

Hungary

Tamás M. Horváth

Zoltán Kristóf

Pál Valentiny

Table of Contents

1.	General Characteristics of the Sector	187
1.1	The Scope of the Public Utility Sector	187
1.1.1	Local Level Public Services	188
1.1.2	Performance Indicators	188
1.1.3	Characteristics of Communal Service Enterprises	190
1.1.4	The Chances of Monopolies	191
1.2.	Local Significance of the Utility and Communal Sector	191
1.2.1	Ownership Structures of Public Utility Companies	192
a)	Water and Sewage Service Providers	192
b)	Solid Waste Treatment Companies	193
1.3	Different Sets of Regulation	194
1.3.1	Local Government Functions, Competencies	194
a)	Mandatory and Important Services	194
b)	Generally Provided Services	196
1.3.2	Property Rights	196
1.3.3	Forms and Operation of Commercial Entities	197
1.3.4	Capital Investment Financing Schemes	199
a)	Addressed and Targeted Subsidies	200
b)	Central Environmental Fund	202
1.3.5	Legislation of Main Service Sectors	202
1.3.6	Competition Law, Anti-monopoly Legislation	204
1.3.7	Rules and Methods of Setting User Charges	206
a)	Officially Set Prices	207
b)	Initiation of Price Increases	209
1.3.8	Social Policy Aspects of Local Public Utilities	211
2.	Specific Issues	213
2.1	Separation of Public and Private Functions	213
2.2	Private Roles in Public Models	217
2.3	Structuring	219
2.4	Privatization	222
2.5	Policy Formulation	225
2.6	Sustainability	227
	References	228
	Notes	231

1. GENERAL CHARACTERISTICS OF THE SECTOR

1.1 The scope of the Public Utility Sector

The Hungarian local government system was established in 1990 by a relatively fragmentary act. More than 3 100 municipalities are working in Hungary which has a population of 10 million. The mean population is 3 242. 55 percent of settlements with an autonomous local authority have less than 1 000 inhabitants, although 7.7 percent of the whole population is living in such like small villages.

At the same time, a relatively wide range of responsibilities is delegated to local self-governments. Apart from these tasks, any other provision of services is allowed to be managed at a local level, depending on the decision of elected representative bodies. Municipality counties (nineteen in total) are working as the second level of local governance. However, they have less competencies in this field. Only the function of regional development is relevant from the point of view of utility and communal sector.

Public utility and communal services in Hungary consist of the following:

- healthy drinking water supply;
- sewage;
- liquid waste removal;
- solid waste removal and disposal;
- district heating;
- electricity;
- urban gas (delivered through pipelines);
- public cleaning;
- park maintenance;
- maintenance of public cemeteries;
- urban road maintenance;
- public lighting;
- services for chimney sweeping and technique of heating;
- social housing;
- public transport.

Most of them are provided at a local level, whereas some are managed at the national level. National public services include electricity (except the capital), public transport outside the boundaries of settlements, maintenance of national roads, and so on.

1.1.1 Local Level Public Services

Among public utility and communal services, some are provided at local level. Typical examples include:

- a) utility services:
 - healthy drinking water supply;
 - sewage;
 - district heating and warm water;
 - urban road maintenance.

- b) communal services:
 - public cleaning;
 - park maintenance;
 - maintenance of public cemeteries;
 - services for chimney sweeping and technique of heating;
 - liquid waste removal and disposal;
 - solid waste removal and disposal;
 - maintenance of social dwellings.

1.1.2 Performance Indicators

There are commonly used statistical indicators on the basis of official statistics, shown by Table 4.1.

These indicators show the relative level of development. From this data, some of the problematic issues are highlighted, for example:

- a considerable difference between the proportion of water and sewage network;
- limits in the extension of waste removal;
- an extremely low proportion of social housing.

Table 4.1
Indicators on Public Utilities

Topics	Indicators	1998
Public water supply	Percentage of dwellings connected to public water conduit network	91.1
Public sewerage network	Percentage of dwellings connected to public sewerage network	47.6
Length of public water and sewerage network	Length of public water and sewerage network per 1 kilometer of water network [m]	341.6
District heating	Percentage of dwellings connected to the networks	16.7
Hot water supply	Percentage of dwellings connected to the networks	15.3
Waste removal	Percentage of dwellings connected to regular waste removal	81.5
Road maintenance	Percentage of length of paved local roads connected to the length of all local roads	73.3
Social housing	Percentage of dwelling stock maintained by local governments	4.9

SOURCES: Regional Statistical Yearbook 1998. HCSO, 1999, pp. 80–85,
Environmental Statistical Data on Hungary 1998. HCSO, 2000, pp. 120–126,
Yearbook of Housing Statistics, 1998. HCSO, 1999, pp. 29, 33.

Environmental conflicts are linked directly to the underdevelopment of some urban services. That is why in the pre-accession process to the European Union these areas are focused on intensively.

The situation in social housing is a result of the transition process that has taken place so far. The privatization process, involving the sitting tenants right to buy was quite rapid and extreme.

18.3% of the total dwelling stock was maintained by local authorities in 1990. This ratio has decreased below 5%, which is comparatively low to other countries.

1.1.3 Characteristics of Communal Service Enterprises

There is a potential competition in almost all of the fields of public utility and communal services in Hungary. Companies providing these services are mixed (ie dealing with different profiles) or specialized. On the basis of available data, the number of providing companies can be estimated as a total.

Table 4.2
Number of Local Providers

1	2	3	4
	Number of Companies According to Their Registered Main Activity, 2000	Available a More Exact Estimation from Different Sources	Number of Companies According to Their Other (Not Main) Activities, 2000
Water	258	<i>cca. 400</i>	735
Sewage	66		1 011
Solid waste	192		1 344
District heating	131	178	438
Burial	235		209
Liquid waste collection and disposal	194		1 151

SOURCE: Company register

It is not possible to collect the exact data on the number of providers. It is difficult to estimate according to the company register, because it is not a necessary requirement. Secondly, there is no obligation to register in any specific chamber or association. However, it is possible to draw some basic conclusions from the estimation.

In the former Soviet type council system, most of these services were provided by state owned enterprises directed by county councils. For instance, there were 33 water and sewage enterprises, which monopolized the provision in the territory of the country. Multiplication in the transition era is proved by this data. *Real estimated amounts are showed in column 2 or 3.* Column 4 is typical of the freedom of choice on profiles (as these companies are not necessarily practicing). On the other hand, these figures are to should be compared with the total amount of municipalities

(more than 3,000). It is clear that integration in service provision is more advanced, in spite of the fragmentation of former state-owned enterprises in utility and communal services.

1.1.4 The Chances of Monopolies

Most of the utility services and some of communal services are provided by monopolies, at least in given settlements or within a service district. In a group of services, mandatory use is prescribed for consumers by the law, as in the case of garbage collection and disposal, and chimney cleaning. Practically, the situation is almost the same in water supply and district heating if you want to use these basic services. However, obligation for use is not prescribed. Competition is guaranteed in the tendering process. In the working period monopolies provide services for consumers.

The other group of communal services, like park maintenance, public cleaning, and maintenance of cemeteries may be provided by competing providers simultaneously in one settlement or service district. This is the case in one of the utility services, for example road maintenance. Monopolies are not typical in these fields.

1.2 Local Significance of the Utility and Communal Sector

Communal services and water management have a much less significant weight in current expenditures than institutional services such as education, health and social care. Naturally, some of these services are financed directly by consumers, so they do not seem to be public functions from this point of view. In the case of public transport, Table 3 below shows a significant decrease from the beginning of the decade. To a large extent, this function has lost its public character.

As far as investment expenditures are concerned, the role of public works is much more significant. Water management is the first sector in this comparison, and public involvement in communal development is also important. It means that incentives offered by local governments play a crucial role in changes of service levels.

From 1998, official financial data have been in another system, integrating current and investment expenditures, as shown in the tables below. Communal and utility services are the sixth largest expenditure group of local public functions. Investment content of this proportion is more important. (See the Annex.)

On the revenue side, specific sources for utility and communal services are hard to find, because according to the basic principle of the financial system, revenues are typically not linked to a particular expenditure. Rather, it is dependent on the policy decision of local representative bodies. However, some of the sources can be defined.

At present, targeted grants are prescribed for three years in advance. For the period 1999–2001 the following targets and grant proportion were announced:

- i) *water management*
 - landfill for waste water treatment: 50%
 - landfill and treatment for collected liquid waste: 50%
 - construction of waste water pipeline-network: 40–50% or +10% connecting to working waste water works.
- ii) education
for the renovation of classrooms: 50%
- iii) health care
instruments for hospitals and surgeries: 40 %
- iv) *solid waste*
construction of landfill: 40 %.

We can observe that two of the announced group of targets (indicated in italics) belong to the utility sector. To these types of matching grants, own sources should be added. There is a right for particular municipalities to get this subvention, if they can fulfil all of the prescribed conditions according to their application. In the starting year, the total amount of grants are approved in annual details. Common constructions are preferred among small municipalities. In this case the proportion of grant can be more with 10–20%. To supplement the necessary own sources, local governments in depressed areas may apply for further sources from regional development subsidies.

1.2.1 Ownership Structures of Public Utility Companies

As there is no exact registration, we cannot have the full picture about the ownership structure of the public utility and communal companies. Neither the company register nor information sources of chambers or professional associations can be used effectively. However, there is a sample survey scrutinized by the ‘Local Government Know How’ program, which gives some relevant details on water and sewage, as well as on solid waste treatment companies.

a) *Water and Sewage Service Providers*

In the Public Utility Service Database created by the ‘Local Government Know How’ program, there is information on 106 owners, on what percentage they own of different companies working in the field of water management.

However, the list of owners does not shed light on the question of how many of them belong to a service provider. Only thirty-four companies are owned 100% by one organization, and the question is ambiguous in all other cases.

Of the thirty-four 'unambiguous' owners 27 (79%) are local governments, 2 (6%) are members of co-operatives, 3 (8%) is the Republic of Hungary (Ministry of Transport, Telecommunications and Water, and the State Privatization Agency) and 2 (6%) are some private enterprises.

On the basis of available data the identity of majority owners can also be analyzed, as there can only be one majority owner of a company, and if an owner has a share larger than 50%, then he is a majority owner.

There are 56 organizations that are majority owners of some service provider in the database. Of these, 40 (71%) are local governments, 2 (4%) are co-operatives, 7 (12%) is the Republic of Hungary, and 7 (12%) are some private enterprises.

Table 4.3. below summarizes the above¹:

Table 4.3

Ownership Structure Distribution of Water and Sewage Service Providers

Owner	Service Providers with One Owner	Service Providers with a Majority Owner
Local government	79% (27)	71% (40)
Republic of Hungary	8% (3)	12% (7)
Co-operatives	6% (2)	4% (2)
Private enterprises	6% (2)	12% (7)
Total	100% (34)	99% (56)

b) *Solid Waste Treatment Companies*

After performing the analysis that we have seen above regarding water management companies, it can be observed that there are 66 single owners and 79 majority owners of the 129 owners in the database.

