distributed by function. In 1996, local government expenditure covers approximately 20% of total current public expenditure. The main local functions, as measured by the proportion of total local expenditure, are educational activities (almost 1/3 of total expenditure), followed by health services, and social services and welfare benefits.

If local expenditure is considered as a proportion of total public expenditure, then local governments are covering almost 92% of total public expenditure on housing and community amenities. For environmental protection, the ratio is 67%, whilst the proportion on primary education is 63% and that on health services is 29%.

In Table 3.3.2, local expenditure is distributed by economic category. The profiles of the three largest local government sectors differ to some extent. Wages and employer contributions cover 60-70% of the overall expenditure on education and health services, whilst the profile on social security and welfare is composed of grants (47%, welfare benefits to citizens, etc.) and a relatively small share (31%) of wages and employer contributions.

The profiles on expenditure by economic category may be compared with Tables 6.1 - 6.2 on specific grants, to get the full picture on expenditure compositions by function.

**3.2 Gross current expenditure of the public finance system by subsystem and function**  
(1996 HUF millions)

	Functions	Central government	Separate state funds	Social security funds	Local Governments	Total
1.	General public services	135,355.6	0.0	66.0	103,109.0	238,530.6
	Legislative and executive agencies	60,819.7			93,746.0	154,565.7
	Financial and budgetary operations and services	40,012.9		66.0	9,363.0	49,441.9
	Foreign affairs	12,379.8				12,379.8
	Basic research	13,513.6				13,513.6
	Technical development	3,873.9				3,873.9
	Other general public services	4,755.7				4,755.7
<b>2.</b>	<b>Defence</b>	<b>64,551.5</b>	<b>0.0</b>	<b>0.0</b>	<b>234.0</b>	<b>64,785.5</b>
<b>3.</b>	<b>Public order and safety</b>	<b>115,718.8</b>	<b>0.0</b>	<b>0.0</b>	<b>7,613.0</b>	<b>123,331.8</b>
<b>4.</b>	<b>Education</b>	<b>265,192.0</b>	<b>1,556.4</b>	<b>0.0</b>	<b>248,798.0</b>	<b>515,546.4</b>
	School preparatory and primary education	86,577.2			144,204.0	230,781.2
	Secondary education	62,539.3	1,556.4		58,538.0	122,633.7
	Higher education	104,262.9				104,262.9
	Other education	11,812.6			46,056.0	57,868.
<b>5.</b>	<b>Health</b>	<b>54,340.3</b>	<b>0.0</b>	<b>323,969.0</b>	<b>152,673.0</b>	<b>530,982.3</b>
	Hospital operations and services	40,579.6			100,913.0	141,510.6
	Family physician and paediatrician service				8,296.0	8,296.0
	Other medical, dental services				39,461.0	39,461.0
	Public health operations and services	11,646.8			2,340.0	13,986.8
	Other health care	2,095.9		323,969.0	1,663.0	327,727.9
<b>6.</b>	<b>Social security and welfare</b>	<b>350,975.7</b>	<b>61,377.8</b>	<b>660,308.0</b>	<b>113,267.0</b>	<b>1,185,928.5</b>
<b>7.</b>	<b>Housing and community amenities</b>	<b>5,011.1</b>	<b>0.0</b>	<b>0.0</b>	<b>60,525.0</b>	<b>65,536.1</b>
<b>8.</b>	<b>Recreational, cultural and religious affairs</b>	<b>81,368.5</b>	<b>1,513.8</b>	<b>0.0</b>	<b>32,781.0</b>	<b>115,663.3</b>
	Sports, leisure activities, services	11,086.5			4,680.0	15,766.5
	Cultural activities and services	24,437.2	1,513.8		26,716.0	52,667.0
	Broadcasting and publishing operations	34,473.5			712.0	35,185.5
	Religious activities	3,315.1				
	Party activities	1,345.8				
	Other community and entertainment operations	6,710.4			673.0	7,383.4
<b>9.</b>	<b>Fuel and energy</b>	<b>1,452.6</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>1,452.6</b>
<b>10.</b>	<b>Agriculture, forestry, fishing and hunting</b>	<b>95,962.4</b>	<b>0.0</b>	<b>0.0</b>	<b>5,378.0</b>	<b>101,340.4</b>
<b>11.</b>	<b>Mining, manufacturing, construction, except fuel and energy</b>	<b>7,800.4</b>	<b>0.0</b>	<b>0.0</b>	<b>1,034.0</b>	<b>8,834.4</b>
<b>12.</b>	<b>Transportation and communication</b>	<b>55,852.9</b>	<b>39,886.8</b>	<b>0.0</b>	<b>9,615.0</b>	<b>105,354.7</b>
	Transport by road	10,918.9	39,886.8		8,410.0	59,215.7
	Transport and services by rail	27,110.4				



### 3.3 Total expenditure by economic category

#### 3.3.1 Total (current and capital) gross expenditure structure of local governments by function

(1996 HUF millions)

	Function designation	Local Government
1	<b>General public services</b>	<b>121 708</b>
	Bodies preparing and implementing laws	111 142
	Financial and budgetary activities and services	10 551
2	<b>Defence</b>	<b>274</b>
3	<b>Public order and safety</b>	<b>7 986</b>
4	<b>Education</b>	<b>265 343</b>
	Preparatory and basic education for school	151 358
	Secondary school education	66 620
	Other education	47 365
5	<b>Health</b>	<b>173 356</b>
	Hospital activities and services	117 063
	Family doctor and family paediatrician provision	9 240
	Provision of other medical and dental surgeries	42 413
	Public hygiene activities and services	2 368
	Other health care matters	2 273
6	<b>Social security and welfare</b>	<b>119 327</b>
7	<b>Housing and community amenities</b>	<b>76 447</b>
8	<b>Recreational, cultural and religious affairs</b>	<b>40 845</b>
	Sport and leisure activities and services	8 223
	Cultural activities and services	30 746
	Broadcasting and publication activities	776
	Other public and entertainment activities	1 100
9	<b>Fuel and energy</b>	
10	<b>Agriculture, forestry, fishing and hunting</b>	<b>6 412</b>
11	<b>Mining, manufacturing and construction, except fuel and energy</b>	<b>6 405</b>
12	<b>Transportation and communication</b>	<b>27 088</b>
	Public transport	25 444
	Telecommunications	919
	Other transport and transportation	728
13	<b>Other economic affairs</b>	<b>5 909</b>
	<b>Environmental protection</b>	<b>36 998</b>
14	<b>Other functions</b>	<b>29 720</b>
15	<b>Total</b>	<b>917 818</b>

Note: Table 3.3.1. on total expenditure (HUF 917 918 million) differs by HUF 4 524 million from the total of Table 3.3.2 on current expenditure (HUF 767 679 million) and Table 7.2 showing capital expenditure (HUF 145 615 million); the difference was spent by the local governments on purchasing shares.



