

**MODERNIZING
FINANCIAL
MANAGEMENT FOR
HUNGARIAN LOCAL
GOVERNMENT
PROGRAM:
FINAL REPORT**

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EXECUTIVE SUMMARY

This report describes the genesis and implementation of a United States Agency for International Development (USAID) training program on municipal budget reform in Hungary carried out between 1996 and 1999. The reform responded to the need of cities to change the way they make decisions and manage their finances—based on the greater autonomy and responsibility given to local governments since the transition. From the inception of a pilot program of budget reform for the city of Szolnok, the program grew to reach more than 30 cities via three yearlong seminar series paralleling the municipal budget cycle.

The program had an overall focus on the preparation of budgets that could serve as policy, management, and communications tools as well as financial documents. It also included training on strategic planning, financial analysis, performance measurement, forecasting, sectoral analysis, and capital planning. The program was designed to give cities the opportunity to have access to these skills and new approaches over an extended period so that the attitudinal changes as well as the technical tools would have a chance to take root. Mentoring by more advanced municipal counterparts was built into the program and proved to be a key component. While many of the key techniques and principles originated from United States (US) based experience, what emerged was a hybrid Hungarian form of budgeting focusing on linking finances with the city's programs and emphasizing the importance of transparency and communication. One financial officer described the objective of the new approach as follows: "Make outsiders better understand what I know. Make them think about issues and help them make good decisions."

An independent survey of all training participants found that substantial reforms had indeed taken place in most of the cities, with particular impact on the following:

- Transparency of financial management
- Changes in the content, structure, and format of the budget and in the budget making process
- Improvement in decision-making
- Positive change in the attitude regarding involving citizens in the budgeting process

Some comments about the new local government budgets were:

- "More to the point"
- "More informative"
- "It is comprehensible to almost anyone"
- "From a financial technical presentation it has been transformed into a document that genuinely presents the city"
- "Sectors started to develop their programs in a way that is tailored to [their] particular community"

Many respondents mentioned the greater ease with which the budget was adopted and better decision-making. One participant cited an instance in which council members started to discuss an issue with the volume of indicators in hand. “This meant that the decision was made on the basis of professional argumentation, which earlier was not the case.” Another mentioned the positive reaction of the business community to their new budget documents: “The minute they saw data, information, analyses, and background, they understood our problems.”

The sustainability of the program can be measured by the following:

- Ongoing market-based training sessions offered by a Hungarian firm
- Establishment of a national Municipal Finance Officer Association
- A network of specially trained municipal consultants based around the country
- Wide distribution of training manuals based on this project’s curriculum
- Development and distribution of a computer financial model, the Budget and Creditworthiness Analysis Model

MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN LOCAL GOVERNMENT PROGRAM: FINAL REPORT¹

BACKGROUND

The 1990 Act on Local Governments brought about fundamental changes in the organization and financial management of Hungarian local governments, restructuring their assets, providing options for new funding mechanisms and transferring responsibility for a number of public services to municipalities. The law was in line with changes that had taken place in other areas of the socio-economic landscape and sought to increase local autonomy and responsibility. The professional environment dramatically changed for local governments as they reoriented themselves to perform new functions and adjust to the new role of facilitator and regulator of private development and business activity at the local level. In the business sphere, banks and investors became important partners while citizens became clients or recipients of municipal services. Involving citizens in local decision making (even if only indirectly) became an important tool for strengthening democracy. The 1990 Local Government Act made Hungary probably the most decentralized country in the region. Below describes some of the factors that made changes in financial management essential for Hungarian municipalities.

The New Role of the Local Government

The Local Government Act changed the distribution of power among government levels. While local governments inherited additional responsibilities, they also assumed a more proactive role in governing the local community. Before local governments were simply empowered to comply with Central Government regulations with minimal decision-making responsibility or flexibility in allocating resources. After the transition, local governments' expanded responsibilities included the long-term attainment of community wide goals, objectives, and strategies. Tasked with increased decision making authority and ultimate responsibility for the community's well being, local governments realized they needed a new system of municipal management.

Decline in Revenues

Since 1990, local government responsibilities continued to increase while central government transfers consistently decreased. While the grant system provided additional resources, the system was inadequate to finance municipalities' expanded responsibilities. It became clear to local governments that in order to strengthen their capacity to provide services to citizens and maintain and improve their infrastructure, they had to review the structure of services and increase efforts to generate more own source revenues.

¹ The authors gratefully acknowledge all the contributions of Philip Rosenberg, whose work was the cornerstone of the municipal budgeting training program and thus also pivotal in preparing this report.

The New Decision Making Mechanism

Despite all the changes brought about by the Local Government Act of 1990, municipal budgets (the most important document of local financial management) were prepared with unchanged techniques and structure. The traditional budget was more an accounting document than a policy statement—it listed how much the municipality would spend on every item. Each year, the operating budget was calculated by adjusting the previous years' budget for inflation and potential revenues. There was no multiyear forecasting, program or budget analysis, performance measurement, or monitoring, which limited the budget's usefulness as a management tool.

Designed to provide the central government with information that served its purposes, the budget did not provide sufficient information for local governments to obtain an accurate overview of the activities and functions of a program, department, or municipality. It was difficult to determine the efficiency and effectiveness of programs and make decisions about allocating limited funding resources. The decrease in resources forced municipalities to examine how much they spent and on what, in order to be able to identify emerging trends and prioritize resources. Municipalities realized they needed modern financial analysis and management tools. Traditional budgets were outdated and new challenges could only be addressed through a new type of budget that would enable municipalities to gain a better understanding of the municipalities' fiscal situation and expenditure needs.

THE HISTORY OF THE PROGRAM

Due to the above factors, many municipalities started to think about modernizing their financial management, and their budgets. Some local governments limited changes to certain elements of the budget (such as multi-year information or more comprehensible spreadsheets), while others introduced novelties in the area of institutional financing (such as service financing or small treasury). On the demand side, however, municipalities became more receptive to training programs encompassing the whole scope of budgeting. Building on interest in financial reform evolving from the successful Housing Allowance program in Szolnok, the Urban Institute (UI) initiated a USAID pilot municipal budget reform program, which served as the genesis to the Modernizing Financial Management for Hungarian Local Governments program.

The Szolnok Experiment²

² This section draws heavily on "An Evaluation of Municipal Reform in Hungary. The Szolnok Case Study," Philip Rosenberg, UI, Project No. 6610-533, May 1999.



As part of the USAID-sponsored housing program, the Szolnok City housing office collected financial and non-financial data for the municipal budget related to program performance and beneficiaries. It was clear to the Finance Office that the availability of these data led to more informed decision making and analysis of program results.

Through this process city officials began to question the overall purpose of the budget and their budgeting methods. Who makes budgetary decisions? What services are being provided? Who will benefit? What are the anticipated and actual results? Why are certain items not included in the budget? Few people understood the figures contained in the budget and thus intelligent budget discussion was impossible.

There was a recognition that the status quo budget process obscured what was truly happening in the City. Were the best budget investments being made? In what context were budget decisions made? Were program managers challenged to think about the most efficient and effective ways to deliver services? What services were being provided? At what cost or benefit? What were the results? The desire to know the answers to these and many other questions moved City officials to rethink the Szolnok budget process, content and format.

The City requested USAID technical assistance to examine the budget process and consider various reform strategies. The effort resulted in a commitment on the part of the City administrative leadership (Mayor, Notary, deputy mayors and Office of Finance) to bring budget reform to Szolnok. Szolnok chose to adopt a program budget structure, modified to the City's unique needs, as the budgetary approach of choice. The key elements to Szolnok's strategy, which ensured both political viability and feasibility of budget reform, included:

- City administrative leadership endorsement of the reform effort
- Broad based political support
- The professional staff's firm intellectual understanding of program budgeting concepts and their applicability to the real world of municipal budgeting in Szolnok
- Public education efforts to highlight the benefits and results of reform efforts via the media and local press

The pilot sector for program budgeting was housing, as Szolnok had already developed the basic structure of a program budget through the earlier USAID sponsored housing program. Also, the City housing department was eager to participate in this pilot. Housing staff felt the City's housing programs were exemplary and program budgeting would provide the opportunity to describe the program and its

prior and anticipated accomplishments. It was felt that the existing budgetary practices concealed rather than revealed the program's achievements. The Finance Office developed budget forms that reflected the type of information required for a program budget.

At the conclusion of the housing sector pilot for program budgeting, the following attributes of Szolnok's housing sector were identified in the budget and reported upon during and after budget implementation:

- The program's goals and objectives
- The activities to be carried out
- The number of units of housing to be produced or repaired
- The number of citizens benefiting from the program
- Sources of revenues used to pay for the program and activities
- The expenditures necessary to implement the program and activities
- The number of city employees required to carry out the program

For the City administrative leadership, the pilot program proved to be a success. Its results confirmed their thinking and strengthened their conviction that budget reform was essential to Szolnok's management ethic. The Notary, as well as the Mayor, embraced the notion of institutionalizing program budgeting for the entire City.

The General Assembly members were quick to identify the differences in the housing budget and the types of reports it generated versus the rest of the Szolnok budget. Assembly members focused on the informative nature of the pilot budget with its narrative, program display and supporting charts and graphs. They wondered aloud why other departments and budgetary institutions did not do the same thing. According to the Szolnok administrative leadership, this was a critical turning point in the thinking about budget reform. Here was an actual Szolnok program budget for housing that policymakers could understand and evaluate with clarity and comfort. More informed decisions could be made. Elected officials were now demanding financial and non-financial information in other sectors upon which to base their decisions.