Of the 66 with 100% ownership, 59 (89%) are local governments, 1 (2%) is a co-operative, 1 (2%) is the Republic of Hungary and 5 (8%) are individuals.

Of the 79 majority owners, 67 (85%) are local governments, 1 (1%) is a co-operative, 2 (3%) is the Republic of Hungary, 3 (4%) are some private enterprises and 6 (8%) are individuals.

Table 4.4. below summarizes the above.

Table 4.4
Ownership Structure Distribution of Solid Waste Service Providers

Owner	Service Providers with One Owner	Service Providers with a Majority Owner
Local government	89% (59)	85% (67)
Republic of Hungary	2% (1)	3% (2)
Co-operative	2% (1)	1% (1)
Private enterprise	0% (0)	4% (3)
Individual	8% (5)	8% (6)
Total	100% (66)	100% (79)

This partial data has limited validity. Private involvement seems to be stronger according to the practical experiences. However, the common conclusion arises from this information that public and private actors can cooperate. Both are involved in a common market situation in the provision of communal services.

1.3 Different Sets of Regulation

1.3.1 Local Government Functions, Competencies

a) Mandatory and Important Services

According to the Act LXXV of 1990 on Local Governments, the local government acts independently in the public affairs of local interest, which belongs to its sphere of duties and jurisdiction. *Local public affairs* are committed to providing the population with the services of public utilities, as well as ensuring the exercise of local public power in self-government, and the local creation of the organizational, personal and material conditions thereof.

The local government may regulate independently, and in individual cases direct freely, the local public affairs that fall within its scope of duties and jurisdiction.

The scope of duties and jurisdiction of local governments are highly varied. An act—in order for any cross-measures to be avoided—may also determine compulsory spheres of duties and juris-

diction for the local government. An act may also determine voluntary duties for the local government. Within the sphere of voluntary duties the local government may freely decide the extent of the duty it undertakes. It has no such authority of decision in the case of compulsory duties. Compulsory duties must be fulfilled, though the local government has certain independence also in these cases in terms of methodology, quality, and so on.²

The local government disposes independently of its municipal property; allocates independently its revenues; and it provides from its unified budget for the delivery of the municipal duties, whether undertaken voluntarily, or compulsory. It is also necessary to mention that the local government may pursue entrepreneurial activity of its own responsibility not only for the undertaking of voluntary and compulsory duties, but also on other—potentially economically profitable—fields of business³.

The Act LXV of 1990 nominates several duties that are worthy of highlighting due to their importance. Nevertheless, the list is not complete, though it contains both compulsory and voluntary duties. The Act Section 8, Paragraph (1) refers to the importance of the duties listed therein with the adverb “particularly”. It contains the following duties:

- development of the settlement;
- settlement planning;
- protection of buildings and the natural environment;
- housing management;
- water resources planning and drainage of rain water;
- maintenance of the public cemetery;
- canalization and sewerage;
- maintenance of the local public roads and public areas;
- local mass transportation;
- public sanitation and ensuring of the cleanliness of the settlement;
- participation in the local supply of energy.

Apart from these obligations, local government is responsible for the participation in the solution of employment; provision of kindergartens; primary education and instruction; health and social provision; looking after other duties concerning the children and the youth; ensuring the provision of community space or forum; support of public education; scientific and artistic activities and sports; ensuring the enforcement of rights of national and ethnic minorities; and the promotion of the community conditions of a healthy way of life. In total, municipalities have a wide range of functions.

Acts assign duties and public services for local governments that are compulsory for every single local government notwithstanding their size and capacities. These are thus the *mandatory duties*,

to which range belong duties that are indispensable for the basic support of the local community and the operation of the settlement. The Act requires the local government to perform the following utility and communal duties on a compulsory basis:

- provision for healthy drinking water;
- collection and disposal of normal (non-hazardous) solid and liquid waste of settlement;
- public lighting;
- maintenance of local public roads;
- maintenance of public cemeteries.

‘Mandatory’ means a general obligation for the provision of services. It does not mean, of course, a direct delivery by municipalities. They are responsible for provision notwithstanding the particular solution of management. However, this obligation should be fulfilled by all of the municipalities. Since the relative amount of municipalities is quite huge in Hungary, guarantee of these tasks is a control of sufficient capacities of municipalities.

b) Generally Provided Services

In the vast majority of settlements the local government provides the following services:

- supply of drinking water;
- sewerage, sewage water treatment⁴;
- maintenance of the public cemetery;
- maintenance of local public roads and public areas;
- public sanitation⁵ (including solid waste collection and disposal);
- ensuring of the cleanliness of the settlement⁶ (including liquid waste collection and disposal);
- chimney cleaning.

Except mandatory services optional are involved in this group, as well. The extent of municipal role depends on the actual capacities in principle. Practically, the other listed services are provided by larger municipalities (towns and cities), spreading their activities in many respects to their rural area. Some of the optional public utility services are supplied also by smaller municipalities.

1.3.2 Property Rights

The ownership of local government includes building structures, pipe-lines and conduits; fixtures and equipment of public works which serve the needs of the population within the inner borders of the settlement, with the exception of those owned exclusively by the state.

The electric or gas public utility property—due to the local governments of the localities - is part of the assets of the economic association operating the public utilities. Shares of municipalities will be paid although it is under a long discussion between the State Property Agency and associations of local governments.

Assets of local governments consist of entrepreneurial assets and primary assets. Primary assets serve directly in the carrying out of compulsory duties and so have limited saleability. Property belonging to the range of the primary assets is either non-saleable or saleable in a limited way:

- (a) non-saleable commodities are the local public roads and their structures, the squares, the parks and any other real and personal property which is designated as such by an act, or by the local government;
- (b) saleable in a limited way are the public utilities, institutions and public buildings, as well as real property and movable assets, so designated by the local government. Disposition of items of the primary assets saleable in a limited way may be made in accordance with the conditions defined in an act, or in a decree of the local government.

1.3.3 Forms and Operation of Commercial Entities

The Act CXLIV of 1997 on Business Companies (in this section referred to as the Act) re-regulated the Act VI of 1988 which had been in power until 16 June 1998. The Act does not provide an explicit definition for business companies, but from its decrees the following definition can be drawn: ‘company’ is a collective term for organizations that pursue business-like economic activities and which fulfils the requirements for one of the business forms that are listed in the Act.

Beyond the rules of the Act, the Act IV of 1959 on the Civil Code of the Republic of Hungary also provides rules on business associations. (See Sections 52 to 56 of the Civil Code.) According to Section 685 of the Civil Code, economic organizations are: state-owned companies, other state-owned economic agencies, co-operatives, business associations, professional associations, non-profit companies, companies of certain legal entities, subsidiaries, water management organizations, forest management associations, and private entrepreneurs. The provisions governing economic organizations shall be applied to the state, local governments, budgetary agencies, associations, public bodies, and foundations in connection with their economic activities, unless the law provides otherwise for such artificial persons.

There are five possible forms of business companies. Two of these are without legal personality: unlimited partnerships (Hungarian abbreviation: ‘kkt’) and limited partnerships (‘bt’). The three other forms have a legal personality: joint enterprises, limited companies (‘kft’) and joint-stock companies (‘rt’).

With the exception of limited liability companies and joint-stock companies, for which one-member formations are allowed, at least two members are required for the foundation of a business association.

For unlimited partnerships and limited partnerships the business companies' supreme body is the meeting of members; for joint enterprises the council of directors; for limited liability companies the members' meeting; and for companies limited by shares the general meeting. Issues falling within the exclusive competence of the supreme body of business associations are regulated by the provisions on the individual forms of business associations.

The liability of a member for the obligations of the business association varies depending on the form of the business company: before the termination of the company it is unlimited and joint in the cases of unlimited partnerships and the general members of limited partnerships, while it is limited and only extends to the value of capital contributions or shares in the cases of limited liability companies and joint-stock companies.

The 'Local Government Know How' program by the commission of the Hungarian local government associations made a sample-survey on the business forms of companies operating in businesses of public sanitation, water and sewage treatment in the years 1996 to 1998. Upon the basis of this research service providers can be categorized as follows:

Table 4.5
Distribution of Organizations Operating as Local Public Utilities

Form	Ratio [%]
Budgetary institution	37.80
Joint-stock companies	11.42
Limited company	30.31
Private undertakers	11.02
Limited or unlimited partnership	1.97
Non-profit organization	4.33
Other	3.15
Total	100.00

Budgetary institutions, i.e. organizations that are institutions owned by some local governments, represent a significant share of organisational forms.

Of business companies, the majority of limited liability companies is apparent, this one is the most popular form. Private entrepreneurs also represent a high percentage. Non-profit

organizations rather unfairly only have a small ratio, even though their number has been recently increasing among public utility service providers.

In the case of local government owned companies three legal forms may be used in practice: limited companies, joint-stock companies, and non-profit organizations. The share of the private form is also significant.

Companies that have mixed ownership may be established and operated in any of the business forms listed in the Act on Business Companies provided that the limitations of the Act on Local Governments are also obeyed.

Joint ventures between local governments are a very important possibility for capital inflow for local governments. In such cases a local government lacking capital may elect to obtain capital by allowing private entrepreneurs to acquire part of its own company.

This type of co-operation makes it possible for the local government to keep its majority stake and voting share in its company without objecting to the ownership interests of the private sector. This solution may make higher efficiency, lower costs and a higher quality of services possible at the same time. This type of co-operation is generally more accepted by the public and politicians, as the presence of local governments in decision making represents a higher probability that the interests of consumers remains safe.

A special problem that may arise in such cases is the conflict of interests on the side of the local government, i.e. the conflict of the interests of the owner and the regulator. The local government as proprietor is interested in the increase of revenues, but as a regulator and the representative of the public interest, it is interested in keeping rates at low levels. Its partner, however, is not a representative of the public interest and usually does not aspire to political power, therefore is not participating in elections (at least not directly). For this reason the interest of the partners with respect to the question of prices may conflict, which could influence the operation of the company in a detrimental way.

In each one of the above cases it is important to emphasize that the responsibility of service provision still rests on the shoulders of local governments, and it is they who have to solve the problem of controlling the service provider, and have to stand ready to provide the service in some alternative way in the case of the faulty provision of service by the existing service provider.

1.3.4 Capital Investment Financing Schemes

Capital investment schemes are based on central government expenditure and local government expenditure. Central sources are involved principally in the budget of Ministry of Transport, Telecommunication and Water Management.

These are:

- central investment schemes (esp. development of regional water works);
- sources particularly defined for water management purposes (maintenance and investments);
- targeted sources for road maintenance and development.

As far as particularly local government revenues are concerned, it is a characteristic of subsidies that local governments usually receive it with obligations about its accounts; may only use it for the specified objectives; and may not transfer it to the fulfillment of other duties; and are fully accountable for their use.

The existence of these sources in development of public works shows the public responsibility in utility and communal services.

a) Addressed and Targeted Subsidies

Addressed and targeted subsidies are subsidies that support local governmental investments and (re)constructions, in order to stabilize the development potential of local governments. Such subsidies may only be applied for in order to complete investments that serve basic function purposes, that have been planned from technical, financial and economic aspects, and that are required for the efficient performing of local governmental duties.