## Annex B - Country Report: Hungary

## 3.3.2 Total of gross current expenditure and current grants of local governments for 1996 (HUF millions)

	Final Consumption Expenditure	Wages & Salaries	Contributions imposed on employers	Purchase of goods	Purchase of services	VAT	Grants	Others	Total
<b>1</b>	<b>General public services</b>	<b>40 912</b>	<b>15 971</b>	<b>4 019</b>	<b>8 069</b>	<b>1 341</b>	<b>26 318</b>	<b>6 479</b>	<b>103 109</b>
	Bodies preparing and implementing laws	36 948	14 242	2 552	6 308	901	26 316	6 479	93 746
	Financial and budgetary activities and services	3 964	1 729	1 467	1 761	440	2	0	9 363
<b>2</b>	<b>Defence</b>	<b>56</b>	<b>23</b>	<b>62</b>	<b>74</b>	<b>19</b>	<b>0</b>	<b>0</b>	<b>234</b>
<b>3</b>	<b>Public order and safety</b>	<b>4 471</b>	<b>1 827</b>	<b>526</b>	<b>631</b>	<b>158</b>	<b>0</b>	<b>0</b>	<b>7 613</b>
<b>4</b>	<b>Education</b>	<b>126 815</b>	<b>56 413</b>	<b>26 259</b>	<b>30 100</b>	<b>7 213</b>	<b>1 998</b>	<b>0</b>	<b>248 798</b>
	Preparatory and basic education for school	79 088	35 322	12 114	13 557	3 173	950	0	144 204
	Secondary school education	31 229	13 785	5 326	5 960	1 395	843	0	58 538
	Other education	16 498	7 306	8 819	10 583	2 645	205	0	46 056
<b>5</b>	<b>Health</b>	<b>61 186</b>	<b>27 235</b>	<b>25 665</b>	<b>30 792</b>	<b>7 706</b>	<b>89</b>	<b>0</b>	<b>152 673</b>
	Hospital activities and services	37 051	16 592	18 906	22 682	5 677	5	0	100 913
	Family doctor and family paediatrician provision	4 193	1 778	930	1 116	279	0	0	8 296
	Provision of other medical and dental surgeries	18 586	8 276	5 040	6 047	1 512	0	0	39 461
	Public hygiene activities and services	849	377	445	535	134	0	0	2 340
	Other health care matters	507	212	344	412	104	84	0	1 663
<b>6</b>	<b>Social security and welfare</b>	<b>23 671</b>	<b>11 621</b>	<b>10 203</b>	<b>12 243</b>	<b>3 060</b>	<b>52 469</b>	<b>0</b>	<b>113 267</b>
<b>7</b>	<b>Housing and community amenities</b>	<b>7 117</b>	<b>3 112</b>	<b>16 266</b>	<b>19 518</b>	<b>4 880</b>	<b>9 632</b>	<b>0</b>	<b>60 525</b>
<b>8</b>	<b>Recreational, cultural and religious affairs</b>	<b>12 260</b>	<b>4 871</b>	<b>6 238</b>	<b>7 487</b>	<b>1 873</b>	<b>52</b>	<b>0</b>	<b>32 781</b>
	Sport and leisure activities and services	1 318	536	1 128	1 354	338	6	0	4 680
	Cultural activities and services	10 532	4 179	4 796	5 755	1 440	14	0	26 716
	Broadcasting and publication activities	204	72	172	207	52	5	0	712
	Other public and entertainment activities	206	84	142	171	43	27	0	673
<b>9</b>	<b>Fuel and energy</b>								<b>0</b>
<b>10</b>	<b>Agriculture, forestry, fishing and hunting</b>	<b>952</b>	<b>413</b>	<b>1 605</b>	<b>1 926</b>	<b>482</b>	<b>0</b>	<b>0</b>	<b>5 378</b>
<b>11</b>	<b>Mining, manufacturing and construction, except fuel &amp; energy</b>	<b>120</b>	<b>50</b>	<b>345</b>	<b>415</b>	<b>104</b>	<b>0</b>	<b>0</b>	<b>1 034</b>
<b>12</b>	<b>Transportation and communication</b>	<b>410</b>	<b>166</b>	<b>3 616</b>	<b>4 339</b>	<b>1 084</b>	<b>0</b>	<b>0</b>	<b>9 615</b>
	Public transport	123	52	3 294	3 953	988	0	0	8 410
	Telecommunications	142	54	144	173	43	0	0	556
	Other transport and transportation	145	60	178	213	53	0	0	649
<b>13</b>	<b>Other economic affairs</b>	<b>781</b>	<b>319</b>	<b>1 673</b>	<b>2 008</b>	<b>502</b>	<b>0</b>	<b>0</b>	<b>5 283</b>
	Environmental protection	718	315	3 525	4 231	1 058	1 148	0	10 995
<b>14</b>	<b>Other functions</b>			<b>1 699</b>	<b>2 039</b>	<b>509</b>	<b>0</b>	<b>12 127</b>	<b>16 374</b>
<b>15</b>	<b>Total</b>	<b>279 469</b>	<b>122 336</b>	<b>101 701</b>	<b>123 872</b>	<b>29 989</b>	<b>91 706</b>	<b>18 606</b>	<b>767 679</b>



**Notes to Table 3.3.2:**

The expenditure is detailed here, too, in accordance with the functional classification used in Table 3.1.1. The VAT expenditures contain the following:

- the value-added tax paid by the local governments (as end users) into the central budget on their purchase of stocks and services needed by them. The VAT rate is generally 25%; on certain products (medicine and some food ) and services (electricity, water, and sewer rates) it is 12%.
- the value-added tax paid into the central budget on the products sold and services performed by local governments in the course of their entrepreneurial operations.

The “subsidies” column includes the financial resources transferred to other fiscal sub-systems and subsidies advanced to facilities outside the public finance system (as welfare to the population and for businesses and non-profit-making organisations, including religious institutions).

***3.4 Decision-making authority of local governments during the performance of duties***

The Constitution of the Republic of Hungary summarises the fundamental rights of local governments as follows:

**Box 3.1 The local representative body**

- shall independently manage and administrate the affairs of local government, and its decisions may only be reviewed with respect to their legality;
- shall exercise the rights of ownership in the assets of local government, independently manage local government revenues, and may undertake business activities at its own risk;
- shall be entitled to its own revenues for attending to the duties of local government as prescribed by law, and shall furthermore be entitled to state support commensurate to the scope of such duties;
- shall determine the types and rates of local taxes in accordance with the framework established by law;
- shall independently establish its own organisation and rules of procedure in accordance with the framework established by law;
- may develop symbols and emblems of local government, and establish local honours and titles;
- may present proposals to the authorities responsible for decisions that affect the local population;
- may freely merge with other local representative bodies and create associations of local government for the representation of their interests, may co-operate with the local governments of other countries and may be a member of international associations of local government;
- may issue decrees which do not conflict with legal statutes of a superior order.

Pursuant to the act on local governments, the local government itself decides – on the basis of the population demands and depending on its financial possibilities – which duties it shall perform, to what extent and in which manner.

Pursuant to the act on local government, law can oblige local governments to attend to certain public services. These obligations can be established, in contrast to that which is evident from chapter 2, depending on the size of the population and other conditions.

The act on local government also states that if a law establishes a compulsory sphere of duties and authority for local governments, at the same time Parliament shall provide the financial terms necessary for its provision and shall decide on the level and manner of budgetary contribution.

Hungarian local governments independently possess their assets, and independently manage their revenues. The central budget grants an amount of around 10% of their annual budgetary total (not including the expenditure financed by the health insurance sub-system).

The departmental laws and other legal regulations naturally limit the decision-making freedom in the organisation of public services. Thus, for example:

- the act on public education defines the compulsory number of hours for teachers, the requirements and parameters for class organisation, including possibilities for splitting into groups,

Annex B - Country Report: Hungary  
time frameworks for occupying pupils (compulsory and non-compulsory teaching hours, extra-curricular hours, individual attention, etc.);

- the acts on social provision define the professional parameters of social institutions, the minimum values for the different supplementary income grants, and the grant frameworks for acquiring and maintaining housing.

As regards the Hungarian local government system, it can be said that with regard to the transferred tasks, the decision-making independence of the local governments is complete – within the legally defined framework. In the local public affairs that it has undertaken voluntarily the local government can do anything that does not violate legal regulations, as long as carrying out the task does not jeopardise attending to the compulsory sphere of duties and authority of the local government, as prescribed by law. The Government has no right to “consult”.

Local governments have the right to voice their opinion in the law-creation process – through representative bodies – in respect of the acts and other legal regulations which affect them.

### **3.5 *Method of providing public services***

The local government itself decides whether to perform the duties arising from the requirements of the local population and the legal regulations through its own budgetary body, with the support of other business organisations, through purchasing services or in any other way.

Of course, the performance of the tasks by its own budgetary body is crucial. Since 1990, in Hungary, non-local governmental organisations, mainly churches, have been playing an increasingly greater role in education, social provision, and even health care. Their support is left to the discretion of the representative bodies. (The state financing of church-run, educational institutions is to all intents and purposes 100%, this is why the “obligation” of the local governments does not arise here strongly.)

With regard to community provision – water supply, sewage drainage/cleansing, rubbish removal/disposal etc. – it is rarer for the budgetary body to solve the task, it is more common for the business organisation established by the local government to do this. This applies to local transport, too. In all these matters, the local government representative body has authority over pricing.

There is no central provision for a compulsory number of staff in local government. However, the local governments have to establish the staff number framework for their institutions.

Estimates for wages – personal allowances – are not set centrally for local governments, either individually or collectively. Two acts – on civil servants working in mayor’s offices and on state employees working in the institutions – set the payment categories and the career system. The salary fund defined in the civil servant act is just a recommendation for the local governments, it is possible to deviate from the payment categories either

## Annex B - Country Report: Hungary

upwards or downwards (the latter with defined restrictions). Whilst the state employee act determines the minimum wage to be paid, it is possible to increase this.

With regard to the employment conditions of workers, in addition to the two acts mentioned above, the labour code also contains regulations. The act also compels local governments and budgetary bodies to harmonise decisions relating to the working world with local employment organisations. There is no possibility here for the central government to intervene.

### **3.6 *Macro-economic control of local governments, budgetary co-operation between government levels***

#### **3.6.1 *Auditing of local governments***

The legal audit of local governments and the review – exclusively from the legality point of view – of local government decisions made with deliberation, are carried out by the **public administration office** – the regional state administration body of the government. Under current law, the **State Auditing Office (SAO)** is obliged and entitled to inspect the management of local governments.

The SAO can perform the following audits during its inspection:

- comprehensive audit, where every two (or three) years the whole management process on the basis of expedience, efficiency and legal aspects is inspected;
- target audit, where only one defined area of the local government operation is inspected;
- subject-based audit, where the body performing the audit inspects a defined area of operation in several local governments, at the same time, and based on the same aspects;
- subsequent audit, when for the efficient realisation of one of the previous inspection types, it is necessary to check if the faults and deficiencies have been eliminated;
- audit on the utilisation of state subsidies, when the legality of the demand and utilisation of subsidies received from the central budget are thoroughly examined.