To this end, the General Assembly passed a resolution adopting program budgeting as Szolnok's budgetary method. In 1996, budget reform, with program budgeting as the centerpiece, was greatly expanded to include all departments within the Office of the Mayor and ten budgetary institutions—identified as good performers.

From 1995 to 1999, the Szolnok program budget evolved from a simple budget covering the housing program to a three volume document embracing both program budget data and indicators of municipal, program and departmental performance. If one were to compare them, the evolutionary nature of Szolnok budget reform would be evident. These documents give testimony to the progress that Szolnok has made. The current budget contains one volume that is the traditional budget required under



Hungarian law—a listing of revenues and expenditures by service. The second volume provides a program budget framework. It provides three-year data that facilitate year to year comparisons and assist the reader in judging municipal performance over time. The third volume presents financial and non-financial data for a diverse array of technical indicators relating to every aspect of City services. These indicators have been critical for decision making.

The ease of readability of the Szolnok budget document is a major strength of the reform effort. The document provides transparency. The budget is enriched with a variety of tables and charts all enhanced with color and graphic symbols that facilitate the reader's comprehension. Citizens and General Assembly members alike now understand the kinds of municipal investments that are being made, how these investments relate to overall City plans, and the results that can be expected from these investments.

Now into its fifth year of program budgeting, Szolnok's vision of budgeting is still emerging. Over time, the City has added all components of the Office of the Mayor and 14 other budgetary institutions. As City leadership learns more about the art and craft of program budgeting, and their demand for programmatic information increases, the type and quality of data keeps improving. Sector analysis is more sophisticated. People feel more comfortable about the decisions they make and the budget document has grown more informative. Quite simply, program budgeting changed the corporate culture of the City. While central government cutbacks forced the City to think about improving municipal productivity, program budgeting provided the light to guide the way.

The Birth of the Nationwide Program

With the success of budget reform in Szolnok, USAID expanded its efforts and launched a series of seminars for a wide range of local governments to acquire the techniques of program budgeting. The theoretical objectives of the program—efficient decision making, decision making based on consensus, creating openness, and democracy—were combined with the technical objectives of increasing participants' technical knowledge, strengthening their motivations as well as their financial and professional expertise.

The three year program “Modernizing Financial Management for Hungarian Local Governments³” was launched in 1996 and focused on the following areas:

³ Several individuals contributed to the management and development of the training program: Katharine Mark, Urban Institute Program Director in Hungary; József Hegedüs, Director of the Metropolitan Research Institute; Philip Rosenberg, Municipal Finance Specialist; Róbert Kovács, Andrea Tönkö, and Judit Kálmán of MRI; Ritu Nayyar-Stone, Margaret Tabler, and Wendy Graham of UI; Hungarian consultants Katalin Pallai, Mihaly Lados, József Kéri, Mária Kürthy, Erzsébet Krajsóczki, András Vigvári; and US consultants Blue Wooldridge and Ed Lehan.

- Strategic planning, identifying programs and goals
- Making financial reports, developing financial indicators, making analyses
- Performance measurement, efficiency, cost/benefit analysis
- Forecasting techniques, trend analysis
- Information collection, analysis and computerized processing
- Planning investments and making capital budgets
- Revenue alternatives, user fees and taxes

The program was designed to assist municipalities in developing a new budget, which would serve as:

- *A Policy Document*—The budget would document the financial, operational policies, and priorities that guide municipalities' budgetary decisions. Budgetary goals and objectives, and expenditure priorities would be articulated and documented.
- *A Financial Plan*—The budget would serve as the City's financial plan by identifying revenues and expenditures. Furthermore, the assumptions and trends upon which these financial projections are made would also be described. Through the use of charts and tables, municipalities would present financial data in a clear, concise and easy to comprehend manner.
- *An Operations Guide*—The budget would describe the activities, services or functions to be carried out by institutions. Qualitative and quantitative measures, or outputs, by which program performance and results will be evaluated, would be identified. Program beneficiaries, such as the number of citizens served, and the number of employees required to carry out each activity would be specified. Therefore, the budget of each institution not only identifies the cost of each activity, but also the level of service to be provided, the number of citizens who will benefit from the service, and the staffing level required to carry out the activity.
- *A Communication Device*—The budget document would serve as the mechanism by which citizens, municipal officials, policy-makers, potential investors and others can understand a municipality's budgetary issues, trends, and choices addressed in the budget.



In the course of the three year program, the notion of “program budgeting” became generally applied though it has to be noted that the concept is not identical with the one used in the English technical literature. Participants and organizers together tried to develop a definition tailored to the Hungarian environment, and to each of the municipalities. Generally speaking, in this context “program budgeting” refers to a document and a budget preparation process that links finances with the city’s programs, and that meet the criteria mentioned above.

During the three years, the program evolved considerably—to meet the participants needs—based on feedback, and in certain regards was substantially transformed.

The Design of the Program

The program structure was designed by organizers to address specific concerns. First, the objective was to reach more cities than could be reached through repeated pilot program initiatives such as the Szolnok experience (which concentrated all the resources on one community). Second, the Szolnok experience demonstrated that budget reform not only requires considerable time and energy from participants, but also continuous efforts to reform over an extended period of time.

Budgeting is a year round activity requiring substantive financial and non-financial data to plan, implement, monitor and evaluate the budget. Therefore, the program was designed as a series of regular meetings and seminars spanning the Hungarian budget cycle so that participants could be introduced to the concepts more than once and learn over a period of time. Organizers believed that fewer meetings or shorter more consolidated training sessions would not result in the necessary attitudinal change, which would later be the driving force for reform.

Based on these concerns, a structure was designed in which participants met six times a year, each time for a one or two day seminar. Seminars and the topics discussed at each of the occasions matched the real budget cycle (for example, the early summer seminar focused on the work plan, the December one on the preparation of a budget policy). There were no seminars in the summer months and in the period from January to March to fit the participants’ schedules: holidays and the extra workload of the final stages of the budget preparation and adoption, respectively. This schedule worked well and remained the same throughout the three years.

The program was advertised through several channels (national dailies and weeklies, local press as well as the Local Government Bulletin of the Ministry of Interior), yet the most effective way of recruiting participants was direct mail: mayors and notaries of municipalities were informed about the program in a letter. As a matter of fact, the overwhelming majority of applications were responses to these letters (very few applications were received in response to advertisements). From a marketing point

of view, an equally important factor was that after the first year, the seminar became known by word of mouth: those who had found new techniques useful started to apply them in their day to day activities. To gain popular support for changes, the participants described the benefits of the new techniques to their colleagues and discussed their results with neighboring municipalities while encouraging them to participate. Budget documents from Szentes, Püspökladány and Szolnok were convincing enough by the end of the first year for other local governments to want to try reforming their budgets themselves.

The Participants

There were a wide range of participating municipalities from very small towns with a population of a few thousand (Szegevár with 5000) to large cities with county rights (Győr, Székesfehérvár, Szolnok). Most of them, however, were middle size municipalities with a population 40 to 80 thousand. A large percentage of participants were from the eastern part of Hungary, where economic conditions in provided the impetus for municipalities to implement municipal budget reform. In fact, the most enthusiastic participants in the first year (Püspökladány and Szentes) were from Eastern Hungary, and they later played an instrumental role in attracting new participants from the region.

Over the course of three years, 90 individuals from almost 40 municipalities participated in the training program.

In the first year of the program (1996), 10 local governments out of 14 participating cities “graduated” from the training program. Graduates were those participants who did not miss more than two occasions. The following year, 17 local governments applied. Both years there were dropouts. In 1998 and 1999, (the final year of the program) there were over 20 local governments registered, but as there were several individuals from each municipality the actual number of participants was over 60. The program reached maximum capacity at 60 participants as too many people make small group exercises and interactive presentations difficult. Over the course of the program, organizers observed that seminars are more effective forums rather than large conferences, to achieve a higher level of understanding when the objective is to introduce complex topics.

In the first year the majority of participants were chief financial officers or finance staff. In the second year, however, organizers started to encourage participants to invite staff from other sectors (education, social and communal) to participate in the training. In order to perform the analyses and implement reform finance officers depend on sector officials to gather, analyze, and monitor data. Since there was little precedent of communication and cooperation within the municipal administration, organizers believed that the best strategy to facilitate this process was to include sector officials in the training program so that the municipal officials would learn how to work together towards a common objective (see also section on sector analysis).



In the first two years, some finance officers from the Budapest districts attended the training. However, it soon became apparent that Budapest districts are significantly different from other municipalities in terms of structure and flexibility causing them to drop out of the program. In the third year, there were exclusively non-Budapest municipalities participating in the training program.

A few of the local governments (Orosháza, Püspökladány, Szentes and Szolnok) attended all three years of the program. There was a tremendous carry-over of participants in the second and third years. With each successive year, these local governments expanded their reform efforts and have gone the furthest in applying elements of program budgeting. By the third year, many municipalities had applied budget reform to several sectors (Szentes and Szolnok to the entire budget). Also, these local governments did the most to recruit new participants and helped them by sharing their own experience and giving advice.