A *basic function* is the professional and technical contents of an establishment prescribed compulsorily by building standards, and standards of the sector, which serves the purpose of performing a local governmental duty.

Targeted subsidies assist the accumulation of duties of local governments by partially financing the fulfillment of socially important tasks. The conditions of the use of targeted subsidies are determined by the Parliament. Local governments that fulfil these conditions may receive the subsidy. The amount of financial aid is provided by the annual central budget.

If the local government utilizes the subsidy in a mistaken or unlawful way or not for a basic function or not for the specified investment, it has to repay the subsidy together with applicable interests.

Addressed subsidies serve the purpose of financing investments that may not be aided by the targeted subsidy system but that help the fulfillment of local governmental, regional, national, roles. It may only be used for purposes outlined by the Parliament. Its use and accounting have to be done in a way that complies with the Act LXXXIX of 1992 on the Addressed and Targeted Subsidy System of Local Governments.

For local governmental investments that serve socially important (this is determined by the Parliament) goals, provided the set conditions apply, local governments may receive targeted subsidies automatically.

By the system of addressed and targeted subsidies, the central government can influence the investment of local governments in a given period. Some mention this fact as the negative side of these subsidies, but it has to be taken into account that this is an important tool of the state to dissect complex programs into manageable parts. Another reason that supports this kind of central governmental subsidization is that international funds also support pre-set objectives, which also have pre-announced preferences. The goal of the central government may also be to direct local governments towards these international funds and to encourage their use. The fact that international applications can be more successful if the central government supports local governments in this way. The table below shows the division of addressed and targeted subsidies in the 1990s.

Table 4.6
Addressed and Targeted Subsidies of Local Governments in the Period 1991 to 1998

HUF million								
	1991	1992	1993	1994	1995	1996	1997	1998
ADDRESSED GRANTS								
Water management	496	1 154	1 334	1 473	740	762	1 280	1 025
Education	546	1 350	1 838	1 344	963	1 867	4 196	5 646
Health care and welfare	5 620	7 343	8 553	8 676	9 025	9 179	12 034	10 520
Other	5 152	224	209	190	366	357		
Total	11 814	10 071	11 934	11 683	11 094	12 165	17 510	17 191
TARGETED GRANTS								
Water management	496	8 532	10 049	14 734	16 998	18 448	21 560	24 321
Education	546	4 868	2 772	2 711	2 038	1 073	581	547
Health care and welfare	5 620	2 977	3 944	3 861	3 470	1 732	1 376	1 380
Other	5 152	181	30	21		611	1 446	1 092
Total	6 211	16 558	16 795	21 327	22 506	21 864	24 963	27 340
ADDRESSED AND TARGETED GRANTS TOTAL								
Water management	2 146	9 686	11 383	16 207	17 738	19 210	22 840	25 346
Education	3 547	6 218	4 610	4 055	3 001	2 940	4 777	6 193
Health care and welfare	7 130	10 320	12 497	12 537	12 495	10 911	13 410	11 900
Other	5 202	405	239	211	366	968	1 446	1 092
Total	18 025	26 629	28 729	33 010	33 600	34 029	42 473	44 531

SOURCE: Department for Local Government Economy, Ministry of Interior

Addressed and targeted grants which are relevant, are mainly in water and sewage services, because the necessary added sources are available in these fields. Due to this reason, mainly targeted grants are relevant and increasing progressively, compared with all the other types of local public services. There are specific forms of economic associations, such as water management associations, which are available for concentrating consumers' financial sources for development.

b) Central Environmental Fund

The Central Environmental Fund subsidizes construction of landfills according to EU standards. The proportion of subsidy may not be more than 30% of the total investment cost. Regional projects are preferred and a strong incentive is working for cooperation among local governments.

Table 4.7
Subsidies on Landfills from CEF

Index	1993	1994	1995	1996	1997	1998	1999
Number of regional landfills	11	4	3	5	13	5	3
Capacity of landfills [1,000 m ³]	598 443	1 221 000	370 920	1 385 000	4 031 525	1 209 000	1 758 000
Population involved	79 460	97 350	82 725	1 544 384	626 372	113 500	414 500
Total expenditure of investments [1,000 USD]	922.5	2 519.5	868.7	4 077.6	14 543.3	3 942.6	8 844.1
Subsidy from CEF [1,000 USD]	218.4	532.3	245.5	706.5	3 101.8	933	2 461.2
Proportion of CEF-subsidy in the total expenditure	24%	21%	28%	17%	21%	24%	28%

SOURCE: Dax and co., 2000: 7

1.3.5 Legislation of Main Service Sectors

Laws and government statutes for different sectors have been re-regulated since 1990. Key laws and connecting statutes refer to:

- water management;
- economics of waste;

- district heating;
- cemeteries and burial services;
- particular public services to be used mandatory (nowadays it is referring on chimney cleaning);
- electricity;
- gas services.

The essence of the new legislation is a division of different roles in provision in the circumstances of market economy or quasi-market environment. Apart from the position of public providers and consumers, tasks of local governments and state administration is clarified independently and in relation to each other.

- *State administration* is generally the regulatory authority. It does not require solely a legal position, but economic regulation including partial or full rights to set prices, influencing the level of services. State administrative authorities entitle providers to pursue their activities, however they are allowed to control conditions prescribed by laws. They do not have the right for discretion according to their own particular points of views. Technical and professional abilities of providers are given as evidence by the permission.
- *Local governments* are responsible for self-governing tasks, i.e. making policy-decisions in strategic issues of the particular local service delivery. They are responsible for managing services, setting prices in the framework of laws. Cooperation with consumer protection is also their task, although policy formulation is based on legitimacy in this case, rather than public consumer's representation. On the other hand, municipalities realize state administrative functions as well, like authoritative control, giving permission in matters with less importance, and so on. On most of the services local governments may regulate passing local decrees on the basis of authorization given by parliamentary acts.
- *Providers* are obliged to provide services in their area of operation. It means a direct obligation in making contracts for delivery, if consumers declare their demand and accept conditions. Bargaining on a provider's offer is almost always negotiable. However, the level of public service delivery is supervised by the authorities. Furthermore, consumer protection has a right to initiate modification of conditions of contracts.
- *The consumer's* main obligation is to pay fees and charges for services. Prices are expected to be in keeping with the quantity and quality of the service delivered. The right to complain is guaranteed, however mechanisms are not formulated too rigorously. Consumer protection is also not really strongly organized. Sometimes, local governments take overrepresentation of the consumer's interests.

The main importance of the new legislation is to make an attempt to separate and clarify different public roles and functions in public service delivery. From this point of view water management might be an exception. It is traditionally one of the most developed branches of administration

in Hungary. Due to geographical necessity (the Kárpát-basin is the water-collecting place of the whole surrounding area), defense against floods and water management in general is organized quite accurately, and legal institutions have been developed since the mid nineteenth century. The relatively detailed legal environmental rule preserved many of its specific features even in the communist era. Due to the relative autonomy of this sector, water management seems to be less opened to the mentioned direction.

1.3.6 Competition Law, Anti-monopoly Legislation

Competition in the field of public services is regulated through different areas. Main subjects of legal regulation are:

- public procurement;
- concessions;
- mandatory utilization of particular public services;
- competition.

The Act on Public Procurement (1995:XL.tv.—in this section referred to as the Act) governs the manner in which government contracts are awarded. The policy aim is development of transparency and control of the utilization of public funds ensuring conditions for open competition. The value limit of procurements regulated by the acts is defined by the annual budget. Until the end of 2000 limits are as follows:

- HUF 16 million (53 000 USD) in the case of procurement of goods;
- HUF 32 million (106 000 USD) in the case of construction projects;
- HUF 8 million (27 000 USD) in the case of utilization of services.

These limits are under EU requirements. From the point of view of public utility and communal services, the most important limit is referring to the services. However, the problem is that the eventually missing payment for services makes questionable the obligation for announcement of public procurement process. This is the situation, when consumers are paying for services. At this point the practice has not yet been unified.

The Act mentioned above specifies three types of procedure. According to the principal rule, the open procedure must be used, which starts with a call for tenders or a pre-qualification procedure. In both cases, the tenderer is obliged to publish the tender via a public notice. The content of the call for tenders, the nature of the necessary documentation and the preliminary notice, possibly the amount of guarantee undertaken are regulated in detail by the Act.

In addition to the open procedure, the Act provides for invitation and negotiation procedures for specific cases. Tendering by invitation takes place when only a limited number of bidders are

suitable for the performance of the contract, or if qualified bidders are being invited. A negotiable procedure follows if the open or invitation procedures have proved unsuccessful, if the period is too short for various reasons, or if other special reasons have arisen. An accelerated procedure is possible in both special methods if justified by urgency.

The Public Procurement council supervises the procedure in accordance with the Act. Public procurement committees are operating in conjunction with the council that is responsible for administering legal remedy. Members of these committees are civil servants, employed by the council. Appeals against the resolution of the committees are submitted to the court.

2. According to the Act on Concession (1991: XVI. tv.), activities subject to this process include the operation of public roads and structures as well as local utilities which form a part of the primary assets of local government. However concession is not the exclusive form of operation if the public ownership is overwhelming in the providing company.

In the case of the establishment of concession, public tenders are obliged to be announced. Elements of the announcement are prescribed by the law. Rules of the procedure are also regulated.

The winner of the tender becomes a subject of public contract, of which the basic content is based on the act, like the amount of concession fee (as a counter-performance for giving over the right of practicing the particular activity) or any other counter-performance (like investments). For the practicing of activity, being subject of concession, concession company is to be founded. New assets establishing by the company become the property of the contractor state or local government.

In the sectors of transport and water management, specific acts declare a more detailed regulation on the basis of the Act on Concession.

3. According to the Act of Compulsory Utilization of Specific Local Services (1995: XLII. tv.), local governments are required to call public tenders for delivering particular services, like public service activity of chimney cleaning and connected heating-technical services. The same obligation is prescribed by the Act on Waste Management (2000: XLIII. tv.) for the collection, removal and safe disposal of solid and liquid waste. Tendering rules are not so detailed in the case of procurements.

The given order of providing such public services needs to be regulated by a public service contract and a local government decree regulating either providers or consumers obligations. Consumer obligation on using the offered service and pay particular fee for it is based on the local decree as a legal rule. This fee can be collected as taxes. In the case of waste removal this possibility is based on the authorization of the Act.

4. General rules on economic competition refer on delivery of public services, as well. The Act 1996: LVII. tv. regulates prohibition of unfair market behavior and limitation of

competition. The State should ensure the fairness and freedom of economic competition through legal regulation. This requires the admission of rules of competition law which prohibit market practices violating the requirements of fair competition and restricting economic competition, and prevents the interlocking of undertakings in a manner detrimental to competition, providing also for the required organizational and procedural conditions.

It is prohibited to conduct economic activities in an unfair manner, in particular, in a manner violating or jeopardizing the lawful interests of competitors and consumers, or in a way which is in conflict with the requirements of business integrity. It is also prohibited to mislead the consumers in economic competition.