The organisational system of the SAO and its staff numbers are not sufficient for it to be able to inspect the whole management process of the local governments with the required frequency on the basis of expedience, efficiency and legal aspects. The relevant legal regulations do not specify the frequency for the full-scale audits of each local government. This can be attributed to the fact that with most of the local governments, instead of the comprehensive-type audit ranging over the whole management system, the auditing inspections affect only one area, and at the moment, the area is state

Annex B - Country Report: Hungary subsidies. However, the legal remedy possibility with regard to the prescription of repayments is still not resolved regarding the auditing of state grants.

At the current SAO capacity, a comprehensive audit can take place at each local government, on average, every 50-60 years.

With regard to external audits, mention must be made of the central tax office inspection, and the tax and contribution payment discipline inspection of local governments and their institutions.

With regard to internal local government audits, current legal regulation is satisfactory because the local government makes the institutional and internal audit obligatory, as well as employing an accountant when prescribed by legal regulation, (e.g. for local governments which have an annual budget and long-term credit stock of more than HUF 100 million). In addition to this, the Financial Board also has auditing duties.

### 3.6.2 *Recently implemented reforms*

The reform of the local government system in Hungary took place between 1990 and 1991. The essence of this was that local governments possessing adequate economic and decision-making autonomy were created from the local authorities that, until this time, had been directed from above. (The system initiated with the 1990 reform is presented in different sections of this document.)

It has come to light – as described in Chapter 2 – that there was excessive decentralisation in the sphere of duties and authority. The smallest settlements possess almost the same authority as the capital city. Organisation of task performance for suburbs is missing from the system. The establishment of a regional local government level stretching over several counties has been pushed into the foreground from the point of view of EU accession, too. These all represent future targets for public finance and state administration reform.

Following the change in the local government system in 1990 and 1991, there was further development in local government regulation in numerous areas, namely:

- With the formation on 1 January, 1996 of the Hungarian State Treasury, so-called net financing was introduced into local governments, the essence of this being that local governments receive an amount of contributions and grants from the central budget and through the Treasury which is reduced by the amount of taxes and contributions related to personal allowances. In this way, cash-conscious financing is realised, since these taxes and contributions are directly credited by the Treasury to the central budget and to the Health Insurance Fund and Superannuation Fund.

This did not lead to the Hungarian local governments becoming subject to the Treasury: they do not have their accounts there, instead they are kept at

## Annex B - Country Report: Hungary

the commercial banks, freely chosen by them, and without the requirement of a Treasury counter-signature.

- In 1995, a restriction on local government borrowing was introduced. The essence of this is that the law maximises the upper limit of the credit to a percentage of the joint amount of the principal own revenue sources of the local government.
- Similarly, there has been a legal regulation on the settlement of debts for local governments who have slipped into a situation of insolvency since 1995. The insolvency criteria were defined as well as the course of the debt settlement procedure. (When and where the procedure must commence, who must initiate it, what is the duty of the court, the appointment of a financial trustee, his role in the operation of the local government during the debt settlement, the method of establishing the debt settlement committee, crisis budget acceptance, the re-organisation programme, preparation of conciliation proposals, conciliation negotiations with the creditors, and judicial division of assets in the absence of conciliation.) No local government can be dissolved at the end of the procedure. To this end, according to the legal provisions, the local government can receive a share from central budgetary grants – as a supplement to its own sources - to be able to fulfil its compulsory duties at a minimum level.
- With grants serving to moderate the excessive income difference between local governments, local government capacity for collecting business tax is being taken into account from 1999. (This is discussed in more detail in chapter 6.)

### 3.6.3 *Budgetary co-operation*

The act on public finances and its implementation decree regulate the relationship between the central budget and the local government budget, and the content and publication times of the interim reports.

By 15 May every year, the Government submits to Parliament the guiding principles for the following year's budget. At the same time, it informs the local governments of the main directions of budgetary policy, and on the preliminary notions of financial regulation that concern them.

At the same time as the budget bill is submitted to Parliament (and this by 30 September), the Government puts at the disposal of the local governments the data and regulation proposals that apply to them. In this way, the local governments find out the budget conditions originating from the macro-economic aspects (wage development, increase in material expenditure, expansion of accumulation expenditure, increase in social benefits for the population), the public finance priorities, in which areas particular increases are justified, as well as the duty amendments originating from other acts which may concern them. All these determine the formation of central sources which relate to the local government sub-system - the validity of the expenditure conditions is not of a compulsory nature with regard to local

Annex B - Country Report: Hungary  
government expenditure. (Wage development constitutes an exception, but only if the salary fund defined in the civil servant or the state employee law, or the rates linked to the individual allocation categories change, as well as the supplementary income grants for the population which are tied to the minimum pension.)

The volume of the sources originating from the central budget and which are implemented and can be freely used by the local governments ultimately determine the local public services expenditure possibilities. Taking these into account, the local governments begin by preparing their budgetary ideas – by 30 November of the year preceding the budgetary year.

Following acceptance of the budgetary act, the Minister for Finance and the Minister of the Interior publish, in a joint decree, per local government and per legal title, the central sources due to the local governments.

After this – the second part of the planning – the local government compiles them independently and accepts the budgetary decree by 15 March of the budgetary year, at the latest. (In accordance with the provisions of the act on public finance, the budget must be planned for a period of three years.) No central body may approve or counter-sign any of the contents in the budget. However, a condition for the transfer of central sources is that the local government provide public finance information within 30 days of the accepted budgetary decree. The local government will not receive central subsidies until this obligation is fulfilled.

During the year, the local government may amend its estimates in a decree without restriction, it does not have to provide an explanation of this to government bodies.

In connection with the public finance information system, local governments must prepare reports on the amount of cash in circulation, by 15 April, 15 June and 15 October, every year. In addition, a six-monthly report is due by 10 August and a yearly report by 15 March.

By 30 April, the local government accepts its final accounts in a decree - which, in those cases defined in legal regulations, must be supported by an accountant's report – and it must also provide public finance information on this. During the year, the representative body of the local government accepts the six-monthly and other budgetary reports listed in the paragraph above..

The provision of public finance information on management – implementation of the budget – cannot be considered as a statement of accounts for a superior body. There is, however, no doubt that there is some accounting-type provision of data there. For example, if there is a deviation in the normative, state contribution indicators from the planned figures – on the basis of which the financing takes place throughout the year – this must be noted in the final accounts and the difference must either be paid into the central budget (if the value is exceeded then the amount is increased by the punitive interest) or reclaimed. Likewise, the final accounts create the possibility for settling fixed state subsidies. The authenticity of these cannot be inspected by government bodies, only the State Audit Office can do this.

#### **4. Tax revenue**

Total tax revenue in 1996 amounted to HUF2 795 billion (Rev. Statistics 1999, Table 52). As appears from Table 4.1, the tax revenue to the local governments was HUF204.2 billion, or 7.3% of total revenue.

In Table 4.1, local government tax revenue is distributed across levels of local discretion and types of tax sources. The category “b” (local government set tax rate, but not tax base) covers 43% of the revenue. This revenue accrues primarily from business taxes and, to a lesser extent, property taxes. The remaining 57% of revenue is categorised as “e.3” (revenue split determined annually by central government as part of the budget). Personal income tax accounts for the all-important part of this revenue.

## Annex B - Country Report: Hungary

## 4.1 Classification of tax revenue at local governments - 1996 - (HUF millions)

Category	a	b	c	d	e0	e1	e2	e.3
1000 Taxes on income, profits and capital gains	0	0	0	0	0	0	0	101,274
1100 Individuals								101,274
1200 Corporations								
1300 Unallocatable as between 1100 and 1200								
2000 Social security contributions	0	0	0	0	0	0	0	
2100 Employees								
2200 Employers								
2300 Self Employed								
2400 Unallocatable as between 2100, 2200 and 2300								
3000 Taxes on payroll and workforce****		1,174						
4000 Taxes on property	0	18,618	0	0	0	0	0	15,509
4100 Recurrent taxes on immovable property*		11,562						
4200 Recurrent net wealth taxes								
4300 Estate, inheritance and gift taxes**								1,413
4400 Taxes on financial and capital transactions								
4500 Other non-recurrent taxes on property*****								14,096
4600 Other recurrent taxes on property***		7,057						
5000 Other taxes	0	0	0	0	0	0	0	
5100 Taxes on production, sale and transfer of goods and services								
5200 Taxes on use of goods								
5300 Unallocatable as between 5100 and 5200								
6000 Other taxes	0	67,635	0	0	0	0	0	0
6100 Paid solely by business*****		66,130						
6200 Paid by other than business, or unidentifiable*****		1,505						
<b>Total</b>	<b>0</b>	<b>87 428</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>116 783</b>
% distribution	0	42.8	0	0	0	0	0	57.2

**Key:**     \* building tax + land tax + tourist tax for buildings + community tax for private individuals  
           \*\* inheritance and gift duty  
           \*\*\* domestic vehicle tax  
           \*\*\*\* communal tax for enterprises  
           \*\*\*\*\* business tax  
           \*\*\*\*\*tourist tax paid for residence  
           \*\*\*\*\* property transfer duty subject to certain liabilities

**Note:**   There is some overlapping between the values of categories e.3 and f. In Hungary, personal income tax “almost” operates as a state grant. In the central source regulation of local governments, personal income tax and state contributions are both taken into consideration. This is described in more detail in chapter 6.