The municipalities, who most successfully implemented budget reform, sent representatives that were in a decision making position or a position of authority (for instance the chief finance officer) to the training. For example, the participant from Székesfehérvár was one of the most active, yet she could not achieve results because the head of her department was not committed to her suggested changes. A similar situation was witnessed in Szombathely.

Another interesting observation is that most participants, especially chief finance officers, were women. In the communist era, finance officers were not typically decision-makers. Rather, a finance officer's role in the municipal government was more along the lines of a bookkeeper that was responsible for keeping track of what was spent. Because it was not seen as a powerful position, the finance officer's job was considered appropriate for a woman. Today, however, these women have assumed a new level of responsibility and now occupy one of the top positions in the public administration hierarchy. Many now have the power to decide how funds are allocated, and the process of budget reform is transforming the role of these women to one of much greater authority.

The Structure of the Seminars

The structure of the seminars took their form early in the first year, and no fundamental changes have taken place. In order to keep the seminars as interactive as possible, a balance between presentations and small group exercises, i.e., theory and practice, was maintained. Important items on the agenda were the coffee breaks and lunches, for many current problems were discussed then by participants. Many heated discussions and extensive information sharing took place in the breaks.

Presentations

The seminars usually started with presentations in the morning. American and Hungarian experts outlined the theory and practical use of given issues. At the end of the first year, participants provided feedback that they had only understood the program budget concept after having gone through several exercises and seminars. From then on, organizers made sure that the concepts and processes were clear and that the participants understood how the topics/elements of reform fit together in a logical chain of steps.

Organizers also observed that presentations based on US practice—even though interesting and useful—were often met with opposition. The audience distanced themselves from what they heard and did not believe in the potential of adapting it to Hungary. In the second and third year, theory was illustrated with Hungarian examples. The ability to demonstrate how the concepts had been implemented and put into practice in the Hungarian context greatly facilitated the explanation of complex and abstract concepts. Exercises/techniques based on Hungarian case studies also helped bridge the gap: participants now felt that those techniques could be implemented in their city, and that it was worth implementing them.

Exercises

Presentations were usually followed by small group exercises, which were the most popular part of the program. Small groups were presented with case studies related to the current topic, based on information and issues from a fictitious city. Groups were asked to analyze the situation and make recommendations of how to resolve the issue. In a few cases, participants filled out questionnaires (e.g., strategic goals or program objectives) or “experimented” with a computerized model.

Below are some of the comments concerning the exercises based on feedback over the course of the program:

- *“The case is too American and not realistic”*—The team tried to change this and make the cases Hungarian. Sometimes, however, the prejudice was so strong that the same criticism was made when a Hungarian city was used as the model.
- *“Now I can talk about whatever I want to”*—Some participants felt that this was the occasion to present and discuss problems relevant to their municipalities at length. However, other participants often felt themselves suppressed.
- *“This is too simple”*—*The information presented in case studies.* At times, participants stated that the information/data provided was too little or



inadequate to complete the requested task. Organizers felt that they could not provide as much information as in a budget and that too much information was as detrimental as not enough information. However, efforts were made to describe the cases more clearly with sufficient information so that the participants felt that they knew enough about the issue to offer potential resolutions.

- *Special difficulties for sectoral staff*—Starting in year two, setting up the small groups and carrying out the exercise was made difficult by the fact that participants comprised of both finance and other sector staff. Non-finance people often felt that they were not familiar with all the problems discussed in the case studies.

The organizers came to believe that the above criticisms and problems were based on the low skills (or willingness) of participants to think in abstract terms. Very few were able to disregard the circumstances in their own municipalities and think about the exercise as a model (that is, a simplification of the problem). Often the participants wanted more information than was necessary, were inclined to go into too many details in their analysis, and did not concentrate on the stated objective of the exercise. At this point group facilitators became very important. As this kind of training is new in Hungary, the Hungarian trainers had to acquire new skills to be able to help the working groups' function efficiently. By the second year, however, the situation was greatly improved.

Overall, participants regarded the exercises as useful (they often induced exciting discussions) and when asked if they preferred a different balance of presentations and exercises the majority expressed interest in additional exercises (as a result, in year three the exercise to presentation ratio was raised). In year three, the whole program shifted from presenting techniques to their application (by that time, a program budget had been prepared for each of the three sectors by different participating cities, so specific steps and difficulties of implementation could be discussed), and the number of consulting-type sessions increased.

Panel Discussions

Panel discussions became useful in years two and three when some of the municipalities started to apply the modern budgeting techniques they had learned in the previous years. Panel discussions were held at the opening seminars, and also later in the budget cycle (members of the panel were from pioneer municipalities outlining their results, difficulties and future direction). Discussions at the opening seminar helped newcomers to understand the concept of program budgeting; and also served as encouragement.

The next occasion for panel discussions was the November/December seminar, just before municipalities had to prepare their budget concepts⁴. This seminar was structured to achieve a setting in which participants could share ideas and experiences. Participant feedback revealed that small municipalities (Szegvár for instance) learned a lot from the larger ones (Szolnok).

Role Playing

In the December seminar each year, the organizers incorporated a role playing exercise entitled, “How to sell your budget.” This exercise was a simulation of a budget negotiation that was intended to prepare the participants to present and submit their budgets to the General Assembly and citizenry. Participants assumed the roles of various entities (mayor, notary, representative, opposition, for example). The first year, the team approached this event with some apprehension, because, even more than the other exercises, this was a very new technique for Hungarians. But the response to the role playing exercise was tremendous every year, with very dynamic performances—everyone wanted to be a representative of the opposition.

Guest Speakers

Practically every seminar included guest speakers who represented one of the central government agencies. These included for example, the Ministry of Finance, Local Government and Accounting Departments; the Ministry of Environmental Protection and Regional Development; the Ministry of the Interior; the State Treasury; the State Audit Agency; and the Office of the Prime Minister.

Guest speakers spoke about current issues that were usually closely related to the topics of the seminar. In general, local government finance officers are somewhat skeptical of presentations by central government representatives, regarding them as proposals for change. However, the participants learned useful and interesting information that was often discussed during the break after the presentation.

Participants seemed to appreciate being in direct contact with the central government because the current system does not offer many forums for interaction between the two levels of government. Municipal associations have yet to develop to a point where they can represent the views of local government or serve as an influential lobby. The seminars, therefore, were an opportunity to engage in serious dialogue. At the same time, involving guest speakers ensured that central government representatives were kept aware of the existence and content of the municipal budget reform program.

⁴ In Hungary, the budget concept is presented to the city council in end November. It is a brief document that outlines and discusses proposed changes in the next year’s budget.



Presenting the Budget Document

At the last seminar of each training cycle, the new local government budgets were presented. Every participant (municipality) had the chance to explain what they had done, and present the tangible results in the form of the physical budget (which was at the same time the outcome of the program). Participants discussed the difficulties they had faced, how the new type of budget was received and their plans for the future. They were able to see each other's budgets, exchange them and get ideas for the following year. The budgets reflected the attitudes of those who had compiled them. If we were to categorize the types of participants, we could put them into four groups. There were pioneers, followers, and hesitant and latent participants.

- *Pioneers:* As early as the first year, the pioneers “translated” concepts and techniques for themselves and adapted them to their own environment. These were further refined over time, and new elements introduced in the budget.
- *Followers:* Inspired by the pioneers, these participants copied the pioneers’ system with some changes. This does not make their work inferior for in some cases the copy was technically more accurate, unified and carefully thought through than the original and contained new elements.
- *Hesitant:* These participants mostly came to the training in the third year, and felt that one year was not enough to undertake major reform in the budget. Nevertheless, they introduced minor elements of program budgeting in their budgets and declared themselves to be committed to reform.
- *Latent:* These municipalities were not able to achieve significant changes in their budget even after coming to the training two or three years. In many cases, local political resistance was an obstacle to reform.

Topics

During the course of the seminars, several modern budgeting techniques were discussed. On the one hand the seminars helped participants strengthen their professional knowledge and ability to perform their job. On the other hand the program helped create municipal budgets that have more information and are more useful to a broader public than only professionals do. New budget documents promote communication between politicians, municipal staff, various municipal departments, citizens and businesses in the community, and civil groups.

In the first year of the program the following modern budget planning techniques and planning and decision making tools were presented:

- Financial and sectoral indicators
- Strategic goals and program objectives
- Performance measurement
- Forecasting
- Revenue alternatives
- Capital budget
- Financing alternatives
- Debt management
- Citizen participation

During the second year, sector analysis was added to the list. The expectation was that the new budgets should include financial analysis of a significantly broader scope than before, as well as sector analyses. All course topics were discussed as part of and in conjunction with financial and sector analyses.

The general financial analysis was usually based on information of the last five years and included spreadsheets and figures as well as narratives. Its elements were the following:

- The revenues structure of the budget
- The most important revenue resources (normative transfers, changes in the redistribution of the personal income tax (PIT))
- Local revenues
- Debts as a percentage of the total of the budget, structure of loans (liquidity, development loans)
- Expenditures (by sectors and by types of expenditures)
- Budget institutions with respect to revenue resources and structure of expenditures

Sector analyses began with the presentation of legislation governing the given sector. Followed by an analysis of strength and weaknesses, options and threats



(SWOT). Then mandatory and non-mandatory services are listed and described—many new budgets included a description of the institutions in the given sector. Goals and objectives of services and the sector as a whole are identified that fit in with the community's strategy. The core of the sector analysis is calculating the costs of the various services as well as identifying the relative weight of the given sector in the whole of the budget (for instance the share of education expenditures in all expenditures or in operating expenditures).