Agreements between undertakings which are aimed at the prevention, restriction or distortion of economic competition, or which may display such an effect, are prohibited by the law. There are also other restrictions, for example the prohibition of abuse of dominant position, controlling the concentration of undertakings. The Office of Economic Competition is obliged to supervise undertakings and conduct proceedings against firms distorting legal rules. Legal remedy is guaranteed by courts.

There are several problems with the legislation mentioned above. Firstly, the public procurement process can be hardly adjusted to the specification of public services. The whole system tries to react to EU-requirements, whilst Hungarian specifications remain in the background. For instance, many small local entities need regulation on their public decision-making which, due to the large amount of small issues, needs to be carried out in a more simple and effective style.

Secondly, the public procurement system is based on contracting mechanisms. While the tendering is mandatory to a certain extent, contracting-out is not prescribed, and public contracts are not detailed and elaborated in the practice. More severe conditions are linked to the value limit than the public-private contracting process in general.

Finally, tendering is not a general obligation, even its use is extending. Furthermore, it is relatively easy to avoid rules of the game. Generally speaking, continuous development and modernization of the system is slower than changes and techniques used in the practice.

1.3.7 Rules and Methods of Setting User Charges

There are two types of official prices that are relevant from the point of view of local public utility and communal services. One is the official price, stated in public proceedings according to the rules of administrative procedures. The other is based on local legal regulation (statute) of local governments. Preferences of local policy making may be realized more in the latter type, in which the regulation focuses apart from it other issues of the particular public service delivery. On the other hand legal remedy against the setting prices is more direct in the case of first type of procedures.

1. Official prices stated in public proceedings in the following public services:
 - drinking water delivered by municipal water works;
 - sewer delivered by municipal water works;
 - local public transport;
 - public heating and warm water.
2. Official prices stated by municipalities in their local legal statutes in the following services:
 - communal solid waste removal;
 - communal liquid waste removal;
 - chimney cleaning;
 - maintaining services in public cemeteries.

Other official prices in relevant services are set by national government, like electricity and gas delivered on pipeline network.

Setting user charges was under discussion in the whole period of transformation. Mainly waste collection fees stated by local governments were criticized by consumers. In many cases representative bodies linked charges to the size of houses, notwithstanding the number of inhabitants in them. The other typical discrimination was to order the same charges per year for the irregular inhabitants (especially owners of cottages) than regular ones. Because these charges were set in local decrees, the Constitutional Court was the only forum to revise them.

The Constitutional Court consequently used the Constitutional basic principles and the Code of Civil Law to solve the problem. According to the sentences, the key point is the principle of equality of delivered service and its compensation. Proportionality, these should be kept by local decrees. So, it is prohibited to use general prices and charges notwithstanding the real amount and quality of services delivered.

Consequently, in the recent legislation these principles have been adopted (Act on Waste Management, 2000). It is also interesting that the Constitutional Court did not respect any public element in this issue. That is why environmental problems and possible solutions to it are not calculated in these decisions.

a) Officially Set Prices

In market economies, the provision of the right to the freedom of competition requires that prices be regulated according to the principles of the market economy.

The primary rule in terms of prices and fees in Hungary is that they are set by the contracting partners, with regard to the Act LVII of 1996 on the Prohibition of Unfair Market Practices; and the Act LXXXVII of 1990 on Prices, and furthermore with regard to one another's interests and with co-operation.

In reality, set prices are an exception compared to this rule. The reason of their use is the fact that governmental intervention may be needed in the case of a market economy, if the complete rule of market mechanisms would lead to behavior that is in contradiction with the public interest. Such a case may present itself in the case of monopolies, i.e. the price setting of monopolies must be regulated. These interventions may hurt the operation of the market economy, unless they are limited to a tight set of market participants, and are regulated with laws and governmental institutions are not able to adversely affect market mechanisms through their use.

According to Hungarian law, an official price may be set by ministers or the assembly of representatives of a local government. This is supposed to ensure that official prices are set at places where appropriate professional knowledge and necessary organizational background are present. The products whose prices are subsidized by the central government or if the official price is set by a minister, the approval of the Minister of Finance is required.

The setting of the official price can transpire by setting an upper or lower price limit for the specified product⁷. The setting of the price may be resolved by determining a calculation method for the price. In connection with the setting of the price, conditions must be set up regarding the use of the official price. Such conditions can be: parameters regarding the quality of the product or service, the place of transactions (e.g. office of the seller or the buyer); payment conditions; size of the order (e.g. there are prices that have to be used above or below certain quantities); et cetera.

The price setting authority has to publish the newly set price in a decree. In this decree the starting point of the validity of the new price must be determined, which cannot be in the past. Market participants may not go above the set upper or below the set lower price limits, not even by mutual agreement.

Within the limits set by official prices, agreement on price is the right of the partners. However, if the parties involved do not specify a price or specify a price that is outside official limits, the contract must be fulfilled on the official price.

The Act on Prices declares regarding upper price limits as a general rule that it has to provide enough income to finance the “efficient”⁸ entrepreneur’s expenditures and necessary profits. In this sense it is the responsibility of the authority that sets the official price, not to set so low a price that would endanger the normal operation of the producer, and also not to acknowledge expenditures arising from inefficient operation. Therefore it is the duty of the authority that sets the price to analyze the operation and efficiency of companies for whose products the authority wants to set an official price. Furthermore, the Act on Prices requires the authority to continuously monitor whether the set prices are adequate for the efficient operation of the producer. If the authority finds that the official price at the time is inadequate, it should initiate a price change. In practice, there are few cases when the price setting authority is capable of such examinations and the tracking of the operations of the companies involved. That is why price increases are usually initiated by the companies concerned.

According to the Act on Prices, as a general rule, for contracts that are penned before a new official price becoming effective, but that are completed afterwards, it depends on the parties involved whether they modify their contracts with the new official price in mind. This rule ensures the safety of contract by not making it compulsory for the parties to modify their contract (i.e. if there is a valid agreement between two parties, the authority has no right to change it)⁹.

Of the public utility services examined, the prices of district heating, water and sewage services are official prices, according to the Act LXXXVII of 1990 on Prices. The prices of solid waste disposal services are not categorized as official by the Act on Prices, but by the Act XLII of 1995 on the Compulsory Use of Specific Public Utility Services they are, as when it declares that the right and duty of setting waste disposal prices belongs to local governments. The Act XLIII of 2000 on Waste Management, which comes into power on 1 January 2001 also declares that waste collection fees must be set by local governmental decrees.

In terms of the chimney cleaning service, the aforementioned Act XLII of 1995 on Compulsory Use of Specific Public Utility Services also declares that its prices must be set by local governmental decrees.

The Act XLIII of 1999 on Cemeteries and Burial Services declares that as the main rule, the right of setting the prices belongs to the owner of the cemetery. Regarding public cemeteries, however, it says that it is the local government that sets the types and amount of fees that must be paid for the use of the public burial service. This latter regulation is not in contradiction with the main rule, as the owner of a public cemetery can only be the local government. What is an addition in this regulation is the factor that the local government has to create a decree regarding the pricing of burial services.

b) Initiation of Price Increases

Public utilities have had to execute exceptionally frequent and high price increases in the past decade, and in the period that remains until the EU accession of Hungary further significant price increases are inevitable. Price increases are generally not well received, especially by consumers, but due to the tensions that arise when initiating a price increase, the management of the companies in question are often unwilling to get down to this task.

The most important reason of price increases is the increase of costs. One part of the cost increase is an external factor for the company, for example the increase in energy prices cannot be offset by a service provider. Another part of the price increases—the one that depends on the particular situation and circumstances—can be offset with economic measures. The most important prevention against cost increases is the increase in productivity¹⁰. Cost increases that are not offset by productivity increases are the factors that force companies to raise their prices¹¹.

The increase of the demand for a product or service may also lead to price increases. If the company is unable to meet the demand for its product, it may mitigate the demand by increasing the price.

Government measures may also cause price increases. Such are taxes that are built into the prices of products. The most characteristic example for this is the value added tax, which can be found in the price of almost every product. This type of price increase is completely out of the control of a single company.

There are cases when—against all efforts—a price increase is the only solution to offset the cost increases of the public utility service provider. If this measure is unavoidable, it has to be implemented in such a way that does not incur strong counter-feelings in consumers, which may create a worsening situation. As discussed above, price increases may be initiated within the range of officially priced products by either the authority that sets the prices, or the company that deals with the appropriate product or service. The most frequent method is that the company initiates the price increase in the form of filing a petition.

The company has to support its claim for price increases with data. This data has to be able to justify costs and the need for more profit. The price setting authority may also require further data, which extends the 30-day justification period.

The company may elect to periodically or when an exceptional cost increase happens, to revise its operations, and file a price increase plea if it so sees fit.

Another possibility is the enclosure of a *clause of constant value* to the contract regulating the provision of the public utility service. This is, practically, a price setting formula. The formula must contain all the factors that have (a significant) influence on the costs of the company. These factors must be weighed in the formula according to their weight in the real cost structure of the company. Afterwards, prices have to be increased proportionally to total cost increases.

The periods of price revisions may also be set in the clause of constant value, and in this way price increases can be automatic.

The advantage of the solution is that the continuous monitoring of operation and the examination of price increase claims can be greatly simplified. In this way, the price adjustment procedure can be shortened, the price increase can be executed faster and with fewer conflicts, and price changes can be more easily forecast.

The disadvantage of the use of a clause of constant value is that unless precise cost ratios are entered into the formulas when signing the contract, the distortions that arise can exist for longer periods of time or even increase. Both parties have the same chance when signing the contract of having to face the disadvantages that this presents.

Public utility service provider companies in Hungary can choose either the manufacturing cost or the capital cost based price setting model on the basis of the Act on Prices. The key element of both price setting methods is the determination of the unit cost, therefore public utility companies have to emphasize the correct calculation of unit costs when determining their accounting policies.

1.3.8 Social Policy Aspects of Local Public Utilities

Transformation of public utility services lead to social inequalities in different meaning. The whole process in the 1990s increased differences among particular groups of people, categories of settlements and the regions of the country.

1. *People's social inequalities.* As a consequence of the privatization of assets and devolution from state to local self-governments and radical decrease of subsidies, fees and charges are raised in a crucial way. In the same period a lot of people lost their job and were placed in crises. Many families cannot pay fees of consumed public utility services and the installment of their housing credits.

Table 4.8
Households in Arrears, 1998

Type of Public Services	Number of Households in Arrears	Proportion to the Consuming Households	Amount of Arrears [million HUF/year]	Proportion to the Whole Amount of Charges
Electricity	603 871	13.2	2 700	3.0
Gas (network)	137 352	5.5	2 223	2.6
District heating	135 183	21.1	5 082	12.1
In sum			10 005	

SOURCE: Ministry of Welfare

Local governments choose different strategies to relieve this quite huge and complicated situation. Possible instruments are

- compensation;
- assistance;
- consulting to solve family and job problems;
- transfer of apartments;
- legal process in the case of non-welfare situation;
- bargain on charges with utility companies if local government has a competency in pricing.

The aim of these actions are to prevent people from getting into deeper crises, i.e. from eventual non-payment to cumulated arrears, or from cumulated arrears to losing dwellings.