The explanation given to Table 4.1 is supplemented by the following definitions:

- The objects of **structure tax** include residential and non-residential properties, buildings, and parts of buildings. The object of the tax is the owner of the structure. The tax is based on the usable floor space of the building calculated in square

## Annex B - Country Report: Hungary

meters, or the adjusted market value of the structure. The annual tax ceiling is HUF 900/m<sup>2</sup> or 3% of the adjusted market value. The following facilities, for example, are not subject to taxation: residential units not suited for such purpose, social and health care institutions, and structures owned by budgetary agencies or churches.

- The object of **land tax** is vacant residential lots located in the area administered by the local government. The features discussed for the structure tax apply to the tax object and the tax base. The annual tax ceiling is HUF 200/m<sup>2</sup> or 3% of the adjusted market value, as decided by the local government.
- The **local private individual tax is another type of local tax connected to property**. The objects of the tax are those private individuals who can also be subject to the structure tax or land tax, as well as private individuals who have rental rights to residential units that they do not own and are situated in the area administered by the local government. The annual amount of tax can reach a maximum of HUF12 000 per taxable object or residential rental right.
- The **local business tax** is linked to employment. The basis of the tax is the adjusted average statistical number of staff employed by the taxpayer within the local government's territorial jurisdiction. The maximum tax is HUF2 000 per capita.
- **Tourist tax** is to be paid by private individuals who spend a minimum of one guest-night (as a non-resident) within the local government's territorial jurisdiction, and private individuals who own property that can be used for recreation (and not considered a residential unit) within the territorial jurisdiction of the local government. The tax base in the first case is the number of started guest-nights or the accommodation cost per started guest-night and, in the second case, the structure's usable area. Tourist tax on dwellings is not paid by private individuals below the age of 18 and above the age of 70, private individuals staying in health care or social institutions, or those who stay within the territorial jurisdiction of the local government owing to employment, academic studies, or business reasons.
- **Local business tax** is paid on business operations, and is connected to the headquarters or site that is located within the territorial jurisdiction of the local government. The taxpayer is the entrepreneur. Industrial operations can be permanent or temporary, which will also affect the tax base and tax rate. The tax base for permanent industrial operations is the net sales revenue from the product sold or service performed, less the value at cost of the goods sold, the value of subcontractors' performance, and the percentage of material costs specified by law (in 1999 the tax ceiling was 1.7%). In the case of temporary industrial activities, the tax is calculated on the basis

Annex B - Country Report: Hungary  
of the number of calendar days during which the operation is performed.

- **Duties** can be divided into two groups, based on their economic contents and functions: duties to be paid when property is purchased, and duties due in connection with state administration or court procedures. (The latter type will not be dealt with, because the duty paid on that category is to be paid to the central budget.) The duties related to obtaining property are due on gratis transfers (inheritance, donation) and when property is obtained for a consideration. Generally, the duty on obtaining property is based on the market value of the property. When rights with pecuniary value are acquired, the duty is again related to the commercial value, and it is on that basis that the duty is to be calculated as stipulated in law.
- An **inheritance tax** is charged on estates inherited from the deceased, and a **gift tax** when property is acquired as a gift (by donation). Tax must be paid for the inheritance or donation of property, personal property, and rights with pecuniary value. The tax base is the market value minus the burdens specified by law. The law sets the average percentage rate for both types of tax and differentiates on the basis of the family relationship between the deceased or the donor and the beneficiary, putting such relationship into one of three groups. The tax rate when residential property is obtained is the lower of the two types of tax and in all three categories of family relationship.
- The other major type of tax on property acquisition is the **tax charged on transferring property for a consideration**. Such tax is typically levied on the transfer (for a consideration) of real property and rights with a pecuniary value attached to real property as well as when property is obtained in some other way that is not otherwise subject to inheritance and gift tax. Tax is charged on personal property obtained at auction and on vehicles and trailers. The general tax rate on property acquired for a consideration is 10%. For residential property, it is 2% for the first four million forints (HUF), and 6% for the rest of its value. For vehicles, the tax rate is HUF10 for every cubic centimetre (cc) of cylinder capacity. It is HUF5 000 for trailers up to the weight of 2 500Kg, and HUF12 000 for trailers above that weight.

The common feature of all types of tax on acquired property is that the tax is independent of the manner in which the property is obtained and the tax is to be paid by the beneficiary in proportion to the actual ownership ratio. Apart from this, the tax law provides for tax allowances and even exemption from tax obligations for all three types of tax.

The above-mentioned law specifies the manner in which the tax base is to be calculated and its amount. The county government (duty office) cannot deviate from these regulations.

**4.2 *Independence of local decision-making – tax administration and relation with central government***

The relevant acts provide for the local governments and the scope of duties and authority of the local governments in harmony with the Constitution. The regulation in force, starting from the principle of local government, provides the local governments with a wide range of autonomy. Separate laws regulate local taxes, vehicle tax and duties.

With the democratic election in Hungary in 1990, self-organising local governments created organisational frameworks for exercising local authority. The fundamental duty of local governments – besides exercising public authority in local affairs – is the provision of local public services. The performance of this duty in accordance with the local characteristics and requirements made the creation of independent management conditions for local governments indispensable. One of the means of becoming independent is the local tax system. The local taxes have particular importance within the own revenue sources of local governments.

Pursuant to the authorisation and provisions of Act C of 1990 on Local Taxes, the representative body of a local (community, town, capital city or district) government (hereafter referred to as “local government”) may, within its area of jurisdiction, introduce local taxes (hereafter referred to as “tax”) by way of a decree. The introduction and operation of local taxes is not binding on the local government. The act in question creates the possibility for taxation. It is worth emphasising that the decree creating the right of local government to establish local taxes and the liability that accompanies it is identical as regards content to the right of Parliament to establish a tax law – with the obvious difference that local tax only and exclusively means a taxation obligation imposed on the given local population and enterprises. In this case, the state has partially ceded a traditional tax-establishing right reserved for Parliament to the local governments, within legally defined frameworks. It is a significant opportunity, which means that the trustee of the local tax policy is the settlement. Whether it taxes or not, and the fact that it can decide with which type of tax - within the framework offered by the law - and to what extent it shall make use of its taxation right can fundamentally shape the local economic policy and the local budget revenue structure.

From 1991, the local tax system replaced the former, centrally governed, so-called council taxes, so changing the taxation proportions in the Hungarian system. The main aim was the establishment of new tax sources in the interests of increasing local independence, and, within the local government budget – in line with the main objectives of the public finance reform process – the increase in the share of own revenue.

The tax obligation in the area of jurisdiction of local government extends to:

- property ownership, rights representing assets related to property;
- employment of the workforce;
- stay as a non-permanent resident; and

Annex B - Country Report: Hungary  
– the practice of so-called industrial (business) activity.

Local government can establish the following taxes by means of a decree: building tax, land tax, community tax for private individuals, community tax for enterprises, tourist tax, and local industrial (business) tax.

The tax-levying right of local government covers the following:

- a) introducing the taxes mentioned or some thereof, repealing or modifying the already introduced tax, however, modifications during the year may not aggravate the tax burden of the taxpayers within the calendar year;
- b) determining the time of introduction and the duration (defined or undefined) of the tax;
- c) determining the rate of taxation in accordance with the local characteristics, the operational requirements of the local government and the capacity of taxpayers to bear the burden – within the upper tax limits defined by law;
- d) expanding the exemptions defined in law with further exemptions, and the tax relief with further tax relief.

In the interests of avoiding over-taxation, the taxpayer can only be obliged to pay one kind of tax for a given tax object, and the value of the tax introduced may not exceed the tax maximum.

Experience of local taxation autonomy is favourable. Local taxes have been in operation as part of the Hungarian taxation system for more than eight years. The number of local governments who operate local taxes, and their tax revenue have continually increased. In 1998, 85% of the total number of local governments – 2 672 – were taking advantage of the opportunity to introduce local taxes. Within the local government budget, the share of local taxes in 1998 was around 11%, in contrast to the share of so-called council taxes which, in 1990, amounted to around 3.5%.

The share of local taxes within the local government budget seems low in comparison to other OECD countries. However, it must not be forgotten that in the majority of OECD countries, the central budget contains cover for the payment of teachers, for example, whereas in the Hungarian financing system, this expenditure is borne by the local government budgets. If we examine the Hungarian local government budget in a comparative structure, the local tax share would amount to 20-25%.

It is the general experience, as regards local taxation, that the local governments make use of their taxation opportunity prudently, according to the local circumstances, and taking into account the burden-bearing capacity of taxpayers.

The taxes most commonly used by the local governments are local business tax and community tax for private individuals, representing 84% of total tax revenue. The rising demand for local tax revenue is indicated by the fact that more than 20% of local governments collecting business tax use the maximum tax value. With regard to the other taxes, most of the local governments remain significantly under the upper (maximum) tax level.