An additional part of sector analysis was performance measurement. Using indicators was a crucial element in both financial and sector analysis. Due to central accounting requirements, local governments have plenty of information that they do not use at all or not adequately. Some of the indicators provide a measurement of the current situation or trends while others measure performance (input, output, outcome, and efficiency indicators). Throughout the program it was emphasized that the objective is not to produce a great number of indicators, but to select a few that give useful information.

Trainers

One of the program objectives was to root the training firmly in the Hungarian environment so that the process of innovation would continue beyond the presence of USAID in Hungary. To that end, Hungarian professionals were involved in the development and offering of the training from the beginning. This included: the staff of the Metropolitan Research Institute; a group of independent consultants with special expertise (for example, a banker and an advisor to the city of Budapest); and local government practitioners. The third year of the program a fourth group of professionals was added. Consultants from around the country were recruited and trained, to form a cadre of advisors to local governments seeking ongoing assistance in budget reform.

Speakers and trainers in the first year were:

- American experts
- Hungarian experts drawn from the staff of Metropolitan Research Institute (MRI)
- Outside experts (bankers, local government advisors, and other municipal specialists)
- Practitioners (local government officers)

In year two, more local trainers were involved. The most successful participants from the first year became trainers in the second year as experts. By the end of the third year, the trainers were almost exclusively Hungarians.

The American and Hungarian Experts

The program was designed by American and Hungarian experts, and in the first year the various fields were divided between them. In the second, and particularly in the third year, several presentations were given jointly and some of the topics were taken over by the Hungarian staff.

The key role of the American partners was to motivate the participants, to introduce new concepts, and to bring case studies, exercises and work sheets (primarily in the first two years). As the program became Hungarianized and was adapted to the local environment (with local trainers playing an important role), the proportion of American contribution decreased.

Outside Experts

For some special issues, like strategic planning and impact assessment, outside experts were invited. In addition to giving presentations, they facilitated small group exercises. In practice, however, they were most effective at giving the special presentations and not at providing other training support, perhaps because they had less continuity with the training program as a whole. The effort to involve outside experts from specific sectors was the least successful, as it proved difficult to find people who had all the necessary skills: the sectoral expertise, familiarity with local governments, and the ability to quickly understand the new budget techniques. The most successful approach turned out to be the use of certain local government financial officers who gained sufficient sector-specific knowledge to provide the needed insights to the sectoral participants.

Local Trainers

Involving active municipal staff proved to be an excellent idea. They helped enormously not only in adapting but also in popularizing concepts and techniques. They Hungarianized examples, gave presentations and provided external technical support (at home, at the seminars, over the phone). They pointed out the elements that needed further clarification and which ones were not applicable in Hungary.



IMPACTS AND RESULTS OF THE PROGRAM⁵

Taking into account multiple program objectives and the diverse set of local government participants, there are many different levels and dimensions of program results.

The most general and broadest result, as suggested by a survey of participants⁶, was a change in the spirit of budget creation. All the participants in the program mentioned it, regardless of whether a significant change had taken place in the budgeting practice of their municipalities. Each participant learned something useful that he or she could apply at the very least to his or her own work, over the course of the program. This section draws on survey findings to illustrate the results.

During the course of three years altogether 38 municipalities applied for the program, and six dropped out very early (did not come at all or only once). Eventually 32 municipalities participated with regularity, and 18 of them undertook budget reform. It is important to note, however, that even in municipalities lacking overall budget reform, small changes did take place in the budget (for instance the document was better looking, or modern budget techniques were applied in one of the sectors).

Almost all—86 percent—of municipalities where the reform took place use program budgeting in one or more sectors and 94 percent (100 percent of small municipalities and 92 percent of cities) plan to go on with the reform.

Results varied by the size of the municipalities. The best results were achieved in small municipalities and in municipalities with less than 100 thousand population, while large cities had the biggest difficulties in applying the techniques (see section on Constraints below).

⁵ Parts of the Development of the Budget Making Process and Improving the Decision-Making Process sections are based on “An Evaluation of Municipal Budget Reform in Hungary: The Szentes Case Study” by Ritu Nayyar-Stone and Andrea Tönkö. UI, Project No., 06610-533, February 1999.

⁶ A survey was undertaken at the end of the program, for which all training participants were contacted and interviewed over the telephone by an independent polling company. *Az önkormányzati pénzügyi gazdálkodás korszerűsítése felmérés (UI-MRI Evaluation Research on Program Budgeting Reform)*, Hungarian Gallup Institute, June 1999.

Depending on the scope of the reforms, municipalities can be put into three categories:

- *Reforms were begun in all sectors.* Because time was short, only a few municipalities managed to do this and it is a sign of great determination and cooperation. These municipalities will also continue to implement/refine the reforms. As one participant expressed it:
 - *“In practice, we have covered all areas. The difference is that where we are in reforming the communal sector is not at the same level as in education and in other areas. You can never stop, you have to work to improve continuously, improvements have no limits.”*
- *Reform has been introduced in one or several sectors.* Many municipalities only had time to apply new techniques in one sector. The selection was based on either personal contacts (*“the social and financial departments have always had an excellent working relationship, which is why reform could be implemented here”*) or on the type of services. For instance, many started reforms with the communal sector because this sector is much simpler, less complex than the social and education (most difficult) sector. In some municipalities, the representative of the given sector was much more motivated than the financial leadership so they started to apply what they had learned in the program by themselves:
 - *“I prepared the program budget for our social sector and the whole was adopted in the municipal budget and into the budget report. Other departments did not make one. In my opinion it is a very good thing. I worked a lot to prepare the program budget but I think I will be able to use it as long as I’m here. I processed data from the last five years. I used the format I learned at the program budgeting seminar, that is, I identified programs and sub-programs and through this I presented all the welfare benefits the municipality finances. The total was presented as a percentage of the expenses of the Mayor’s Office, the per capita amounts and the share in the total permanent population. And all this for five years.”*
- *Partial reforms.* In the third category, municipalities did not apply what they had learned to a systematic overhaul of the budget, but included certain modern budgeting techniques, such as indicators that ensure transparency and comparability. Other municipalities started to prepare evaluations, for example, how much one pupil costs and what differences there are between similar institutions. In some cases the only thing the municipality did was to make their budgets more easily comprehensible by inserting graphs and



spreadsheets. Regardless of the scope of reforms, the training program had an impact on the following areas:

- Transparency of financial management
- Changes in the content, structure and format of the budget document
- Changes in the budget making process
- Improvement of the decision making process
- A radical change in the attitude toward involving citizens in the budget process

Transparency of Financial Management

One of the most important outcomes of applying the new budgeting techniques is more transparent financial management. Due to their dire financial situation, local governments must see exactly how much each of these services cost. The traditional type of budget does not provide this information. Thus, the first step of municipalities was to identify the cost of services. This was done as follows: in the chosen sector (or sectors) services were broken down to a basic need—for example, the number of pupils and therefore the number of teachers needed—and costs are assigned to them. By determining the cost of services, the municipality could determine which services should be financed rather than blindly financing the institution “in a general way.” In some municipalities, the local government set standard normative costs for basic inputs (e.g., utilities) across institutions, instead of relying on each institution’s estimates. Developing indicators was closely related to budget requests. An increasing number of municipalities used indicators that helped them compare per unit costs as well as trends in institutions and in time. Data was collected over a longer period (generally five years) and forecasting methods as well as monitoring debt servicing was used to promote transparency.

Several participants, mostly the sector specialists, remarked that now they could understand and see clearly the budget of their sectors. The budget became a “living document:”

“In my daily work, the budget document is in front of me and thus I know how much money we have, what we have spent and how much we can spend [in the social sector]. As a matter of fact, the budget is my Bible.”

According to participants, further outcomes of a transparent budget are:

- The budget is comprehensible even to lay-people

“Earlier the budget document said that wages and wage related payments in the Mayor’s Office cost HUF 68 million or 300 million. And everyone just thought that the staff takes all that money. They

have salaries that are high. In the current budget, this total is broken down. It is presented in detail how much officers earn, how much is the remuneration for the members of the City Council, how much operations related to the municipal staff cost, and how much the functioning of the City Council costs. And then the whole thing is perceived in a different way, everyone can see that this is a very diverse thing.”

- The adoption of the budget has become easier (see more in the section below on decision-making)
- Planning is more accurate
- The budget is more controllable

“It became more controllable as the draft budget goes down to the smallest details. And it has made next year’s budgeting easier because the cost items were identified at that level of detail which provides a basis for seeing what the actual costs are in a fiscal year.”

“We have managed to show what level of services can be provided from the funds ensured by the local government.”

However, as one interviewee pointed out, “a more transparent budgeting process may violate interests”, especially in the independent institutions. For instance, the more successful institutions may worry about losing their own resources. Accountability itself may seem threatening to those managers who feel their own expertise and good judgment is sufficient to ensure good management. Clearly it is in the interest of the local government to overcome this resistance in order to ensure a better overall allocation of resources, but in the course of reform it can be a significant difficulty.