2. *Inequalities of settlements* in social terms means that some communities have necessarily to cooperate in order to be provided with public utilities and communal services. Companies provide particular district or a higher concentration of the population. In contrast, influence

of local governments is quite selective. It depends on the size or other capacity of the community. For instance, a municipality can have a decisive or more influential role if it has own budgetary institute as service provider (an independent cost center), or it has majority share in utility companies, or it has other influential position in the companies.

In contrast, typically smaller communities have only minority share in the delivering companies. It means that their role in strategic issues of the management is not decisive. If they have no shares at all, they are in the position of contractor and public power. The contractor's position is clear, based on Civil Law, and without any proprietor's influence on the operation. The scale of public power is being decreased continuously. In some services it has already existed, like in the case of pricing in district heating, water supplement and sewage, although the range of activity is more limited if shares are restricted

In conclusion, inequalities are among different communities according to their size and capacities. Typically larger settlements have more influence on their own territory and they have the chance to control at least one district area outside their own legal power.

3. The third type of social *inequalities is based on regional differences*. The level of services is different in regions of Hungary according to their general and infrastructure development. Traditionally the central part of the country is the most developed and the western zones are also well provided. The Eastern part is less wealthy. Mainly small settlements and villages have limited sources produced in-site, in spite of having their own self-government.

Table 4.9

Data on Provision of Particular Public Utility Services by Regions in Hungary, 1998

Regions	Ratio of Dwellings [%] Connected to Public Water-conduit Network	Ratio of Dwellings [%] Connected to Public Sewerage Network	Ratio of Dwellings [%] Connected to Regular Waste Removal
Central Hungary	93.7	70.8	95.5
Transdanubia			
• Central Transdanubia	94.8	48.9	86.2
• Western Transdanubia	95.9	51.6	83.0
• Southern Transdanubia	93.0	42.9	80.4
Eastern Hungary			
• Northern Hungary	85.0	36.2	80.3
• Northern Great Plain	88.7	29.8	66.6
• Southern Great Plain	86.2	27.0	65.0
Total	91.1	47.6	81.5

SOURCES: Statistical Yearbook of Hungary 1998. HCSO, 1999, p. 138,
Environmental Statistical Data on Hungary 1998. HCSO, 2000, p. 123.

The table shows the regional differences in the country. Socially these figures are characteristic. Local policies should be adjusted to regional inequalities, as well. Chances for policy formulation seem to be more limited in less developed areas.

2. SPECIFIC ISSUES

2.1 Separation of Public and Private Functions

It was in the late 1940s and early 1950s when public utilities created their own national networks from regional companies in Hungary. Accordingly, because of their size and importance, public utilities became departments of Ministries or even constituted a whole Ministry. The ruling ideology declared that public services should be cheap and available for everybody. Only the first part of this maxim was fulfilled. Tariff structures of public services, contrary to the evidences from market economies, showed—in line with the concept of 'free public goods', like education or health care—the preferential treatment of households was in terms of prices.

Residential consumption was constantly under priced compared to industrial consumers, and cross-subsidization of consumer groups became a permanent feature of the tariff structure of public services. Tariffs of public services in general did not reflect real costs in Hungary. This was sustainable due to the lack of feedback mechanism between prices and investment. Investments in public utilities were covered by the central budget through taxation without any reference to revenues raised by the utilities. This was to conform with the general rules of investment: the Planning Office's selection amongst new investments was not based on rate of return analysis but on administratively set targets.

Energy industries (gas and electric utilities) were in a more advantageous position providing basic input to material production. In the system of the central allocation of investments, their development didn't yet go beyond what was regarded as strictly necessary, thus creating bottlenecks and 'black-outs' in rapid growth periods. The transport and the telecommunication industries suffered more from the rules of central allocation of investments, where planners first satisfied the requirements of 'material production' and the services obtained the remainder of financial resources.

This classification of activities could also be detected within each service. While network expansions in electricity or gas supply already showed some sign of preferential treatment of industrial or bulk consumers, the development of transport and telecommunication services made the

distinction between industrial/communal and residential/individual consumers more explicit. The standard classification of activities separated, for example passenger transport, as a non-material service, from the transport of goods, as a material service. The chance for getting a telephone line was much better for an industrial/communal consumer than a residential customer. These distinctions expressed, that instead of satisfaction of the consumers, the delivery of planned inputs and outputs and the communication among the commanding heights of the economy constituted the fundamental priorities in the services.

As a result, public utilities were relatively weak monopolies. Because of their low prestige, reflected in the investment allocation system, they were provided with less and less resources. Weak bargaining power among many other state monopolies; inefficient use of resources; permanent and severe shortages; and a low quality of services indicated the milestones of public utilities' development in Hungary between the 1950s and 1980s. The performance of energy industries, transport and telecommunications all lagged behind those of the market economies. The relative backwardness even grew in many areas and became a major factor contributing to the inefficient use of resources.

The inflexible and relatively cheap prices of public services led to an excessive demand and the intensity of service utilization was much higher in Hungary than in the developed economies. The performance of the transport sector influenced working capital requirements in the manufacturing sector. The high share of railways in transportation hindered inventory minimization and increased costs. Hungary was at the bottom of the European league in telecommunications. Moreover, the existing networks suffered also from technological backwardness due to autarchic development. The lack of technology transfer disposed of competitive pressure, often raised costs and separated public utilities from the rapid changes in technology in the West.

Before 1990 the economic regulation of utilities was not at all recognized as a separate activity in Hungary. It was carried out along with policy and the ownership and management of the state-owned enterprises by the relevant ministries. The regulation of investment and prices was not recognized as separate from policy or from the running or financing of the enterprises.

Economies in transition inherited from the previous system an inadequate infrastructure provided by under-capitalized and inefficient firms. They also inherited a disadvantageous tariff structure characterized by prices generally below economic costs and relative prices containing a strong element of cross-subsidy. This situation has placed the governments in a difficult situation. Raising tariffs and correcting the tariff structure may increase prospects for raising new capital and returns from privatization, but imposes heavy social costs, as it is residential tariffs which require the greatest increases to eliminate subsidies. Governments are therefore reluctant to incur the unpopularity and inflational consequences of permitting such price increases.

The pressure for the rationalization of prices and for privatization are equally powerful. Utilities are attractive to private investors, and in most cases the private investors are the only source of funding for development in the infrastructure on the scale required. The governments of economies

in transition are balancing between their macroeconomic and social objectives and the need for access to capital and technology. The dilemma takes on different forms in different countries. In Hungary, the governments were committed to selling substantial stakes in the country's utilities, whereas in other countries progress is much slower.

A further key issue facing governments is how to structure the sector in question. The maintenance of a monopoly potentially increases privatization proceeds, but may be against the benefits from competitive entry, in the form of greater efficiency, more innovation, or lower prices. Irrespective of the form of ownership, the economies in transition are still groping for suitable institutions for regulation. Current evidence suggests that governments will more or less continue to be directly and centrally involved in the regulation of entry and price, so that the scope for independent regulatory agencies is limited. Governments face issues in sequencing the privatization and regulation process. Privatization may speed up the reorganization of the former regulatory framework, although as the Hungarian experience suggests, it may create more formal solutions, where departure from the existing structures needs much more efforts than expected.

Municipalities bear the basic responsibilities of government and its lowest tier for allocating resources and for ensuring the provision of local public goods and services through partnerships with the private sector. Local governments, or designated agencies such as public utilities, have essential roles to perform in providing local public goods, in ensuring coordination through planning and policy corrections, if needed, to account for positive and negative externalities of private activities (such as pollution), and in protecting public safety. These vital functions require the local government to support markets and correct sources of market failure as well as sources of government failure, such as inappropriate regulations that create excessive transaction costs and risks for local investors.

Delivering local services to a consistently high standard at an acceptable cost means, that the local government needs to be clear about the services which local people expect and the resources and opportunities available to deliver them. Most authorities recognize that providing everything themselves is both unrealistic and unnecessary. They need to establish priorities and to set them out clearly. These priorities flow from an authority's performance as an organization and as a provider of services. It needs to know how its work relates to other service providers. It needs to know what local people think of its performance, and what others are capable of achieving, and it needs to know where improvements are most needed. To help authorities establish objectives and performance measures, governments should introduce performance indicators, standards and targets.

Severe shortages, poor quality of services, drying up of central financial sources, all are characteristic features of public utilities entering the era of transition to a market economy. The bureaucratic conduct, while determining the role and development of public utilities in the previous system, fundamentally contributed to the striking condition of utilities. After more than four decades of total state intervention many argue against any form of intervention.

Two challenges have to be faced in the transition process. One is an increasing role of private providers in the sector. A new scheme emerged in which competition, and the public–private partnership has been highlighted. On the other hand, the role of the state is not only diminished, but as far as its remaining part is concerned, has changed quite basically in its character.

Basic functions are separated according to the following logic. *The state* preserved its regulatory position, but losing direct influence. Regulation means passing legal rules in particular competencies, and economic regulation on fees and charges, basic conditions of delivery allowed by acts. The next state function is to give operational permission to applying providers. It is a clear authoritative function based on Parliamentary Acts. The sense of it is to control minimum standards of public service delivery. There is no right for the authority to make individual discretion, only normative rules are allowed to implement.

The state, including local governments remained owners of some basic public assets, like public roads, some elements of networks and conduits. In its position, the present and future task is to guarantee the equal accession for any providers.

Private actors occupied all the fields where competition is possible. Different providers appeared, such as

- private undertakers;
- private companies;
- NGOs;
- different forms of cooperation.

Systems of tendering and public procurement emerged as a symptom of real competition even in this field.

However, the process occurred not without conflicts. Privatization process was criticized from many aspects by the opponents. The second group of critics focused on contracting processes, because selection process is greatly influenced, neglecting professional or cost–benefit points of view.

Critics in general are against extremist solutions. Neither radical contracted policy, nor exclusively state orientation can get too many supporters. The reduction of the strength of the State was regarded as one of the most important task of governments. The exaggerated belief in the omnipotence of market mechanisms could render the transition period more difficult. There are areas in which markets do not necessary function well and some kind of regulation is demanded. The terrain of public utilities certainly falls into this category. On the other hand, in many situations of state influence, conflicts cannot be limited to basic market mechanisms. For instance, in the case of a government decision on freezing the price of pipeline gas, shareholders were panicked and as an answer different unwanted transactions were realized in the stock exchange, for example unfriendly buyout.

2.2 Private Roles in Public Models

Private roles emerged in different ways. One of the most promising processes, is that private investors can take part in different models in constructions and operation. The second is that the privatization process may link the building up of state regulation functions into the process. Finally, devolution of a part of the assets to local governments is an important element to establish public owners.

Models of *public—private partnership* involves several variations¹². As already mentioned before, large industrial users offer loan or additional sources to the project company or the municipality in return for quicker construction or construction at all. In this way subsidies can be substituted or a loan may be offered which is covered by a promised subsidy realized later on. There are several contracting and institutional forms to implement this option.