#### Annex B - Country Report: Hungary

Vehicle tax is a special type of tax and is provided for in a separate law which also stipulates the minimum tax level. The tax collected at this level is split equally between the central budget and local government budgets. The local government is entitled to tax at a higher rate, and in this case the additional tax revenue is at its sole disposal.

Pursuant to the local government act, the local government performs the duties arising from the requirements of the local population and the legal regulations through its own budgetary body, with the support of other business organisations, through purchasing services or in any other way. In accordance with its duties, the local government chooses its management form, and, within the frameworks defined in legal regulation provisions, independently develops the rules of participation. Thus, as a result of local autonomy, there are no separate central measures taken in the interest of increasing local government tax revenue. The Ministry of Finance assists local governments with the computerised registration of tax by providing them with the necessary software programmes free of charge. This is done in the interests of providing unified records.

The value of duties is regulated by Act XCIII of 1990. The duties offices of the county and capital city local governments are entitled to collect duties (for inheritance, gifts, and property transfer which carries certain liabilities) to raise revenue, which towns with county rights receive a share of – identical to the revenue from their area. In general, 50% of the collected revenue remains with the two types of local government mentioned, while 50% goes to the central budget.

The duties offices also collect the property registration duties, but the central budget is due 90% of these and only 10% remains at its place of origin. A general feature with these revenues is that they do not serve to refund service costs but are a general contribution to the duties of the local governments affected.

## 5. Non-tax revenue

The non-tax revenues of the local governments only include revenues directly collected by the local government or its institutions. This category does not include service rates collected by economic organisations owned by the local government. The information system of the public finance system has no data on such revenues.

Local governments establish and state their rates in local ordinances.

Local governments have unlimited freedom to establish the rents for their properties (public areas, residential properties, and premises being used for non-residential purposes) and their assets as well as the rates for community and public utility services (water, sewage, district heating, refuse collection, burial, etc.). These rates are determined on a market basis, with due respect to the provisions of the law on prices, according to which reasonable expenditures and honest profit margins should apply when determining rates. The above principle also applies to the establishment of the rates of local transport managed by the local government, provided that, in view of the central budgetary subsidy to such rates, the prior consent of the Minister of Finance is obtained for promulgating rates that have been determined within local government jurisdiction.

Local governments are authorised to determine:

- the fees for care provided in social institutions, with due regard to prime costs and the patient's income. The fee charged cannot surpass 80% of the patient's income, but the remaining 20% cannot be less than 20% of the minimum old age pension;
- the fees charged in nursery schools, kindergartens, student dormitories - these fees cannot surpass the per capita ratio of current expenditures; and
- the fee for providing meals in educational institutions - these cannot surpass the per capita meal ingredients norm stated in the local government ordinance. The ingredient norms must have the caloric values specified in central government regulations. Central government regulations stipulate that members of families with three or more children should be given discounts on the fees charged for meals.

Duties collected in cash by the local government in the course of state administration procedures can only be used in the cases and to the extent that central government regulations permit (e.g. data supply duty, which can, in specified cases, be collected on data from the register of citizens' addresses that have been made available, or when a cattle licence (cattle ownership paper) is issued to certify the origin of four-legged domestic animals).

### ***Non-tax revenues distributed by legal title and by function***

In 1996, revenues other than taxes made up some 60% of own revenues (Table 6.1) and 16% of total revenues from operations.

## Annex B - Country Report: Hungary

Administrative fees and charges form the main share of non-tax revenues. Table 5.2 shows the non-tax revenues by function. The main categories are education, social security and welfare, housing and community amenities, and “other functions”. Taken as a proportion of the overall local expenditure by function (Table 3.2) the non-tax revenues cover 10% of the education activities, 15% of the social security and welfare activities and 27% of housing expenditures. The same high share of coverage of the expenditures can be identified in the recreational and cultural activities.

### 5.1 *Non-tax revenue by legal title of local government*

(HUF millions)

	<b>Base</b>	<b>Local government</b>
1	Entrepreneurial and property income	18,761
1.1	Cash operating surpluses of departmental enterprise sales to the public with a surplus	
1.2	From non-financial public enterprises and public financial institutions	2,012
1.3	Other property income	16,749
2	Administrative fees & charges, non-industrial and incidental sales	88,621
3	Fines and forfeits	364
4	Contributions to government employee pension and welfare funds within government	
4.1	Employer contributions from other levels of government	
5	Other non-tax revenue	24,420
	Total	132,166

## Annex B - Country Report: Hungary

5.2 *Non-tax revenues of local governments, by function, for 1996.*

(HUF millions)

	Functions	Entrepreneurial and Property Income	Administrative fees and charges	Fines and forfeits	Other non-tax revenues	Total
<b>1</b>	<b>General public services</b>		16,263		1,682	17,945
	Bodies preparing and implementing laws		14,264		1,118	15,382
	Financial and budgetary activities and services		1,999		564	2,563
<b>2</b>	<b>Defence</b>		39			39
<b>3</b>	<b>Public order and safety</b>		193		54	247
<b>4</b>	<b>Education</b>		19,830		5,593	25,423
	Preparatory and basic education for school		5,618		1,584	7,202
	Secondary school education		3,450		97	<b>4,424</b>
	Other education		10,762		3,035	13,797
<b>5</b>	<b>Health</b>		6,199		1,749	7,948
	Hospital activities and services		3,384		955	4,339
	Family doctor and family paediatrician provision		298		84	382
	Provision of other medical, dental surgeries		1,369		386	1,755
	Public hygiene activities and services		567		160	727
	Other health care matters		581		164	745
<b>6</b>	<b>Social security and welfare</b>		13,699		3,863	17,562
<b>7</b>	<b>Housing and community amenities</b>		12,832		3,619	16,451
<b>8</b>	<b>Recreational, cultural and religious affairs</b>		7,095		2,002	9,097
	Sport and leisure activities and services		1,468		414	1,882
	Cultural activities and services		5,029		1,419	6,448
	Broadcasting and publication activities		107		30	137
	Other public and entertainment activities		491		139	630
<b>9</b>	<b>Fuel and energy</b>					0
<b>10</b>	<b>Agriculture, forestry, fishing and hunting</b>		659		186	845
<b>11</b>	<b>Mining, manufacturing and construction, except fuel and energy</b>		410		116	526
<b>12</b>	<b>Transportation and communication</b>		883		249	1,132
	Public transport		278		78	356
	Telecommunications		248		70	318
	Other transport and transportation		357		101	<b>458</b>
<b>13</b>	<b>Other economic affairs</b>		5,379		1,204	6,583
	<b>Environmental protection</b>		1,775		501	<b>2,276</b>
<b>14</b>	<b>Other functions</b>	18,761	3,365	364	3,602	<b>26,092</b>
<b>15</b>	<b>Total</b>	18,761	88,621	364	24,420	<b>132,166</b>

Notes:

“*Entrepreneurial and property income*” means payments after the result of the entrepreneurial activity, dividends from shares and dividends in connection with other ownership participation, concession fees, and payment obligations related to investment assets and interest revenue.

“*Administrative fees and charges, non-industrial and opportune sales*” covers the refund fee type revenue related to the activity of the local

Annex B - Country Report: Hungary

government institutions, and the official, procedural and charges type revenue.

The regulations for setting the refund fees are contained in governmental and ministerial decrees. From time to time, these prescribe compulsory benefits (e.g. for families with three or more children).

The most characteristic are the meal payment fees in education as well as the fees paid for nurseries, crèches, colleges and social homes. The requirement for these is that they cover the specific costs that have arisen.

In some local governments, community provision is still provided by budgetary bodies. In these cases, the related service fees are part of the combined revenue of the local government. The local government sets the service fees on a “market basis”.

Sometimes, the charges listed here are paid for in cash instead of the stamp duty normally used to pay for state administration procedures.

“*Fines and forfeits*” covers environmental protection, nature protection, historical monument protection and building fines, and also penalties, indemnity and forfeit money.

The annual budget act stipulates the level of the environmental protection fine due to local governments. Departmental legal regulations contain the division of the fine imposed or collected by the historical monument supervisory boards and the level of the building penalty that can be imposed by the local government.

“*Other non-tax revenues*” covers cash donations and gifts from the private sector, revenue from the sale of used up, superfluous assets, settlements of value added tax, invoiced products and services, and the value added tax from sold tangible assets and intangible assets.

## **6. Local government current grants originating from the central budget**

### ***6.1 Development of the grant system***

1990 was a milestone year in the regulation of local government sources. Source regulation here means the allocation of sources from the central budget.

In the 40 years before 1990, central sources were mainly allocated using direct methods, and only in the second half of the 1980s was there a change: namely, under the council system, the alteration of the then direct regulation began. First of all normative elements appeared with the allocation of central grants aimed at development, e.g. using county target grants or development head quotas.

A fundamental change began from 1<sup>st</sup> January, 1990, when a completely new regulating system was initiated. Two to three years were needed to develop it.