“The internal life of institutions has become visible. It might not be in the interest of everyone. In discussions, ‘how do you do it, why, who allowed it’ type of issues were raised; nevertheless, it is obvious that an absolutely clear system has been created.”

Changes in the Format of the Budget Document

The budget is the most important document of municipal financial management. As a tool, its format and structure has to be in harmony with its content. In other words, as transparency is a requirement of the content, its format has to meet this requirement, too. In the course of the seminars, it was often mentioned that the budget should be compiled in such a way that it is comprehensible, transparent, and informative to all actors involved in municipal finances rather than to a small group of professionals. As one participant put it, one objective that should be kept in mind when creating the



budget is to: *“Make outsiders better understand what I know. Make them think about issues and help them make good decisions.”*

Almost all (91 percent) local governments engaging in reforms feel that their budgets have become “better looking and more attractive.” About the importance of format (which many regard as less essential than content) one finance department head said: *“Several times I laid municipal budgets from previous years next to each other, and I always started with the 1947 budget. One could see at first sight that format mattered a lot at that time. For an outsider, I guess, it is not that important, but format makes a budget a document that is a pleasure to leaf through and then convey more information about the local government to the reader.”*

The structure of the budget has changed, too. Over the years, a logical structure developed (with pioneer local governments playing a key role) in which each sectors’ revenues and expenditures are looked at by the cost of specific tasks (e.g., cutting the grass in the parks or operating a home for the elderly), rather than by the traditional broad centrally-defined categories (e.g., “social tasks” or “culture, sport, and media”). In addition, financial data, natural data, descriptions and narrative analyses and indicators are included in the document. All this makes the document “intelligible” for laypeople.

As an illustration, below are some words that participants used to describe their new budgets in comparison to the old ones:

- Draws more attention
- More detailed, includes more information
- More colorful, more figures are included
- More structured
- More to the point
- More visual, graphs, spreadsheets and pictures are included
- From a financial technical presentation it has been transformed into a document that genuinely presents the city
- It is comprehensible to almost anyone

The last point is especially important, because professionals who had created earlier budgets thought, *“it has a special language that the average citizen does not understand.”*⁷

Generally speaking, everyone is satisfied with the new type of budget: the City Council is glad to have better insight into the budgeting process, the staff is proud of their work, and institution heads feel that something has changed. The head of the Family Center in one of the municipalities said:

⁷ This quote is from an interviewee from a community where reforms were not implemented; the answer was given to the question whether he/she thinks that the budget document in that municipality is easy to understand.



“Someone looking at the budget earlier could only see that the Family Center had received so much money to pay wages, to buy supplies etc. and a list of services we provided. In contrast, if one looks into the budget today, first a presentation of the institution is given, then several pages of indicators relating to clients and staff. One is provided a picture of what budget items featured in the spreadsheets are being spent over several years, and what are the trends.”

Interviewees said that current budgets are more colorful, contain a lot of information and are more than a financial plan. The objective is that the budgets tell the reader what the local government is doing. It is a cause to celebrate when this objective is reached:

“Not long ago, I met a colleague from Debrecen for the first time, who had never been to Sz. I gave him a municipal budget and while on the train from Budapest to Sz., he was given a full picture of our local government. In the budget one can see the growth of the population since 1993, its mix, what the infrastructure is like, what contacts the local government has, what the system of institutions is like and what each of the institutions do. This budgets provides a lot of information to investors or visitors. I’m really proud of it.”

The Development of the Budget Making Process

As program based budgets include more information, budget creation requires more work and greater cooperation. The three most important changes were:

- Revised work plan
- Improved holistic thinking
- Increased cooperation among departments, institutions and the mayor’s office and increased respect for each other’s roles, responsibilities, and point of view

The Work Plan

Before 1990, the budget development process followed a well established routine based on decades of experience. The budget cycle started in October and lasted until February of the following year. However, this practice did not allow adequate time to develop the program budget because a majority of the data and information had to be collected in June or July. Municipal departments collected some of the information, while other data sheets were submitted by institutions. The number of actors and time needed to process this workload made it imperative to develop work plans with phases, deadlines and strict deadlines. The coordinator of the process, usually the head of the



finance or budget department, enforced deadlines. Naturally, the number of coordination meetings (with institutions, department heads and committees) increased (though these meetings become shorter; see more details in the section on the changes of decision-making mechanisms).

Holistic Thinking

Many participants said that the most important outcome of the training program was the participants' change in perception and approach to municipal budgeting. The seminars taught participants how to view the municipal budgeting process holistically rather than piecemeal. The seminars demonstrated how to take a global and comprehensive approach and recognize a broader spectrum of interrelated concepts ("the momentum and broader understanding has changed us a lot"). In addition, participants reported that they learned how to define goals and identify the necessary steps to systematically achieve those objectives.

"When I plan something I plan it as a process and try to see where I want to get from where and through what steps. How much each of the steps will cost. One does not think from one day to another but tries to coordinate tasks and see them in perspective, i.e., by progressing in small steps and monitoring costs. In order to achieve one's goal one progresses slowly."

Goals and concepts were formulated accordingly:

"This system of planning forces professionals—not finance people but the education, health care, community education and communal people—to present what they are doing, what are their achievements and for whose benefit; in other words, sectors started to develop their programs in a way that is tailored to that particular municipality."

Planning a process covering 5 or 6 years has become the norm. New budgets usually present the past 3 to 5 years in order to see trends, directions and prospects. This approach involves analytical techniques and models.

"The City Council reviews a part of a process, which is a period of 5 or 6 years, to see where the process is going and why. They are continuously setting objectives and applying what they have learned from their experiences."

Thinking holistically has also helped municipalities that could not implement reforms (for various external reasons):

“The training came just in time: a system was simulated and then we started to implement it. In real life we could not complete the process but at the seminars we did it at such a level as if we had done it really. We got as far as a kind of simulation system. For me, there was a lot I could use in my work. When I first began the training course, I worked as an analyst in this group and since then I have made several analyses in this spirit, that is in a system.”

Cooperation

Local government cannot provide services in an efficient way and meet real needs of its citizens if its departments work independently from each other. Solutions to certain municipal problems can be found only through a cooperation of all relevant departments. It is important that staff of the local government and institutions identify the interests they have in common and find common solutions. They can do so by making efforts to understand each other's work. In the preparation of the budget, cooperation between the finance/budget department and staff in charge of various sectors (education, social, communal services, housing) is especially important. In municipalities where real results were achieved, cooperation was strengthened as well as empathy and respect for each other. As one participant put it:

“What I feel is that before no one remembered what happened at a City Council meeting; now colleagues listen in excitement together. Recently cooperation has strengthened and we respect each other's work much more. We have a much better understanding of each other's thoughts, concerns, and of course common interests.”

In other municipalities, however, the process revealed that there was not adequate contact between departments and cooperation is diminishing:

“Information flow requires close cooperation among departments. This is what became apparent in implementing reforms. Unfortunately, we do not have good cooperation. It is very difficult to obtain information from one another, which was again revealed in the reform process.”

In some of the municipalities not only has interdepartmental cooperation improved but also the way institutions lobby and the tools they use:

“Clearly, cooperation strengthened because it became clear that saying nice words, writing letters and complaining does not improve conditions. Analyses and debate underpinned by figures do. Realizing this,



institutions started to lobby, first only by saying 'it would be wonderful if...' then by citing figures and serious ideas. They soon realized that cooperation is useful."

Improving the Decision-Making Process

A more detailed and transparent budget led to more objective decision making. The program budget provided a framework for better articulation of municipal policies and priorities and better allocation of scarce resources. By showing what kind and how much work was associated with total figures in the budget, the program budget created checkpoints for whether an activity had really been performed. It also emphasized the identification of alternatives to achieve program goals and objectives and the use of criteria in choosing among alternatives. Therefore, the program budget enabled City Council members to develop a better understanding of sector tasks and the amount of effort and work involved in achieving municipal objectives.

The majority of City Council members are not qualified financial professionals and the City Council is elected every four years. With those in decision making positions continuously changing, it became more important to have a budget, which could be easily understood. It had also been observed that when City Council members do not understand what the figures mean, budget discussions were subjective and decisions were made based on political concerns. The reformed budget provided more information to politicians and objective decision making became possible. The most important impacts of the reform on decision making are as follows:

- The quality of the decision making process has clearly improved. The majority of participants experienced that a more detailed budget helped to make decisions that were more objective than those made under the traditional budget format. An important achievement is when the decision making process includes serious and targeted deliberation. A general opinion of local governments that have implemented reforms is that the whole planning process has become more civilized, comprehensive, detailed and thorough.

"For me the greatest experience was when one Council member, with the volume on indicators in his hand, explained to another the possible consequences of the decision and why it was important to look at indicators, under what circumstances a service would be more expensive etc. This meant that the decision was based on professional argumentation too, which earlier was not the case."

"Our politicians pay increasingly greater attention to per pupil costs and operating costs and these figures has a meaning; and there is one thing they certainly do: raise questions. Why is the cost of heating in one institution

different from another, for example. And one cannot but go into details to see the circumstances, possibilities and constraints (for instance technical) clearly, and this raises new questions. In fact, a system has been created that connects to next year's planning and thoroughly thinks over its own problems."