Another variation is to involve a build—operate—transfer (BOT) arrangement between a private concessionaire and the municipality. In this case, the concessionaire finances builds conduits and later transfers ownership to the municipality in return for a guaranteed rate of return. Another technique is that a piece of infrastructure is built with public funds, then sold by the State Property Agency or municipalities to a concessionaire.

Privatization and regulation options. The most advanced progress among infrastructure sectors was realized in the gas and electricity industry. Because of the recent local involvement, the gas privatization process will be followed step-by-step. In the natural gas industry, after breaking up the former monopoly, the gas supply and distribution companies were re-established as separate enterprises in 1991. Work on their privatization began in the same year, mainly on their own initiative. The distribution companies appointed an Austro-Hungarian firm as financial adviser. Its work resulted in a tender document, issued on behalf of the five gas distribution companies to potential investors in May 1992. Bids were invited by August 1992. The information provided by this tender document was, however, not complete and rose concerns amongst potential investors. At this stage, the State Property Agency (SPA) decided to play a more active role in the preparatory work on the privatization of gas distribution companies and postponed the date for the submission of bids.

It was envisaged that the privatization of the gas distribution companies could not proceed prior to the approval of a new Gas Act (1994: XLI. tv.) . The new Gas Act (approved in March, 1994) established the regulatory body (Hungarian Energy Office (HEO)—for gas and electricity regulation) under the auspices of the Ministry of Industry and Trade (from 1998 the Ministry for Economic Affairs). Its decisions can be appealed to the Minister and to the courts. The HEO is accountable to the Parliament. It has the following core duties: issuing licenses; preparing rules for price regulation; proposing price changes; and ensuring consumer protection. The licenses are for an indefinite time period. The Act opted for exclusivity in gas distribution in a given settlement. The regulator became responsible for the elaboration of details in pricing policy, but the Minister of Industry and Trade has continued to determine the price formation. Economic regulation

included provision on the application of the least cost principle, on the requirement of financial stability of licensee and on the separate account keeping of separate businesses.

The Gas Act reflected that there was little effort to encourage potential competition in the industry. There were few or none recommendations on the structure; operations; organizations; gas purchase arrangements and finances of the gas distribution companies; the cost and tariff structures for each business segment; and the extent of cross-subsidies between business segments.

After the elections in 1994, the new government decided on the merger of the two, often concurring agencies (creating the State Privatization and Holding Company—SPHC) and on the timing and method of privatization of the energy sector. The government intends to hold only a golden share in gas, electricity distribution companies, and in power plants except the nuclear power plant. Other parts are planned to be sold.

In the gas privatization, the problem was the proportion of municipal property. According to regulation of the Act on Local Government, the assets of gas public conduits belong to the primary assets of self-governments. However, utilities had been privatized before local assets were handed over to municipalities. In spite of its illegality, there proved no other obstacles for implementation, and so was it that privatization was realized, and to some extent to foreign companies and investors.

In the meantime, a long debate developed between SPHC and the largest association of local governments in order to implement regulation of the Act. Particular judges interpreted the law in different ways. Finally, Supreme Court unified the interpretations making it obligatory for all judges. The Constitutional Court annulled another Parliamentary regulation, who tried to diminish the responsibility of the state. So now the SPHC is responsible for compensation of concerned municipalities. The implementation of these sentences has not yet been implemented. The whole debate shows the position of local governments and linkages to the privatization process. In this case, the process was going on its route, influenced in a very limited way by central–local compensation. The compensation issue was split from the privatization.

Competition, contracts between public and private parties and the role of regulation in market environment are key elements in the management of the common supplying of functions and tasks in a contemporary society. Transitive countries, like Hungary, after decades of state hegemony, try to follow a more flexible way of public policies than simply reproduction of the monopoly of state. In this section, the Hungarian characteristics are summarized, highlighting mainly the important processes and linkages among different phenomena, and at the same time neglecting all other redundant supplementary information.

Summary

The first point is that competition, contracts and regulations are naturally not local issues. Even in the utility sector these are only symptoms at the local level. In fact, national (or international)

economic environment is determining on emergence and development of these basic relationships. Therefore the question is, what effects the market environment has on local institutions in the circumstances of the system transformation in Hungary. A broader, more prominent issue is a summary of the influential details between the economic and institutional transformations in the field of technical infrastructure services. In this respect, Hungary might be represented as a model, with its characteristic development and the specific restrictions which obscures its path.

The four stages of changes can be summarized as follows:

- 1) the structuring process of the utility and communal sector;
- 2) privatization, fitting in the whole national system of privatization;
- 3) the emerged system of policy formulation; and
- 4) the mechanism of sustainability.

2.3 Structuring

As far as the process as a whole is concerned, a key issue facing governments is how to structure the sector in question. The maintenance of a monopoly potentially increases privatization proceeds, but may be against the benefits from competitive entry, in the form of greater efficiency, more innovation, or lower prices. Irrespective of the form of ownership, the economies in transition are still groping for suitable institutions for regulation.

1. The first step was *decomposition* of former trusts in order to make a new structure of the market. It was a prerequisite to involve real owners to the business. Selling assets made it possible for foreign undertaker and shareholders to participate. This stage has been realized relatively early in Hungary in comparison with other countries. However, it cannot be concluded that restructuring is finished with this action. The end of the whole line of development is to split the public and market sector individually in all of the areas of natural monopolies. From this respect, the process in some of the sectors of utility is currently ongoing.

As a sign of commitment of the Hungarian Government to restructure monopolies and to increase competition, a number of organizational changes have occurred within most companies and sectors. Within the energy industries, the oil and gas company OKGT as a monopoly was dissipated on the field of gas supply. Twelve out of the twenty two subsidiaries were separated from the 'core' businesses. The core companies formed a joint stock company from 1st October 1991 under the name of Hungarian Oil and Gas Company (MOL). The gas supply and distribution companies were established as separate enterprises, but transmission system remained under the control of MOL.

It is important to speak about electricity separately. Although local characteristics are questionable in general, this sector is model of transformation in many respects. The

influence of sector changes made quite a big influence on other utility sectors, such as gas and central heating. That is why it is hard to neglect this area from the analyses.

Electricity generation, transmission and distribution companies were merged and came under the control of the Hungarian Electricity Board (MVMT—Magyar Villamos Művek Tröszt) in 1963. The structure of the MVMT remained intact up to 31 December 1991. The Board comprised of eleven power stations, six regional distribution companies, one company for controlling the transmission grid, and four companies to construct, install and maintain power plants and networks.

In accordance with the 1989 Company Act, preparations for transformation from state owned enterprise into joint stock company began in early 1991. After some mergers, the number of generating companies was reduced from eleven to eight. Restructuring the MVMT, some enterprises providing subsidiary services were separated from the core business. The new joint stock company (MVM Rt.) was established on 31 December 1991, as a holding company comprising of eight generating, six regional distribution companies and the transmission company.

Similar structural changes were witnessed at other public utilities. The Hungarian Post Office was also broken up in 1990 and three new companies were created: the Post Office, Antenna Hungária (broadcasting) and Matáv (telecommunications). In the water sector the twenty-eight smaller and five regional companies were transformed into nearly four hundred local companies and five regional companies during 1991 and 1992. In transport industries the separation of tracks from operating and other business activities at the Hungarian railways was one of the most important steps in the restructuring process in 1993, whilst in urban transport the separation of core and non-core businesses was a common feature in many cities in the early 1990s.

This strategy on the dissolution and breaking up of monopolies should be followed by the national government first of all. In the process of privatization, the first step typically was to establish as many providers as was rational. Local governments may also follow this policy in their territory, although their intention was less dependent on the different type of their representative bodies.

The breaking up of monopolies is implemented in two senses. The first is to split the links of providing activity. For instance, garbage collection is separated from the disposal. In this way, the market area can begin to establish in two fields at the same time. The next type of solution is to separate the same provision physically in its providing of territory. In particular, garbage collection may be divided in the settlement. This solution should be based on the decision of the local council body.

2. The second stage is the development of *independent and normative regulation*. Institutions have already been established. However, the operation can be criticized because public regulation is not autonomous enough from the State as authority, and eventual bargains with the highest monopolies are played off the other private investors' interests.

Current evidence suggests that governments, more or less, will continue their policies to be directly and centrally involved in the regulation of entry and price, so that the scope for independent regulatory agencies is limited. Economies in transition along with many Western countries face issues in sequencing the privatization and regulation process. Privatization may speed up the reorganization of the former regulatory framework, although as the Hungarian experience suggests, it may create more formal solutions, where departure from the existing structures needs much more efforts as expected.

Here the conflict is that regulation includes different instruments, for example:

- permission to entry;
- control of operation and services according to standards;
- participation in price setting;
- guarantee of competition.

However, rights of influence are based on the legal authorization and do not depend on personal consideration. So, regulation means a relatively wide scale of instruments, ruled by the law in a strict way. It is problematic in the Hungarian example, that the regulating authority exists as an office, but it works as an autonomous (not necessarily State administrative) institution to a much lesser extent. Unfortunately, the Hungarian solution is relatively simplified, when bureaucratic character of regulative function is overestimated. For instance, consumers' aspects and representation is missing from the present structure of operation.

3. Public influence on utility and communal pricing is really divided between the national and local level. Municipalities have right to state some fees of services, but this position is not general.

Price control is an element of the supervision of monopolies. Local government may supervise monopolies in public utility and communal services if legal rules allow powers for it. This position is very important mainly in that situation, when competition is less developed or restricted. Price regulation can be based on legal empowerment or the majority owner's position. Quality requirements may be introduced in contracts or by other means.

As far as the national level is concerned, pricing is based more on legal rules than the owner's position. Municipalities, mainly the larger in size, can use both legal causes. Legal empowering is valid for all the local governments notwithstanding their capacities. However, smaller ones can realize their will against the monopolist provider with difficulties. The owner's position with majority shares in utility companies, is generally for city governments, so they can make more influence this way.

The Hungarian regulation system gives a relatively wide range of influence on local governments, however typically in market circumstances. It means that the pricing authority in its decisive autonomy is not unlimited. There is legal regulation on framework of pricing and, of course, economic realities create obstacles as well.

2.4 Privatization

The most important result of the Hungarian *privatization process* is the successful involvement of direct and professional investors. The most advanced progress among infrastructure sectors was realized in the gas and electric industry.

The electricity industry provided another example for the importance of sequencing privatization and regulation. In the early 1990s there was no clear privatization strategy to follow, and consequently there was no consent on priorities between the two agencies responsible for privatization issues (beside the State Privatization Agency, the State Holding Company was established in 1992 with assets having the character of certain strategic importance). The SPA's intention was to sell 15% of existing shares in distribution companies in 1993, with a commitment of the buyers to purchasing another 10% following capital increase. The list of advisors to the six distribution companies was announced in mid September 1993, whose task was defined as to assist the SPA in technical matters but not in forming an overall privatization strategy. The SPA's confidence in a successful sale was based on the activity of potential foreign investors allegedly eager to buy at least a minority stake in distribution companies.