The so-called expenditure-oriented financial regulation was discontinued. This regulation was directed from above, individually, by first defining the expenditure amounts, then adding local sources, and then defining the state grant as the difference. Since 1990, instead of using the former method of defining and harmonising county framework numbers, government bodies have been developing indirect source regulatory elements, i.e. those conditions under which local governments are entitled to central budget grants or revenue collection. The normative factor is crucial, the vast majority of the sources are automatically due to local governments.

Box 6.1 shows the current composition of local government sources.

**Box 6.1 Composition of main current revenue sources for local governments, in 1996**

<b>Designation of Sources</b>	<b>Amount in million HUF</b>	<b>Breakdown in %</b>
Own current revenue	224,932	28
Personal income tax	101,274	12
Vehicle tax	7,057	1
<i><b>Total ceded revenue</b></i>	<i><b>333,263</b></i>	<i><b>41</b></i>
Normative state contribution for unconditional use (general purpose)	237,070	29
Normative state contribution for conditional use (specific)	64,101	8
<i><b>Total state grants and contributions</b></i>	<i><b>301,171</b></i>	<i><b>37</b></i>
Liquid assets received from Health Insurance Fund	148,417	18
Other received liquid assets	31,859	4
<b>TOTAL</b>	<b>814,710</b>	<b>100</b>

## Annex B - Country Report: Hungary

Central regulation in the annual budget act does not just cover state grants and contributions but also ceded personal income tax. The enforcement, at local government level, of the defined priorities for the whole of public finance – for example, high-priority handling of public education or social provision, in other respects the increase of personal allowances or the promotion of investments – occurs through the joint regulation of these two sources.

The financial regulation contains differentiating but to a certain extent compensating elements, namely, elements moderating excessive, extreme income differences.

Ceded personal income tax and state contributions and grants therefore constitute the local government **sources originating from central budget relations**. These are the most important sources of local government revenue (representing a total of 50%).

### *Personal income tax*

In 1988, when introducing personal income tax (PIT) to be paid by private individuals, it was stated that it would be the revenue of the local authority where the paying citizen lived. Since information on this is only available after adding up the tax returns, the principle can only be realised two years later. In 1988-89, they still received a share of the PIT in proportion to the number of inhabitants, however, in 1990, it was according to place of residence. For three years, the cessation level was 100%, although in 1990 (and since then), this was on the basis of tax returns submitted two years previously and not on the annual money circulation performance.

In 1991-1992, the cessation value dropped to 50% due to the multiplication of legal titles to state grants and contributions, and the increase of their importance. This trend continued between 1993 and 1994, when the cessation value was 30%. Until now, all of the ceded part went to the local government where the citizen paying the tax resided.

In 1995, this value rose to 35% but at the same time, in accordance with the regulations, complementing the PIT for settlements with unfavourable economic conditions, the share in proportion to the number of inhabitants for county local governments (in the interests of safely maintaining the area institutions), and the partial cover for income supplement grants to the unemployed, had to be guaranteed from this. For these duties, 6% was separated from the ceded PIT thus 29% could remain at the place of origin.

Between 1996 and 1998, the PIT cessation value rose further to 40% but within this the amount remaining at the place of origin decreased further from 29% to 20%, and the part distributed normatively rose from 11% to 20% (the latter contains the supplement serving to close the gap for local governments having lower than average personal income tax). With normative methods of distribution for the larger sections of PIT, the regulation moderates the increasingly large income difference between settlements.

The part directly serving to moderate the income difference has been given a more important role, from year to year. In the last five years, this fund has quintupled. At the beginning, the estimate serving this aim had to moderate

## Annex B - Country Report: Hungary

the revenue difference caused by the personal income tax remaining in the area. (The following data indicates the difference between the types of settlement: in comparison with communities, the capital city has 3.3 times, towns with county rights 2.2 times, and other towns 1.5 times as much the PIT according to the area where it originated.)

In later years, the strong dispersion of income caused by the year-in year-out dynamically increasing business tax had to be “treated”. (In the mid-1990’s, the annual amount of business tax per capita in the capital city was 27 times the amount of communities, in towns with county rights 9 times as much and in other towns 8 times as much. In the case of some settlements, the per capita value of business tax is even more striking than this, for example, there was a small town where the per capita business tax was 150 times the community average. Today, this difference has been reduced but it is still striking.)

From 1999, therefore, apart from the personal income tax remaining in the area, business tax will also be taken into account when defining the PIT share serving to moderate the income difference, which basically qualifies as a grant. Instead of basing the calculations on the actual business tax revenue that comes in, a revenue capacity or tax collecting capacity obtainable on average will be used. In other words, the regulation disregards which value the local government applies within the maximum rate, and whether it enforces benefits or exemptions. In addition to all this, another new factor in the regulation is that, not only do local governments with poor income backgrounds receive supplements but there is “skimming” performed with those who have prominent revenue possibilities. Through this, the “poor” ones receive more.

Personal income tax amounts to 16% of the total local government revenue.

### **6.2** *State contributions and grants*

These sources fall into three, well-segregated groups. The *first* group contains those central budget contributions given to local governments on the basis of norms, and they can be used completely freely.

The distribution of *second* group sources also takes place through normative methods but with these, the restriction to their use prevails.

With the *third* group, individual decisions precede their distribution and these grants can also only be used for the defined goal.

#### *6.2.1 Normative state (central budget) contributions for unconditional use (general purpose)*

Local governments are automatically entitled to take advantage of normative contributions for their compulsory duties. It is not even a question of financing duties, on the contrary, these grants have no restriction on their use. The local government itself decides how much to spend on the individual tasks. At the beginning (in 1990), the comprehensive contributions (related to the number of inhabitants, including the different age-groups) dominated. Later on, the contributions focusing on the concrete

Annex B - Country Report: Hungary  
 duty indicators (infants, nursery school children, primary and secondary school pupils, college students, people in social institutions, etc.) arose with increasing regularity. The aim of this, however, was first and foremost a more correct allocation between local governments of the sources originating from the central budget.

Only one item is directly linked with the revenue collected by the local governments. For every HUF1 of the actual realised resort fee, there is HUF2 worth of grant. The share of this does not even reach 1% of the whole grant.

It could be a Hungarian characteristic that – in accordance with that which was indicated above on personal income tax cessation – the PIT distributed normatively included part of the traditional normative contributions.

The following table summarises the legal titles for normative state contributions and the PIT distributed normatively, and their specific amounts in 1998 and 1999. The detailed presentation of these with the most up-to-date data is justified by the fact that these items constitute 2/3 of the grants originating from the central budget and of the PIT share.

**Legal titles and specific amounts for local government normative state contributions and personal income tax distributed by normative methods in 1998 and 1999**

	Legal title	Amount for 1998	Amount accepted for 1999
<b>I.</b>	<b>Normative state contributions</b>		
1.	Resort tasks	HUF 2 / tourism tax HUF	HUF 2 / tourism tax HUF
2.	Local administration, community and sports duties	HUF 1200 / head resident population	HUF 594 / head inhabitants
3.	District administrative tasks	HUF 4,000,000 across the board  HUF 200 / head resident population of district for provision  HUF 70 / head resident population of settlements indicated by Government	HUF 4,000,000 across the board  HUF 233 / head inhabitants of district for provision  HUF 81 / head inhabitants of settlements indicated by Government
4.	County and capital administrative and sports duties	HUF 150 / head resident population	HUF 169 / head inhabitants
5.	Basic social and child welfare service duties a) basic contribution b) domestic help and/or child welfare service c) village trustee	HUF 933 / head HUF 300 / head HUF 900,000	HUF 965 / head HUF 328 / head HUF 980,000
6.	Child protection provision	HUF 400,000 / provided	HUF 450,000 / provided
7.	Provision of lodging and institutions offering temporary accommodation a) institutional provision b) provision of methodological tasks	HUF 292,000 / provided	HUF 323,200 / provided HUF 6,000,000 across the board
8.	Social institution provision by day	HUF 60,000 / provided	HUF 77,100 / provided
9.	Temporary institutions for the homeless	HUF 120,200 / space	HUF 159,800 / space
10.	Institutional provision for psychiatric and	HUF 391,000 / provided	HUF 432,500 / provided

Annex B - Country Report: Hungary

	Legal title	Amount for 1998	Amount accepted for 1999
	addictive patients and the disabled		
11.	Crèche provision	HUF 161,000 / provided 365 days of care	HUF 128,000 / provided 261 days of care
12.	Nursery education	HUF 67,000 / head	HUF 80,000 / head
13.	School education		
	- Years 1-6	HUF 72,000 / head	HUF 83,000 / head
	- Years 7-8	HUF 75,000 / head	HUF 83,000 / head
	- Years 9-10	HUF 76,000 / head	HUF 108,000 / head
	- Years 11-13	HUF 96,000 / head	HUF 108,000 / head