- New decision-makers quickly understood problems and became familiar with the work. As 1998 was an election year in Hungary, an important achievement was transparent budgets and clear local government operating procedures, which facilitated the learning process of new City Council members. Several respondents from municipalities where new Mayors were elected reported that the Mayor appreciated the budget changes very much and provided great help in future reform.
- Prevents making decisions with a long-term negative effect.

"We have a specific case in which budget analysis was used to convince the City Council to reverse an earlier decision because it was clear that the assets sales revenues should not be spent on operating costs.

In another case: there was the idea to build a new elderly home, although we had two or three already, all under used—true, not in the neighborhood where the new one was planned. When we went into detail and found there is no elderly home in that neighborhood, but the other ones' capacity is not used and cost that much and we would not have money to operate the new one. Eventually it was decided that we were not going to build the new home."

- Results in a more rational distribution of resources. The reformed budget has been very helpful in allocating limited resources among competing priorities within the community. Financial officers realize the needs will always exceed the available funds and funds given to one department must be denied to another. Through program budgeting, the budget development process has been transformed into a process of making choices based on the municipalities' funding priorities.

The best example of how program budgeting benefits municipalities can be seen in how municipalities now handle funding deficits. Before, Hungarian local governments would simply cut every department's request by the same amount—for example 5 to 10 percent—to eliminate the deficit, a practice commonly known as the "lawn mower" technique. However, when municipalities cut costs indiscriminately across the board, it doesn't know the potential impact to the level or quality of service. In local governments, however, where each program has broken down costs or service, financial officers can determine what negative impacts (or decrease in quality) the budget cut will have if revenues are reduced by a certain percentage. A concrete



illustration is the community in which revenues for kindergartens could be maintained by reducing street sweeping from 5 times a week to 3 times. The change in service level of street cleaning was minimal, but the amount of money that was saved through the budget reduction was enough to enable the community to continue funding one of its most important municipal priority—educations.

In another community where program budgeting was initiated in the communal sector, the person in charge reported that because he is better able to articulate the needs of the communal area, it receives more attention and funding:

- *“Since we have been doing program budgeting, the City Council sees communal services differently. In the traditional budget, the first priority was education, then social services, and housing and what was left was given to communal services. The program budget shows how much should be spent on what services in order to make the city better looking and this affects the distribution of resources.”*
- Shorter coordination meetings and faster approval. Before the budget draft is submitted to the City Council, department heads, institutions and committees meet several times. With more accurate figures on hand, these meetings have become more focussed. By including a detailed sector analysis which examines the legal framework, strengths, weaknesses, opportunities and threats of the programs and services the budget makes a large number of previously asked questions redundant. Several institution heads have recognized that this method assures them a more easily defined set of arguments to justify the needs of that institution. They are able to tell exactly what is the minimal amount they need to provide services. Aimless bargaining has ceased.

Not only have coordination meetings become shorter, the budget discussion by the City Council has reached a record in brevity.

“I think that the amount of time for the budget discussion and approval process has become shorter since we have implemented program budgeting. The fact that there are no questions is a sign that we are doing our job well; reading the budget document answers them all.”

“The time requirement for approving the budget has become considerably shorter. Discussions were shorter and misunderstandings were scarce. Earlier these sessions lasted from morning till night, now it takes a couple of hours. Earlier 120 questions were asked about the reasoning for funding requests. Now, if Council Members take the time to read it beforehand, they do not ask me any questions.”

“The 1999 budget was adopted in half an hour.”

A Fundamental Change in the Attitude to Involve Citizens

In the second year of the training program, a survey was conducted among participants: they were asked to rank topics on a five-grade scale of importance. One of these topics was involving citizens (citizen participation) in the local budget. To the surprise of organizers, participants at that time regarded this topic as the least important, or rather not important at all. One of the interviews carried out at the end of the whole program refers to a national survey that had similar results:

- *“There was an interesting survey about who participates in budget making and in what way. Citizens were named as one of the participants, but interestingly, citizens were ranked last though they should be the first because the budget is for them.”*

It is therefore a great achievement that in the final survey every respondent regarded informing citizens, collecting their opinions and integrating them in the budget as very important. Although citizens show very little interest in the budget development process, at least local governments have started to change attitudes and to recognize that making the budget open and taking steps to inform citizens is essential. Following are some of the answers to the question why it is important to make the budget available to citizens:

- Citizens should know what the city spends their money on.
- The whole thing is for their benefit.
- If they know the budget and problems, individual decisions will be better accepted.
- It is important, because then they will be able to realistically see the situation of the local government and efforts made.
- Presenting figures about the various activities of the city leads to greater respect for those who work for the city.
- Citizens should see whether elected officials are meeting their needs.
- Citizens should know the services provided by institutions, what they can get and why.
- The budget shows what improvements are given priority and what not and why.
- Services to be provided by the local government and their costs are not clear to citizens, and this must be changed.

As one participant aptly put it:

- *“What I would like to see is that people understand that what they regard as the most natural thing in the world—that the clinic opens in the morning, that*



the kindergarten functions well, that the street is lit at night—costs a lot of money to the local government.”

Unfortunately, there was another perspective on citizen participation. As a result of the program, one respondent said involving citizens is important, but because the local government does not agree with his perspective, he feels ostracized and “[adversely] affected since I would like to involve them.

Citizen involvement in the budget making process has not yet been optimized (one of the reasons for this is that citizens are generally passive), though there are some promising initiatives. According to local governments, the most efficient (and the most often used) method to involve citizens is for City Council members to hold visiting hours. Several respondents remarked that at large forums and public hearings people are reluctant to make comments.

“Feedback and advice given to the City Council member during visiting hours gets incorporated in the budget. When the budget concept for the next year is prepared, the City Council holds public hearings where anyone can speak and make proposals concerning the budget concept. This, however, is not typical. The possibility is there, advertised in the radio, in newspapers, but people do not seize the opportunity. They prefer to make their remarks in confidence and go to their representative and then the representative tells us. They serve as an intermediary to communicate information and needs.”

Some local governments try to collect information more indirectly through citizen surveys:

- *“We asked for opinions and what we regarded as good and fair was incorporated in the budget. If citizens have an opinion they can voice it and if it is possible we meet it.”*

In certain municipalities, surveys (with questions by sectors) are the basis for sectoral analyses. In one of the municipalities, representatives are given questionnaires in which they incorporate what they hear in their visiting hours and then forward it to the Mayor’s Office.

Views on feedback from citizens vary but the general opinion is that people are passive or negative towards communication. Many say that citizens primarily complain (regarding paved roads, the income supplement benefit, or welfare payments, for example) and rarely give positive feedback. However, as illustrated by the case presented here, negative feedback can be useful because it makes the local government realize that people see a certain thing differently than was assumed.

“Five or six years ago, trees got so tall in a certain neighborhood that we could call it a small forest. The city Management Company started to clear the area to prevent it from becoming a mess. The area was a construction zone. People started to protest and collect signatures to a petition that said that they liked the woods rather than constructions. We never thought that they wanted this!”

According to another opinion, people are interested in the budget and a close contact should be maintained between budgeting and citizen involvement. A social department head reported:

- *“In a recent event, we held a citizen information event and I could tell by their faces that they were interested.... I explained the budget in general terms and the social budget. To quote all those millions of Forints! Most people surely do not feel how many hundreds of millions the local government spends on social expenditures. But if I explain what it covers, who gets what support, then I think even that a person who once applied for a benefit and was refused will understand better.”*

Generally speaking, the use of local taxes is interesting to people. In the past one or two years' taxes have grown and new kinds of taxes have been introduced, so that people are more interested in how the local government spends that money. A finance department head summarized his experience:

- *“Here it works differently than in more developed democracies where citizens feel that the affairs of their city belong to them. It is only now, introducing a new type of local tax, that people want to know what happens to the taxes they paid.”*

Progress has also been made about the accessibility of the budget document. The old instinct to keep the budget confidential has slowly died among the cities participating in the training. The exception is when the document is kept only in the Mayor's Office and one has to specifically request access to it. Most local governments publish a shortened version of the budget in the local newspaper, and everyone can either read the budget in the Mayor's Office or in the library, or get hold of it through City Council members. Where there is a local TV, the budget adoption session is broadcast. Although it is not a widespread practice, some municipalities mail a shortened version to everyone.



Other Impacts

Outside Participants are More Interested

In municipalities where new techniques were successfully introduced, not citizens but investors, businesses, as well as the media became more interested in municipal financial management. These municipalities adopted program budgeting, and often used specialized appendixes to better communicate information of special interest to the broader community.

“The Mayor took the budget to an organization called the ‘Profit Club’ that brings together businesses. There, in front of a large audience, he talked about our ideas, presented the budget, and the audience reacted in a positive manner. For a businessman, efficiency means something different than in the public sector, but the minute they saw numbers, data, information, analyses and background, they understood our problems. And they also saw that we are open minded, that essentially we were honest and genuine in asking them to help us by getting involved. They reacted positively.”

Sharing Experience

Most respondents underlined that they had learned a lot from the experiences of other local governments participating in the program, and mostly from those municipalities who had started reforms earlier and had developed specific methods.

“We were able to learn a lot from each other’s experiences. One can think of several little things, for instance we got ideas concerning departmental coordination meetings, work programs we started to use in our coordination meetings. What proved to be good in a city similar to us, can be OK here too. Also minor computer application possibilities were shared. These are mainly working techniques.