Announcing the tender of sale of distribution companies, an open rivalry broke out between SPA and SHC. By the end of September, 1993 the SHC also selected its privatization adviser. The adviser has been selected to advice on strategic issues of privatization, including the structure and sequencing of sale. The SHC insisted that any sale of minority stakes before concluding a comprehensive strategy may discredit the whole privatization process. To settle the debate between the two agencies on privatization strategy, the Government transferred all shares of the electricity industry from the SPA to the SHC by a decree on 12 November 1993. Then the SHC announced that the sale offer was unsuccessful; the bids were too low. It was also stressed that investors required a firm legislation.

In 1992, work started on replacing the former act on electricity. By the end of the year, a draft was produced by an expert team (with the participation of foreign advisers) and set up in the Ministry of Industry and Trade. The managers of MVM Rt. were little represented in the team, and they were dissatisfied with the strong regulatory framework developed in the proposals. The blueprint focused on economic regulation of the industry and stressed the importance of competition.

After a reshuffling of the Government in late 1992, a new Minister and under-secretary of State for Energy were appointed to the Ministry of Industry and Trade. A new commission was set up for preparing such an Electricity Bill which would receive the consent of the management of the industry. A draft Bill was produced by May 1993, and was submitted to the Parliament in September and it was approved in April, 1994 (1994: XLVIII. tv.). The structure and logic of the Bill followed the one for gas supply plus specified the responsibility of the State in electricity supply.

Licenses in generation are for a definite period, in transmission and distribution they are unlimited in time. The licenses provide exclusivity rights in transmission and in distribution, in both cases together with the obligation to supply. It should be noted that it became the responsibility of the transmission company to initiate the necessary expansion of generating capacity and to secure electricity imports. Third party access to transmission was not regulated in the Act. Consumer protection issues are discussed briefly, there was no word on fostering competition. Cross-subsidization was not forbidden, but accounts must be separated for separate businesses. Economic regulation included provision on the application of least cost principle.

MVM Rt., retaining full control over the nuclear power plant and the national grid, planned to be sold by 50% minus one vote. Because of a political stalemate (even the later dismissed Minister for Industry and Trade opposed the sale of majority stakes) the final share offer was 47–49% of the six electricity distribution companies, with an option to buy more shares within two years, 38–49% of generating companies (except the nuclear power plant) with an option to raise capital and gain majority stakes, 24% of MVM with an option to buy shares up to 25% plus one vote and 50% plus one vote of gas distribution companies.

By the second half of 1995, the preparations gathered speed: 6 governmental, 21 ministerial decrees and 15 governmental resolutions were issued. Bids were received for all companies except two power companies with underground coal mines. All distribution companies (6 gas and 6 electricity) and the two biggest base load power station were sold in 1995. After some unsuccessful attempt for selling the remaining power stations, the SPHC decided to offer majority stakes in them. Four generating plants were sold between 1996–1998, and one remained in the hand of the state owned MVM. The winning bidders were mainly French and German companies, but American, British, Austrian, Belgian, Finnish, Japanese and Italian companies forwarded bids as well.

Most of the firms were sold to foreign investors/trade partners. Their initial (minority) shareholdings were raised through purchasing and/or increasing the capital very quickly to the level of simple majority ownership or above 75% of shares. In the case of previously unsuccessful offers, the privatization agency decided to offer majority stakes. All but one of the remaining companies were sold under these terms. Not only the foreign investors were eager buyers of shares. The MVM also raised its stake above 25% in two base load power stations (Dunamenti, Mátra) securing board membership in the board of directors. The state retained a golden share in each privatized companies.

Because of the local involvement now the gas privatization process is going to be followed step-by-step. In the natural gas industry, after breaking up the former monopoly, the gas supply and distribution companies were re-established as separate enterprises in 1991. Work on their privatization began at the same year, mainly on their own initiative. The distribution companies appointed an Austro-Hungarian firm as financial adviser. Its work resulted in a tender document, issued on behalf of the five gas distribution companies to potential investors in May 1992. Bids

were invited by August 1992. The information provided by tender document was, however, not complete and rose concerns amongst potential investors. At this stage, the State Property Agency (SPA) decided to play a more active role in preparatory work on the privatization of gas distribution companies and postponed the date for the submission of bids.

It was envisaged, that the privatization of the gas distribution companies could not proceed prior to the approval of a new Gas Act. The new Gas Act (approved in March, 1994) established the regulatory body (Hungarian Energy Office (HEO)—for gas and electricity regulation) under the auspices of the Ministry of Industry and Trade (from 1998 Minister for Economic Affairs). Its decisions can be appealed to the Minister and to the courts. The HEO is accountable to the Parliament. It has the following core duties: issuing licenses; preparing rules for price regulation and proposing price changes; and ensuring consumer protection. The licenses are for an indefinite time. The Act opted for exclusivity in gas distribution in a given settlement. The regulator became responsible for the elaboration of details in pricing policy, but the Minister of Industry and Trade has continued to determine price formation. Economic regulation included provision on the application of least cost principle, on the requirement of financial stability of licensee and on the separate account keeping of separate businesses.

The Gas Act reflected that there was little effort to encourage potential competition in the industry. There were few or none recommendations on the structure, operations, organisations, gas purchase arrangements and finances of the gas distribution companies, the cost and tariff structures for each business segment and the extent of cross-subsidies between business segments.

As an effect of privatization, Hungary's energy industry is majority privately owned. It is the task now to establish more competition on the restructured energy markets. Third party access, pricing, non discrimination are the most important issues to be solved. This is to require a more independent role of the Hungarian Energy Office and further steps in the unbundling process of transmission, foreign trade and wholesale functions at electricity (MVM) and gas (MOL) industries. It should be much easier to do in the electricity industry, where these companies are owned by the state as in gas industry, where the state has only a minority stake. Privatization of transmission facilities and the remaining power plants are also viable options.

All in all, the whole structuring seems to be quite successful, because there are real owners in the sector and private investors are also in the market of public utility and communal services. Nevertheless, the timing of policy implementation could have been better. Where the restructuring of a particular utility sector was not implemented before the privatization, there is a danger that former state monopolies become private monopolies without any real strength or control. The public position, interested in market mechanism is better in sectors, in which monopolist positions are controlled by competitive market conditions. Another disadvantage is that privatization contracts may consist of promises, especially guaranteed fees for years in advance which can be realized only with disproportional efforts of the society, i.e. consumers. So, the 'success' mentioned above is not without conflicts in particular cases. However, these conflicts are not general, the

basic importance of the process is professional investors' presence, that all-in-all seems to be successful in recent years.

2.5 Policy Formulation

Assessments should be more ambiguous about policy formulation of national governments in the utility and communal sector. Regulation, programming and implementation of strategic issues is less coherent in the first decade of transformation.

The Directives of the European Union on the electricity and gas internal markets have speeded up the regulatory changes in these industries. Nevertheless, the Hungarian regulatory system has not been as consistent with EU best practices yet. The institutional set-up of regulation in Hungary causes concern. The Hungarian Energy Office does not have full responsibility for regulation and the regulatory process has no sufficient transparency. The Minister of Economic Affairs still retains the most important regulatory powers. The Minister's final authority over user charges opens the door towards price distortions motivated by all kind of concerns relating to macro-economic developments, social policy objectives and regional policy considerations. It is very important to strengthen competition law enforcement in the energy sector, particularly with respect to market access and anti-competitive conduct and mergers. The Hungarian Energy Office and the Competition Authority should consult regularly, particularly on changes in regulations that affect competition.

The EU liberalization process has reached many other sectors as well, including telecommunications, postal services and transport, particularly railway services. One key element was the *unbundling of services* for competition. By isolating the natural monopoly segments of an industry, unbundling promotes new entry and competition in segments that are potentially competitive. Unbundling is desirable because it makes cross-subsidies between different lines of business more transparent, identifies more precisely the subsidies needed to deliver services to the lower income households, and improves management accountability.

Once sectors have been unbundled, *competition* can be used to increase efficiency and new investment. Several market-based provisions are possible. The threat of losing customers to suppliers of substitute products could provide motivation and discipline. Multiple providers can compete directly with each other, while regulatory control ensures fair competition. Competitive conditions could be created through leases or concessions. In this case firms compete not for individual consumers but for the right to supply the entire market. When direct competition or competition from producers of substitute products will not work, competitive forces can be replicated through comparisons with performance elsewhere. A utility in one region can be motivated to perform better by promises of greater rewards if its performance exceeds that of a similar utility in another region, known as yardstick competition.

The other type of competition is based on the division of services according to its natural monopolistic or possible competitive character. In public utility services the principle of *open access* to networks is one of the most important factors to establish competitive sphere. In order to break monopolies free access to providers should be guaranteed by the norms of the EU.

However, especially at local level the requirement to use and develop *competition* as an essential management tool should not be interpreted as a requirement to put everything out to tender. There are a number of ways that an authority might meet the test of competitiveness. It could, for example:

- commission an independent benchmarking report so that it could restructure the services to match the performance of the best private and public sector providers;
- provide a core service in-house and buy in support from the private sector. This would enable comparisons to be made that could help improve in-house performance or result in more of the service being bought;
- form a joint venture or partnership following a competition for an external partner;
- tender part of a service with an in-house team bidding against private sector and other local authority bidders, before deciding whether to provide the bulk of a service internally or externally;
- dispose or sell-off competitively a service and its assets to another provider.

Although these practices begin to develop, basic regulatory (not only legal) environment is very incomplete. That is why many legalized options are working in quite a formal way.

Another part of missing regulation is linked to the accession to the EU in a lesser extent or indirectly. These are issues of particular sector policies, which would be good to use or introduce in a practice, but basic principles have not been passed because of different economic or political reason, in spite of their great social importance. One group of issues is connected to the whole sector, i.e. the clear definition of system capacities in public service delivery. It would be good to harmonize it with local government competencies. The second group consists of more important specific problems, like landfill regulation. The realization of systemic expectations needs incentives and prohibition. These may be introduced even in the present institutional circumstances, however, some economic counter-interest should be convinced.

As a final result these requirements are leading back to the EU again. The principle of lowest load of environment or expectation to use new sources of energy are both based on new standards of existing public utility services. Formulation of policy oriented to this direction is not really coherent in Hungary. As far as outcomes are concerned, these have been quite contradictory until now.

The implementation of policies are also ambiguous. Incentives and system of prohibition are not working satisfactory enough. Concurrent regulatory principles are a lot stronger than the

viewpoint of public provision. The typical example is local government financial regulation, in which environmental or systemic principles are difficult to incorporate, because these are against municipal interests, at least in the short term.

In contrast, local policy-making seems to be more effective in many respects. There are different options for municipalities and they select following their interests, and try to preserve influence in the new marketable circumstances. Although there are quite a wide range of good practices, traditional methods to keep positions are also widespread.

One is reserving the majority owner's position. The most typical control was, mainly in the first period of transformation to control by keeping proportion of property in the assets of providing company. In this case policy preferences were introduced directly. It was not the best way to assign main priorities. Although monopolies can be restricted in this way, but on the other end market relations are distorted regularly.

The second example is making concession contract. Concession contracts in water and sewer services are eligible at local level. Some successful examples show the possibility of strategic transformation and establishment of company autonomy and preserving public involvement in strategic decisions. On the other hand, conditions of concessions can be assessed very differently from the point of view of involved communities.