Annex B - Country Report: Hungary

14.	<p>Vocational training at school</p> <p>a) - 9-10<sup>th</sup> year organised according to the Act on Education (AE) in vocational schools and industrial trade schools</p> <p>- 11<sup>th</sup> year organised according to the AE in vocational schools and industrial trade schools</p> <p>b) professional-theoretical education in vocational schools according to Act on Public Education (APE)</p> <p>c) professional-theoretical education in vocational secondary schools according to APE</p> <p>d) professional experience training</p> <p>- practical training in a vocational school according to AE</p> <p>- practical training in an industrial trade school according to AE</p> <p>- practical training according to APE in an industrial trade school and a vocational secondary school</p> <p>- practical training according to APE in a vocational school</p>	<p>HUF 68,000 / head</p> <p>HUF 70,000 / head</p> <p>HUF 77,000 / head</p> <p>HUF 100,000 / head</p> <p>HUF 25,000 / head</p> <p>HUF 45,000 / head</p> <p>HUF 45,000 / head</p> <p>HUF 30,000 / head</p>	<p>HUF 80,000 / head</p> <p>HUF 80,000 / head</p> <p>HUF 90,000 / head</p> <p>HUF 105,000 / head</p> <p>HUF 50,000 / head</p> <p>HUF 50,000 / head</p> <p>HUF 50,000 / head</p> <p>HUF 50,000 / head</p>
15	<p>Provision extended within the framework of special care</p> <p>a) education of handicapped children</p> <p>b) early development, care</p> <p>c) developing training</p>	<p>HUF 130,000 / head</p> <p>HUF 94,000 / head</p> <p>HUF 130,000 / head</p>	<p>HUF 194,000 / head</p> <p>HUF 105,000 / head</p> <p>HUF 145,000 / head</p>
16	<p>Basic art education</p> <p>a) music, fine arts and industrial arts</p> <p>b) dance, drama and puppets</p>	<p>HUF 45,000 / head</p> <p>HUF 45,000 / head</p>	<p>HUF 49,000</p> <p>HUF 49,000</p>
17	<p>Boarding and day college provision</p>	<p>HUF 135,500 / head</p>	<p>HUF 152,000 / head</p>
18	<p>Contributions for other public education duties</p> <p>a) art education within the framework of parallel education</p> <p>- vocational school education</p> <p>- vocational secondary school education</p> <p>b) catch-up education in vocational schools</p> <p>c) provision for children and pupils struggling with serious adaptation, learning or behavioural disorders</p> <p>d) provision for children, pupils attending nursery or primary school</p> <p>e) provision for children and pupils attending nurseries and primary schools of associations maintaining institutions</p> <p>f) children attending nursery or primary school in settlements with less than 3,000 inhabitants</p> <p>g) children attending nursery or primary school in settlements with between 2999-3500 inhabitants</p> <p>h) institutionally organised catering</p> <p>i) after-class activity in primary school</p> <p>j) library duties, acquisition of educational material, IT education</p>	<p>HUF 25,000 / head</p> <p>HUF 30,000 / head</p> <p>HUF 9,600 / head</p> <p>HUF 3,200 / head</p> <p>HUF 10,500 / head</p> <p>HUF 12,000 / head</p> <p>HUF 20,000 / head</p> <p>HUF 10,000 / head</p> <p>HUF 13,700 / head</p> <p>HUF 3,800 / head</p> <p>HUF 2,200 / head</p>	<p>HUF 60,000 / head</p> <p>HUF 60,000 / head</p> <p>HUF 21,200 / head</p> <p>HUF 12,000 / head</p> <p>HUF 12,500 / head</p> <p>HUF 16,000 / head</p> <p>HUF 22,000 / head</p> <p>HUF 11,000 / head</p> <p>HUF 16,000 / head</p> <p>HUF 5,500 / head</p> <p>HUF 1,830 / head</p>

## Annex B - Country Report: Hungary

19	Provision of local public education and public collection duties	HUF 555 / head resident population	HUF 635 / head number of inhabitants
20	Provision of county/capital public education and public collection duties	HUF 48,500,000 across the board plus HUF 145 / head resident population	HUF 53,000,000 across the board plus HUF 210 / head number of inhabitants
<b>II.</b>	<b>Personal income tax distributed by normative methods</b>		
2.	PIT share of county local governments - across the board - per number of inhabitants - per institutionalised person	HUF 210 million HUF 450 / head HUF 10,800 / head	HUF 250 million HUF 540 / head HUF 14,471 / head
3.	Settlements with unfavourable socio-economic and infrastructure conditions	HUF 1,695 / head resident population	HUF 2,041 / head number of inhabitants
4.	General duties of communities	HUF 2,000,000 / community	HUF 2,000,000 / community
5.	Local administrative, community and sports duties	In 1998 only distributed as normative state contribution	HUF 421 / head Number of inhabitants
6.	Duties related to inhabited peripheral areas	-	HUF 2,000 / head number of inhabitants of peripheral area
7.	Social and child welfare provisions in cash and in kind (based on compound indicators, for 1998, they appear in Annex 3, partially financed from re-distributed PIT)	HUF 500-12,500 / head	HUF 2,500-12,500 / head
8.	Grant for obtaining and maintaining a flat (on the basis of compound indicators)	In 1998, part of the contribution listed under point II.7	HUF 500-4,000 / head

In addition to all these, the so-called *grant for local governments in a disadvantaged situation through no fault of their own* can be listed which, through the source regulation, is due to local governments which have insufficient revenue – principally due to a weak local revenue background – in spite of the different “compensating” supplementary grants, for the running of their compulsory duties. The budgetary act defines the normative conditions with which the local government must comply in order to receive a share of this support. Its utilisation is naturally not restricted to any goal.

These sources represent 26% of the total revenue of local governments.

### 6.2.2 *Specific state (central budget) grants distributed normatively but for conditional use*

The so-called target grants can be found in this category. The central budget extends the projected estimated share, as defined by law, of the individual prominent investment expenditures to the local governments, while the remaining share must be provided for by the local governments, together with possible additional costs. The central grant, therefore, does not follow the actual expenditure.

In the event that it is not possible to create own sources of revenue, these areas receive local government supplements from the support fund that

Annex B - Country Report: Hungary serves to compensate areas and which falls under the decision-making authority of the county regional-development councils. In recent years, through these target grants, every settlement has gained access to healthy drinking water, primary schools have been built, hospitals and clinics have received new machines and instruments. Environmental protection investments, e.g. sewage drainage and treatment, and rubbish tip grants, are once more coming to the fore.

In addition to this, other grants approved in the annual central budget act – linked to current or accumulative local government expenditure and serving to moderate the infrastructure burden on the population - can be listed here: partial refunding of given population contributions for public utility developments, district notary offices, grants for operation of local government fire brigades, grants linked to public water and drainage services, grants for child education, public education grants for minority local governments composed of several items, as well as child grants, grants for those who miss out on central unemployment provision and income supplement grants for the elderly. The budgetary act also defines the conditions of use. Among these, some can be found where the central grant conforms to the actual local government payments, e.g. income supplement allowances to the population

These grants amount to 3% of total local government sources.

### 6.2.3 *Specific state grants distributed individually with conditional use*

Included here are the grants that mainly serve for the realisation of local government health-care (hospitals) and cultural (theatres) investments and reconstruction linked to large-area tasks. These are decided upon in separate laws and the level of the grant evolves on the basis of recommendations from the Ministry concerned, taking into account total costs – and, in recent years, the local government's own sources, too. This grant has been frittered away, particularly in recent times; relatively small, sometimes not even area-type, investments have appeared among those supported. In the interests of stopping this practice, from 1998, a law narrowed the sphere of central allocations to investments above HUF200 million. The regional development councils can decide on the support of smaller investments from said fund, and from the target-type decentralised fund serving to support local governments which do not qualify as having unfavourable conditions.

Also included in these grants are the less significant grants accepted in the budget act (support of work to avert danger to cellar systems and natural sea walls, and the upkeep of orchestras, choirs, ferries and harbours).

Grants related to expenditure caused by so-called 'vis major' cases (e.g. natural disasters) can be listed here. The Minister of the Interior and the Minister for Finance decide jointly on these, case by case.

The grants in this group constitute 5% of total local government sources.

Annex B - Country Report: Hungary  
**Summary tables on the profile of grants**

Table 6.2 shows that central government grants made HUF301 billion in 1996, covering some 40% of current expenditures of local governments (Table 3.2).

Grants are considered to be for general purposes (general purpose grants) since local governments are free to decide on the use of these grants following the same procedure as for their own revenues. However, it should be noted that the related allocation is, as shown in the detailed description of normative state grants, based on the number of those benefiting from, and commensurate with, local government services in schools, hospitals, etc.

A total of 22% of grants are specific, including, for the major part, those related to standard expenditures (conditional grants, standard costs).

When grants are broken down by function (Table 6.3), it can be seen that supporting the educational and social sectors requires the biggest allocations. Within the grant categories, these two sectors represent 55% and 85% of specific and general purpose grants, respectively.

For the proportion of grants to expenditures, it is recommended that the specific and general purpose grants be considered together since this total figure represents the State's intended contribution to local government services in sectors. The last column of Table 6.3 shows that the greatest percentage of grants is concerned with expenditure for social purposes (73%). Grants for education and environmental protection each total about 60%, whilst those for housing and communal services total 42%.