We were given the opportunity to raise issues on the spot and if they could not provide an answer, we got back to that issue at a later meeting. This was a great help in our every day work too.”

Over the course of the seminars, strong professional contacts were established between local governments. Initially this involved sharing their experiences, but later evolved into close working relationships. Participants called each other on the phone if needed ideas or advice, and will continue to rely on each other in the future.

Determination

One more final achievement was an increase in the determination and motivation to continue reform efforts. Those who have gone through the process and see the results not only wish to continue themselves but will also encourage colleagues. As one respondent put it:

- “If there will be another training course, I will recommend that other department staff go too.”

CONSTRAINTS

Some municipalities faced strong constraints that prevented budget reforms. The two types of local governments’—reformers and non-reformers—have to be discussed separately with regards to the constraints that they faced.

Where Reforms Have Been Implemented

Lack of Time

In this category of municipalities, the greatest constraint was the lack of time. Their staff was overburdened and there were too many daily responsibilities that slowed down the budget reform process. They could achieve results only through significant extra work. Even in places where the staff was adequate in terms of number and qualifications, they had to work three or four extra hours a day during the financial reporting period. Participants reported that in terms of the time commitment, the first year was the hardest. After the first year, they would only have to update databases and the results would make up for the hard work. A social group head said:

- *“I did it at home, sure. The first time it was enormous work. But I was happy to do it. Since then I have kept changing it. So it is up-to-date at any minute. Maintaining it is much simpler.”*

Lack of Adequate Database

This factor is closely related to the lack of time. Municipalities with good records were in a better situation than those without.

“For us the budget reform did not pose serious problems because we had the information. For instance, in communal services we knew how many square meters of park or road we have to maintain; we just never used it because the local government never requested it. And with the



budget reform we integrated these pieces of information into the budget. In municipalities which did not have such records, this was a problem.”

Local Planning Has to Comply with Central Regulations Beyond Local Control

Several respondents mentioned that the Parliament is an obstacle. For several years, the central budget has been decided at the last minute while local governments have to comply with statutory schedules.

Furthermore, local governments have to obey laws on budgetary financial management, government decrees, and formal requirements concerning the budget. This means that local governments preparing a program budget have to double their efforts—create a budget for the central government and for themselves. Another problem is that central regulations keep changing and are very difficult to foresee.

As cynically put by a respondent:

- *“This technique could function excellently at the local level if the central government learned it. You can look at the central budget, figures scattered all over and try understand what you want to learn from it. They throw at us a series of items, here you are, and make your living from it. Maybe we would not have questions if we understood the whole thing. Maybe I would be happy to have that minimum I got.”*

Opposition from Colleagues

Another serious obstacle is opposition from colleagues and the fact that not everyone was able to acquire the spirit of the new technique. Usually, the sector with the greatest willingness to cooperate started to reform first. It was hoped that results would break down opposition from other departments; in some cases results have even made politicians encourage reformers to go on with the process.

Staff and Equipment

Several municipalities mentioned inadequate staff in terms of number and qualification as well as the lack of technical equipment (computers).

Where Reforms Did Not Happen

In these municipalities the greatest constraint was the hostility of colleagues towards innovations. People are reluctant to change their routines. A municipal official said in a self-ironic way:

- *“Really, I can only mention my own limitations. There are things I can solve without thinking with a pencil on a piece of paper and I do not need fancy techniques. But in reality they take a long time to solve, need coordination, have to be done in a democratic way, whatever. I do know that we should do it that way, that’s how it is expected to be done.”*

Another participant remarked on the lack of leadership:

- *“In order to take over a US suggested system we would need strong motivation. As far as I could see, some financial leaders established good contacts with institutions, [and] we could introduce the new system there. Then other cities took the system over too. Our city did not have the motivation. I was not the finance department head and our chief financial officer did not like it. By the way, several officials were replaced, we had no solid financial leadership. Simply no one realized that this possibility is a real option.”*

It is interesting to note that in this municipality a reformed budget was produced for one sector despite the overall lack of political support. Lack of time and adequate qualifications were often mentioned as the main constraints.

“So far the budget was prepared via a process in which departments submitted their requests, the finance department collected the requests, looked at revenue resources and then bargaining started. Of course not with our leadership [the financial department] but with the city leadership. Who transfers what activity, which gets money to what area. That’s how it worked. Program budgeting would change things. Everyone feels that it would be good yet we cannot get started. We are burdened with daily tasks. If we could get qualified professionals we would start it in the future.”



In municipalities with a population over 100,000 the biggest constraint seemed to be that there were too many institutions and that these institutions provided information in different ways. As representatives of the largest cities put it:

- *“We could not implement it in practice because our budget was too big with too many actors. Obviously, smaller municipalities stood better chances.”*
- *“The budgeting technique was not applied by the city of Gy., primarily because its number of institutions is much higher than in municipalities where program budgeting was implemented. Our local government has 110 institutions of which 77 are education and the rest are various health, social or utility organizations. And it is precisely the number of institutions that prevented us from trying to implement these techniques.”*
- *“We have 133 institutions and each of them provides information in a different way. Ten institutions have eleven opinions on the same thing. Providing information exists, there are data sheets but they are filled in very different ways. This is rooted in traditions from early years.”*

It seems that the larger cities need a much greater level of commitment and leadership in order to undertake and sustain a serious reform effort, rather than relying solely on the motivation of one or two committed individuals.

INSTITUTIONALIZATION

One of the objectives of USAID assistance to Local Government Reform in Hungary was to strengthen the institutional and professional management competence of Hungarian municipalities. Moving into the final year of the Modernizing Financial Management for Hungarian Local Governments’ Program, USAID expanded the development strategy to transform current programs into potentially future self-sustaining business activities. With respect to municipal budget reform, the objective was to target a larger audience of municipal players and provide affordable bridges to the information, products, and services that were developed under the program.

In response, three tracks of municipal budgeting activities were developed. The first was the training component that consisted of the current Modernizing Financial Management of Hungarian Local Governments program. However, for the third and final year, organizers introduced a new dimension to the program—the Municipal Financial Training Consultant Program—which was designed to train a group of consultants to assist municipalities in developing the necessary technical skills in managing, tracking, and allocating their resources. As part of USAID’s program to develop and institutionalize the financial management skills of municipal officials, the consulting program’s objective was to identify, select, and train entrepreneurial

professionals who were living outside of Budapest and interested in building a local government consulting career. Over a nine-month time period, the consultants were trained to provide quality-consulting services to Hungarian municipal governments and promote municipal budget reform in Hungary. The training program consisted of specialized training courses which taught western style marketing and consulting techniques complemented by the Modernizing Financial Management seminar series which focused on developing technical municipal financial management skills.

The second track focused on assisting the development of the municipal finance sector. To date, USAID was sponsoring a majority of the costs of the municipal budgeting seminars. To determine if providing similar seminars would be feasible without USAID financing in the future, the contractor together with the Center for Civic and Municipal Innovation performed an environmental scan of the municipal finance sector to identify the current players and measure the demand for municipal budget reform seminars and activities. It was clear that municipalities were willing to pay for the subsidized seminars and consulting services, but unclear whether they would be willing to pay for the same service at market rates. The contractor questioned whether there might be other players who might be interested in the USAID information, materials, and training such as banks, municipal associations, management consulting firms, and universities. Systematically, meetings were held with interested partners to identify outreach opportunities and strategic partnerships.

In addition, UI supported the establishment of the Hungarian Municipal Finance Officers Association and continued its efforts to mentor the Hungarian MRI. These institutions were supported in their development to ensure the sustainable continuation of USAID efforts in municipal financial management training. As part of their mission, these organizations plan to continue municipal budgeting training programs that will not only increase the professional management capacity, but also foster the continued evolution of the municipal finance sector. MRI started a fourth yearlong training series in September of 1999 with 20 cities in attendance.

The Hungarian Municipal Finance Officers Association is based on an informal network of municipal finance officers that evolved as part of the training activity in municipal budget reform. A working group was formed which held a series of meetings in late 1997 and early 1998 to discuss draft by-laws and business plans. These sessions culminated in a founding meeting of the association and election of officers in March 1998. In June of that year, key members of the association participated in an USAID-sponsored study tour to the US to learn more about association management, training functions, and municipal financial management. UI worked closely with the association on developing a business plan, which focused on membership services and recruitment. A membership recruitment drive that was a major Association activity for 1999 led to a membership base of 70 that is still growing and will serve as the foundation of the independent and self-financing association.



The objective of the third track was to identify and develop budgeting materials that could be used by professionals, institutions, and associations to continue municipal budget reform in Hungary. Based on five years of municipal budgeting experience in Hungary, two case studies, five manuals, a citizen brochure and a computer software model were developed. The materials were designed to be training tools that could supplement seminars or be given to clients as a part of a consulting package. The products do not replace the benefits of individual instruction, but can generate interest in learning additional information or possible future attendance at specialized training seminars. At a minimum, the products ensure continued returns of USAID's investment in transferring modern budgetary techniques. These materials are described in greater detail in the Annex.