2.6 Sustainability

As we could see, the Hungarian development may be the best in its institutional progress (restructuring and privatization). The operational experiments are more contradictory. Outcomes of policy formulation in public utility and communal sector are contradictory to a lesser extent. The main problems arise from the operational practice.

Quite a lot of institutions, not necessarily new organizations work for the competitive market environment, with a relatively short history, for examples:

- contracting out;
- public procurement and tendering in general;
- consumer protection;
- performance management.

The main framework of these instruments has been established. It is clear that practice needs much more time to really develop than to prepare a draft law for these questions. However, to make further steps, continuous development in guarantees, regulation, and used methods is needed. If the work stops at the point of institutionalization, outcomes will be restricted.

In Hungary there are different mechanisms which should preserve the operation of mentioned instruments, like the system of operational permission, regulation of authoritative prices (most of them in the utility sphere), supervision of competition, et cetera, notwithstanding the general state mechanisms of control.

In spite of these, operational experiments are very contradictory, especially after some years of practice. The following phenomena should be highlighted:

Corruption. Although we do not have data, but it is known, that corruption in public procurement process is very widespread. There is not any difference from this respect between national and local level. The fragmentation of the system seems to be favorable to the activity. Of course, not only procurement is infected, but all of the tendering processes.

It is important to emphasize here, that public utility and communal tenders play an important role, because of their relatively high budget, in these matters.

Unfortunately, continuous modernization of rules was dropped. That is why different interest groups began to work in an increasingly uncontrolled way. Controlling institutions (like the Council of Public Procurement involving special arbitrators' bodies) and mechanism, which has seen its influence waning to a non-effective state.

Uncontrolled monopolies. This phenomenon may be less widespread, but it exists, and it is also a danger for further spreading. Monopolies sometimes are really in the position of excludability. If the (concession) contract made by local governments is against public interests, there is not any effective way to protect the consumer's position.

It is sometimes the case that a when the particular municipality promises the possibility of fees progressively for a long time in advance, notwithstanding the effectiveness of the provision. In this situation the possible realization of political responsibility is not an adequate response, because the following leadership is obliged by the existing contract.

In Hungary, circumstances are such that the biggest danger is that institutional successes are threatened by operational conflicts. Naturally, this situation is a criticism of the institutional development. On the other hand, the institution-building must not be stopped at the stage of passing the law. In this case (which is the most common), institutional reforms become burdened with compromises.

REFERENCES

A kommunális ellátás fontosabb adatai—public utilities 1998, Központi Statisztikai Hivatal: Budapest, 1999.

A közlekedés, hírközlés és a vízügy EU-csatlakozással összefüggő középtávú gazdaságstratégiai célkitűzései, KHVM: Budapest: February 1999.

Agricultural Water Pricing in OECD Countries, OECD: Paris: 1999.

Amended proposal for a European Parliament and Council Directive establishing a framework for Community action in the field of water policy, COM:271 final, 1999.

Aretz, Henning: *The Current Situation of the Hungarian Gas Market from the Viewpoint of a Western Investor*, paper presented at the 1st Conference Concerning the Liberalization of the Hungarian Energy Market, Budapest: 24–26 February 1999.

Baar, K., *Enterprises in Local Public Utility Services: Transparency, Procurement and Price Setting Questions*, Hungarian Sub-National Development Program of the World Bank: Budapest, 1999.

Bicanic, I.–Skreb, M., *The Service Sector in East European Economies: What Role Can it Play in Future Development?* Communist Economies and Economic Transformation, Vol. 3., No. 2., 1991.

Cave, M.–Valentiny, P., *Privatization and Regulation of Utilities in Economies in Transition*, Privatization in Central & Eastern Europe (ed. Saul Estrin): Longman, London, 1994.

Comparative Experiences with Privatization—Policy Insights and Lessons Learned, United Nations: New York and Geneva: 1995.

Dax, P., Bartus, G., Fucsko, J., Kajner, P., Ungvári, G., *A személtlerakó építésére fordított állami támogatás hatékonysága és ennek magánberuházásokkal való kapcsolata a települési szilárd hulladékkezelés területén: Az Alföld régiójának esettanulmánya*. Kézirat. Előzetes változat. (first draft of unpublished document): 2000.

Debande, O., Drumaux, A., *Overlapping Regulatory Institutions: An Analysis of the Infrastructure Policies in Europe*, Annals of Public and Cooperative Economics 66:2: 1995.

Energy Policies of Hungary—1999 Review, IEA/OECD: Paris, 1999.

Gachet, B., Schulte–Beckhausen, S., Valotti, G., *Evolution of Policies for Local Public Service Supply: A Comparative Analysis*, Annals of Public and Cooperative Economics, 68:3: 1997.

Hermann, Z., Horváth, T. M., Péteri, G., Ungvári, G., *Allocation of Local Government Functions: Criteria and Conditions—Analysis and Policy Proposals for Hungary* (The Fiscal Decentralization Initiative for Central and Eastern Europe: Washington, D.C., 1999.

Horváth, T. M. ed. *Decentralization and Reform: Local Governments in Eight Transforming Countries*, Local Government and Public Service Reform Initiative, OSI: Budapest 2000.

Household Water Pricing in OECD Countries, OECD: Paris 1999.

Hungarian State Privatization and Holding Company, Notice of Forthcoming Tenders for Shares of Companies within Magyar Villamos Művek: 31 July 1995.

Industrial Water Pricing in OECG Countries, OECD: Paris 1999.

Infrastructure for Development, World Development Report, World Bank: Oxford University Press, Oxford 1994.

Jókay, K., Kálmán, J., Kopányi, M., *Municipal Infrastructure Financing in Hungary: Four Cases*, Hungary—Subnational Development Program: The World Bank, October 1998.

Kinnaman, T.C., Fullerton, D., The economics of residential solid waste management, *National Bureau of Economic Research, Working Paper 7326*: August 1999

Kiss, K., *A helyi önkormányzatok társulásairól szóló törvény alkalmazásának tapasztalatai. Belügyminisztérium háttéranyaga*, (18 May 2000), Budapest, unpublished.

Kristóf, Z., ed., *Településüzemeltetési szolgáltatások pályáztatása, kiszereződése*. Településüzemeltetési kézikönyv, No. 3. Budapest: Településszolgáltatási Egyesület, 2000.

Kristóf, Z., ed., *A távhőtörvény végrehajtása*. Településüzemeltetési kézikönyv, No. 4. Budapest: Településszolgáltatási Egyesület, 1999.

Kristóf, Z., *Településüzemeltetési kézikönyv. Árak díjak. A természetes monopóliumok termékeinek árazása*. Településüzemeltetési kézikönyv, No. 5. Budapest: Településszolgáltatási Egyesület, 1999–2000.

Kristóf, Z. ed., *A közszolgáltató tevékenység folytatásának szervezeti keretei és működési szabályozása*. Településüzemeltetési kézikönyv, No. 10. Budapest: Településszolgáltatási Egyesület, 2000

Magyar Távhő Évkönyv 2000, Magyar Távhőszolgáltatók Szakmai Szövetsége: Budapest: March, 2000.

Nagy, Gy., *Helyi hulladékkezelési díjak*. IX. Országos Köztisztasági Fórum és Kiállítás, Szombathely: 20–22 April 1999. Unpublished.

National Programme for the Adoption of the Acquis, Hungary, Ministry of Foreign Affairs, Hungary, State Secretariat for Integration, 15838-3/1999: Budapest: July 1999.

Newbery, D.M. [1998]: *The Hungarian Electricity Sector*, mimeo.

Péteri, G. and Tausz, K. eds., *Megelőzés és együttműködés. A díjhátralák-probléma megoldási lehetőségei helyi szinten*. Nagykovácsi: Pontes Kft., “Helyi Önkormányzati Know-How” Program., 1999.

Regional Statistical Yearbook 1998, HCSO: Budapest: 2000.

Regular Report from the Commission on Hungary’s Progress Towards Accession, (October 1999) Unpublished.

Statistical Yearbook of Hungary 1998. HCSO: Budapest: 1999.

Environmental Statistical Data on Hungary 1998, HCSO, Budapest: 2000.

Sustainable water use in Europe, Part 1: Sectoral use of water, European Environment Agency: Copenhagen: 1999.

Szalay, Á. at al., *Municipal Service Delivery: Hungarian Methodologies, Opportunities and Case Studies*. Manual, Canadian Urban Institute: Canada: 1999.

The State in a Changing World, World Development Report, World Bank, Oxford University Press: Oxford, UK: 1997.

XXIXth Report on competition Policy – 1999, SEC(2000)720 final: Brussels: 5 May 2000.

Yearbook of Housing Statistics, 1998. HCSO: Budapest: 1999.

NOTES

- ¹ The percentage figures may not add up to 100% due to rounding errors.
- ² It is an important requirement that the solution of the local public affairs, undertaken voluntarily, may not endanger the performance of municipal duties and jurisdiction, prescribed compulsory by the Act. In other words: the performance of compulsory duties precedes the solution of voluntary ones. Simultaneously with these compulsory duties, Parliament ensures the financial conditions necessary for their being carried out; as well as deciding on the extent and method of the budgetary contribution.
- ³ There are two basic limits to this entrepreneurial activity: on the one hand no enterprise by local government may jeopardize the performance of its binding duties. On the other hand, the local government may participate in an enterprise provided its liability therein does not exceed its financial contribution. [Act LXV of 1990. Section 80, Paragraph (3)]

- ⁴ The treatment of sewage water that is produced in apartments, factories, institutions and other water consumers, the drainage of this sewage water through the canal system, and furthermore the cleansing and storage of sewage water.
- ⁵ Public sanitation is the collection, transport, temporary storage, treatment and placement of the solid non-hazardous waste produced in households, production, service provision and public areas. It also includes the collection, transport and placement of household litter and construction debris. It furthermore includes the cleaning and watering of public areas, as well as the removal of snow from and the salting of public roads and airports, etc.
- ⁶ The „ensuring of the cleanliness of the settlement” in Hungarian jargon is the emptying and cleaning of liquid waste collection vessels, pits and other substitutes for proper public utilities, as well as the transport of the thus collected sewage water.
- ⁷ In terms of public utility services, Hungarian law only allows the setting of an upper price limit.
- ⁸ In a microeconomic sense, production is efficient if the economy is on the frontier of its production possibilities, i.e. the output of a product cannot be increased unless the output of another is decreased. Efficiency means that there is no loss. Legislators seem to have created a law that cannot be kept.
- ⁹ A piece of legislation may, as an exception, declare that a heightened upper limit be the part of an existing contract.
- ¹⁰ Productivity is the output gained by a unit of labour or capital. Therefore, if the efficiency of using either labour or capital increases, productivity grows.
- ¹¹ The increase in productivity is not automatic. This goal can only be reached by the continuous and determined initiation of technological advances, the exploration and termination of loss-making areas, i.e. very detailed and persistent work. For the monopolist it is a much easier way to maximise profits by simply raising prices.
- ¹² Jókay at al. 1998: 6.