**Table 6.2 The profile of central grants to local governments**

(Million HUF)

Year	Specific Grants		General Purpose Grants			Total
	Current or both		Objective criteria			
	Conditional					
	Standard Costs	Actual Costs	Not Conditional	Without own tax effort	With own tax effort	Discretionary
1996	54,066	6,573	3,462	235 653	1 417	
						301,171

## Annex B - Country Report: Hungary

**Table 6.3 Profile of grants to local governments by function**

(Million HUF)

		Specific Grants			General Purpose Grant	Total
		Current or both				
		Conditional		Not Conditional	Without own tax effort	
Standard Costs	Actual Costs					
1	General public services	3,941			5,487	9,428
	Bodies preparing and implementing laws	3,482			5,487	8,969
	Financial and budgetary activities and services	459				459
2	Defence					
3	Public order & safety	7,283				7,283
4	Education	16,682			134,551	151,233
	Preparatory and basic school education	8,716			83,001	91,717
	Secondary school education	3,957			37,925	41,882
	Other education	4,009			13,625	17,634
5	Health	5,520				5,520
	Hospital activities and services	5,400				5,400
	Family doctor and family paediatrician provision	120				120
	Provision of other medical, and dental surgeries					
	Public hygiene activities and services					
	Other health care matters					
6	Social security & welfare	12,367	6,573		64,020	82,960
7	Housing & community amenities	1,314			23,859	25,173
8	Recreational, cultural & religious affairs	938		3,462	5,368	9,768
	Sport and leisure activities and services				3,368	3,368
	Cultural activities and services	938		3,462	2,000	6,400
	Broadcasting and publication activities					
	Other public and entertainment activities					
9	Fuel & energy					
10	Agriculture, forestry, fishing & hunting					
11	Mining, manufacturing & construction, except fuel & energy					
12	Transportation & communication					
	Public transport	2,000				2,000
	Telecommunications					
	Other transport and transportation					
13	Other economic affairs					
	Environment protection	4,021			2,368	6,389
14	Other functions					
15	<b>Total</b>	54,066	6,573	3,462	235,653	299,754

## 7. Capital expenditure and capital revenue

### 7.1 *Capital expenditure, capital revenue and capital borrowing by local governments for 1996.*

(HUF millions)

	<b>Local government</b>
<b>Capital expenditure</b>	<b>145,615</b>
- Investment in fixed capital assets	95,935
- Renewal of fixed capital assets	18,544
- Purchases of land	1,154
- Capital transfers within public finance	645
- Capital transfers outside public finance	29,437
<b>Capital Revenue</b>	<b>146,545</b>
- Sales of fixed capital assets	47,340
- Sales of land and rights of property	2,282
- Sales of stocks	29,433
- Privatisation revenue	13,409
- Capital transfers from within public finance	11,820
- Capital transfers from outside public finance	16,582
- State contributions to accumulation	25,679

The following changes were made to the template of Table 7.1, in accordance with our recently renewed information system:

- Acquisition of stocks appears in the same line as the investment of fixed capital assets. We displayed the renewal of fixed capital assets and the transfers outside public finance in separate rows.
- The sale of stocks could not be presented separately within capital revenue. Here the capital transfers from outside public finance also have to be indicated separately.
- Within capital revenue, we presented the revenue from sale of stocks and from local government privatisation, separately.

7.2 *Capital accounts of local governments by function, for 1996*

(HUF millions)

	<b>Function</b>	<b>Capital Expenditure</b>	<b>Capital Revenue</b>
<b>1</b>	<b>General public services</b>	18,599	39,851
	Bodies preparing and implementing laws	17,410	39,507
	Financial and budgetary activities and services	1,189	344
<b>2</b>	<b>Defence</b>	<b>40</b>	
<b>3</b>	<b>Public order and safety</b>	<b>373</b>	<b>79</b>
<b>4</b>	<b>Education</b>	<b>16,545</b>	<b>3,257</b>
	Preparatory and basic school education	7,154	493
	Secondary school education	8,082	1,093
	Other education	1,309	1,671
<b>5</b>	<b>Health</b>	<b>20,684</b>	<b>10,475</b>
	Hospital activities and services	16,150	7,346
	Family doctor and family paediatrician provision	944	1,057
	Provision of other medical, and dental surgeries	2,952	2,026
	Public hygiene activities and services	28	
	Other health care matters	610	46
<b>6</b>	<b>Social security and welfare</b>	<b>6,060</b>	<b>1,281</b>
<b>7</b>	<b>Housing and community amenities</b>	<b>15,922</b>	<b>31,647</b>
<b>8</b>	<b>Recreational, cultural and religious affairs</b>	<b>8,064</b>	<b>2,201</b>
	Sport and leisure activities and services	3,543	194
	Cultural activities and services	4,030	773
	Broadcasting and publication activities	64	2
	Other public and entertainment activities	427	1,232
<b>9</b>	<b>Fuel and energy</b>		
<b>10</b>	<b>Agriculture, forestry, fishing and hunting</b>	<b>1,034</b>	<b>73</b>
<b>11</b>	<b>Mining, manufacturing and construction, except fuel and energy</b>	<b>5,371</b>	<b>520</b>
<b>12</b>	<b>Transportation and communication</b>	<b>17,473</b>	<b>4,423</b>
	Public transport	17,034	902
	Telecommunications	360	3
	Other transport and transportation	79	3,518
<b>13</b>	<b>Other economic affairs</b>	<b>626</b>	<b>803</b>
	<b>Environmental protection</b>	<b>26,003</b>	<b>3,760</b>
<b>14</b>	<b>Other functions</b>	8,821	48,175
<b>15</b>	<b>Total</b>	<b>145,615</b>	<b>146,545</b>

In Hungary, local governments can operate with one financial fund, thus current and capital revenue only separate on the revenue and expenditure side.

In addition to the target-type state grants and the liquid assets received for concrete goals, every one of the revenue sources can be applied for current

Annex B - Country Report: Hungary  
or capital expenditure. However, here the performance of the compulsory tasks is the most important.

Box 7.3, produced from the Hungarian information system, is clear as regards capital expenditure but the same cannot be said for capital revenue because, for the most part, local governments do not accurately match their capital revenue with the expenditure functions.

### ***Borrowing (7.4) (7.5) (7.6)***

Pursuant to the act on local governments, a local government can borrow credit. As stated in point 3.6.2 regarding reform measures, the borrowing of local governments has been restricted, in Hungary, since 1995. Moreover, they have to adhere to the general financial institution regulations (which the banks enforce).

There is no superior external control on the borrowing. No approval need be sought to borrow credit or issue bonds.

The borrowing of foreign credit does not come under any separate rule, just the general restriction.

There is, likewise, no specification that the credit be used exclusively for current or capital expenditure.

Short-term loans – liquidity credit – are generally current, while long-term loans serve for investment purposes.

Local governments may borrow credit from any financial institution, in accordance with market conditions. In general, an invitation to tender precedes borrowing, and the bank making the most favourable offer is selected. It is usually the bank holding the bank account which offers the credit at the most favourable terms. There is no central restriction on the duration of the credit.

Once a year, local governments can choose which commercial bank will hold their accounts. Their choice must be made by 31 October. Their institutions are then obliged to hold their accounts at the same bank.

### ***Special regulations:***

- If the local government (just like any business association) participates in organised apartment building, it can borrow state interest-subsidy credit.
- There are also interest-subsidies for credit borrowed for investment by water-works associations.

### ***Summary of key figures - local finance, 1996***

Box 7.3 has been prepared as proposed with regard to the total cash-flow amounts of revenue and expenditure in the GFS system of local governments, in 1996.

Annex B - Country Report: Hungary

In this context, it is indispensable to note that the positive balance in 1996 was exceptionally high and should not be considered as usual or common in the local government sector.

<b>Box 7.3</b> Key figures on local government finances, 1996		
	<b>HUF Millions</b>	
Total revenue		961,255
Current revenue	814,710	
Capital revenue	146,545	
Total expenditure		917,819
Current expenditure	767,679	
Capital expenditure	145,615	
Other (Loan)	4,525	
<b>Balance</b>		<b>+43,436</b>

Based on the information system of local governments, revenue and expenditure from debt (financing) transactions could also be defined, in addition to GFS revenue and expenditure. The 1996 figures for these are shown in Box 7.4 below.

<b>Box 7.4</b> Financing transactions (debt transactions) by local governments, in 1996		
	<b>HUF millions</b>	
Financing expenditures		43,226
Repayment of long-term debts	17,697	
Short-term debts (balance of repayments and income)	3,917	
Purchase of long-term securities	7,824	
Purchase of short-term securities	13,788	
Financing income		18,664
Long-term debts	14,305	
Issue of long-term securities	4,359	
<b>Balance of financing transactions</b>		<b>-24,562</b>

*Note to Box 7.4:* In Table 7.1, state contributions for accumulation purposes are shown in a separate line. As there is only one fund in Hungary, it is not possible to entirely separate credit operations for development purposes from credit operations for operational purposes. Thus, long-term loans were taken out of the Table and put into Box 7.4 on financing transactions.

## Annex B - Country Report: Hungary