CONCLUSION

From a technical assistance point of view, the Hungarian program was tremendously successful. The program fulfilled its stated objectives by contributing to the systemic reform of municipal budgeting in Hungary—a substantial number of cities around the country have permanently changed their financial management practice and will continue their reform efforts. Organizers were able to achieve short-term performance improvement while strengthening long-term capacity building and institutional reform efforts. One key to success was that the program transferred not only a set of technical skills but also a spirit of reform: a desire to revolutionize the role of the budget in the management of Hungarian municipalities.

The paramount reasons for the program's effectiveness are linked to its integration of Hungarian professionals—both experts and practitioners. Designed to ensure the profound transformation of participating cities budgets, the program was then able to build on a small core of pioneers to broaden the scope of the reform, using the new skills and enthusiasm of municipal officials. The role of the Hungarian counterparts in program design and implementation can not be overstated. A majority of the technical assistance obstacles were easily avoided by using the Hungarians' intimate knowledge of the local context to drive the direction of program development. Riding the momentum and enthusiasm for change, the program addressed the needs of the host country recipients and, quite simply, changed the way the participating local governments manage their city finances.

At the close of the program, all the necessary mechanisms were in place for continued progress. By the third year, the Metropolitan Research Institute was organizing and presenting the seminars. A tool kit of municipal finance seminar materials had been completed with slides, handouts, manuals, and computer models. The local trainers and consultants had begun disseminating the materials through their advisory services and university courses. The membership of the Municipal Association of Finance Officers was growing steadily and the leadership was developing plans to

offer future professional development programs. Participants genuinely displayed their appreciation for US sponsored assistance in the area of municipal financial reform. USAID can take pride in the fact that a critical mass of Hungarian local government professionals and practitioners will continue to build on the success of the program.



ANNEX: DESCRIPTION OF MATERIALS

Budget Reform Case Studies

The two case studies were based on the achievements of pioneer municipalities that had undertaken municipal budget reform in Hungary. Szolnok and Szentes were the two cities that were featured as they had been with the program for the longest period of time, demonstrated the necessary level of commitment of resources, and were the first to experience positive results of their efforts. At populations of 80,000 and 30,000 respectively, the cities also provide models for different size Hungarian municipalities. The intent behind the case studies was to capture and document the long-term process of reform so that the experiences and lessons learned would serve as a model and motivator for other cities contemplating municipal budget reform. The Szentes Case Study was published and widely disseminated throughout Hungary. Many of the examples found in the case study were used in the second and third year of the Modernizing Financial Management Seminar Program. It was observed that many Hungarian municipalities became more receptive to the new municipal techniques when they could learn how they were adapted and used firsthand in the Hungarian context.

Training Manuals

Manuals were produced on the topics of Program Budgeting, Financial Analysis, Revenue Alternatives, Capital Improvements, and Performance Measurement. Program Budgeting covers the entire range of the budget formulation process whereas the other manuals are discrete pieces that focus on a particular subject area. The series was designed to demonstrate relationships among subject areas and establish crosscutting linkages with other manuals. Each manual has two sections—a Practical and a Training Guide.

The Practical Guide was intended for self-instruction. The material can also be used as a basis to develop presentations on the topics. Throughout the Practical Guide, there are icons in the left-hand margin that indicate a corresponding slide in the second part of the training manual—the Training Guide.

The Training Guide can be used by professionals to initiate municipal budget reform. Trainers can also use the materials in a workshop for financial managers or different local governments. The Training Guide includes a training agenda, slides, exercises (where applicable), and a bibliography. The slides can be used in their current form or enhanced or changed based on the needs of the particular training situation.

A description of each individual Manual follows:

- **Program Budgeting.** The art of budgeting in government is a process of allocating limited financial resources to services and activities in a manner that will most effectively meet the needs of the citizens. This training manual has been developed to help cities meet this objective. It is designed for individuals who are directly involved in preparing the municipal operating budget, including finance department staff as well as those who prepare budget requests on behalf of municipal departments within the mayor's office and budgetary institutions. Program budgeting is a way of preparing a budget that clearly links the city's finances to the services the city provides enabling city leadership and staff to make better decisions and helping citizens to better understand their city. This training manual focuses on practices and techniques for preparing a program budget. It explains the program budgeting process by exploring why municipalities have a budget, reviewing the types of budgets municipal governments utilize, and defining a program budget and its advantages.
- **Financial Analysis.** Municipal officials need accurate, timely financial information to make good decisions and avoid problems. This is particularly important when municipal needs are great and financial resources are scarce. This training manual will assist municipal officials to gain an understanding of the municipality's fiscal situation and identify emerging trends of which they may be unaware. They can use financial analysis to present the municipality's strengths and weaknesses to the local council, citizens, central government, or investors, for example. This, in turn, will promote budget transparency and enhance the municipality's ability to borrow. Importantly, financial analysis helps guide financial planning and the formulation of fiscal policy.

This training manual presents the tools and techniques used by municipalities to perform financial analysis. It consists of three modules that complement and build on each other. The first module presents a structure for grouping and analyzing budget data. The second module presents fiscal indicators, which are tools for evaluating the fiscal condition of a community. The third module presents techniques for forecasting municipal revenues and expenditures.

- **Revenue Alternatives.** Many municipalities are under increasing financial pressure as they face the challenges of raising adequate revenues in order to provide necessary services to local citizens, as well as improving the quality of those services. In response to these pressures, however, many municipalities have not fully exercised their power to raise alternative revenues whether it be through levying taxes or incorporating user fees for municipal services. Modernizing the local tax system is an essential step for



local governments as revenues from the sale of assets and central government transfers are decreasing and cannot provide for a stable and long-term solution to the financial needs of municipalities. This manual explains the different types of alternative revenues and discusses how to evaluate and reform a local government tax system including a discussion of the steps necessary to introducing a value-based property tax.

- **Capital Improvement Planning.** This training manual focuses on practices and techniques for developing a capital improvements program (CIP), a multi-year planning instrument to identify needed capital projects and to coordinate the financing and timing of improvements in a way that maximizes the benefits to the citizens. It will examine the capital budget process from selecting, timing, and financing capital projects through the production and presentation of the CIP. This training manual is designed for individuals who are directly involved in the capital budgeting process such as finance department staff and those involved in communal services, or other areas that require major capital improvements (also called capital investments). Those involved in urban planning, economic development, and other related disciplines also will benefit.
- **Performance Measurement.** The Performance Measurement training manual is designed for managers who are involved in providing services to the public. These include government officials (local or central), agency heads, and managers of private or non-governmental organizations. This manual will help program managers develop high quality performance measurement systems or improve the ones already in place in order to identify ways to improve the quality and cost-effectiveness of service delivery. The manual focuses on the step-by-step development of a performance measurement system. It covers the identification of program goals and objectives; selection of performance indicators; data collection procedures; analysis and reporting of the information; and using performance indicators.

Citizen Information Brochure

The citizen information brochure evolved from the parallel efforts of the Modernizing Financial Management for Hungarian Local Governments Program and the Public Education Program. While the training program always considered the citizen as a client, the Public Education Program placed additional emphasis on press outreach to disseminate particular important messages more broadly to the general public. In the municipal financial management reform program, it became clear that cities are in the very first stages of developing an open and reciprocal relationship with their citizens. As they face some potentially unpopular measures such as introducing a new tax or cutting schools, city officials realized that it is imperative to inform the public as to why those actions are so important and useful. While municipal staff is starting to make some

effort at outreach, they often perceive citizens to be passive and uninterested. The citizen brochure, developed as a model, should help cities begin the process of providing solid information to their populations, including information about finances and the operations of the city, linking services to revenues, giving names of the key people to contact on a wide range of issues, and important information about how to be involved in municipal affairs.

Computer Financial Analysis Model

The Budgetary and Creditworthiness Analysis Model (BCAM) is a financial analysis software model that assists municipalities in making budget forecasts, analyzing trends, evaluating the municipality's fiscal condition, determining available funds for capital investment, and assessing creditworthiness. The main advantage of the BCAM is that it summarizes the most important aspects of the municipalities finances in a few lines which will be invaluable to consultants providing advisory services or financial officers who are trying to present the current situation and make future recommendations for the municipality. Another potential market for the software product may be bankers or credit rating institutions who either assess creditworthiness or issue municipal credit.

The model utilizes the experiences gained with similar models developed in the Czech Republic and Poland by UI under USAID programs and the knowledge accumulated during the past few years through the Hungary USAID municipal budgeting program. The model is composed of five basic units: unit one is for the input of data from the current budgetary report and of those of the last five years; two is for preparation of the budgetary forecast; three is for preparation of the scenarios for the future; four is risk analysis; and, finally, five is for calculation of creditworthiness. These are supplemented by four figures describing the key budgetary indicators on the basis of three scenarios. A short brochure accompanying the software package was designed to assist with the use of the model. It does not intend to discuss theoretical issues, although it describes the factors—to the extent necessary—which may be absolutely necessary for the interpretation of the results obtained.

Through these products the modern municipal budgeting techniques that have been adapted to fit the Hungarian context continue to be widely disseminated throughout Hungary. Over two hundred financial officers presented the case studies and software package at the final USAID Modernizing Municipal Financial Management Conference in May 1999 attended. The five-piece manual series was also mailed to the 200 largest cities in Hungary. In addition, a cover letter and publications list with all of the products was mailed to the original conference invitation list which totals over 900 individuals. The recipients can complete the form to request the desired products to be sent to them at cost.