MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN LOCAL GOVERNMENTS

PILOT YEAR SEMINAR
SEPTEMBER 12-13, 1996

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TABLE OF CONTENTS

MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN LOCAL GOVERNMENTSPILOT YEAR, SEPTEMBER 12 - 13, 1996

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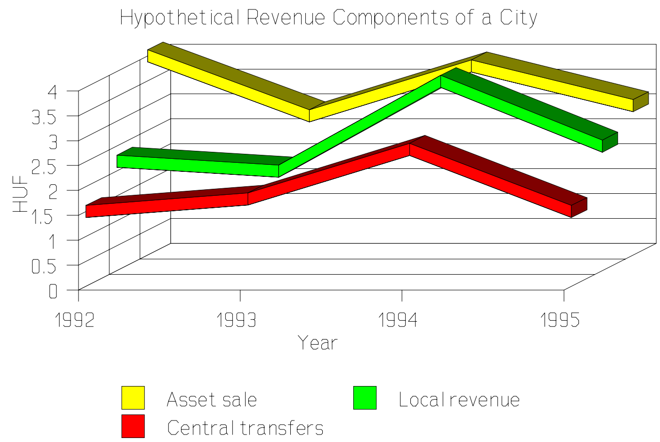
This report is a brief description of the September seminar on modernizing financial management for Hungarian local governments. The program aims at providing financial officers of Hungarian local governments with skills and information to help them improve budgeting and financial management within their cities. The September seminar was the second of six seminars which will be held throughout the Hungarian local budget cycle from June 1996 - March 1997.

The two day seminar was held on September 12 - 13, 1996 at Hotel Rubin in Budapest. The course material handed out to participants, the agenda, and a list of participants are included in Annex A. Thirteen local governments had attended the initial seminar on June 27, 1996 and of these 3 local governments dropped out of the program and there were 4 new local governments who joined the program. Thus a total of 14 local governments signed up to participate in the September seminar. Table 1 shows the list of local governments who attended the two seminars held thus far. The participating local governments represent a wide range of size and location, ranging from large cities such as Debrecen in the east and Pécs in the south and two districts from Budapest to the smaller towns of Kistelek and Jászladány and Dunavarsány. The importance of attending all the seminars was stressed at the meeting, and it is hoped that the core 14 local governments attend all future seminars to gain maximum benefit from the program.

I. SEPTEMBER 12, 1996

The program started with an introduction and follow up of the last meeting by Mr. József Hegedüs from the Metropolitan Research Institute (MRI). Mr. Hegedüs thanked the United States Agency for International Development (USAID) for funding this program and stressed that this program is different from previously held programs in Hungary for the following reasons: 1) the program is a joint effort by both American and Hungarian organizations; 2) the program focuses on providing topical skills and training in a pattern closely linked to the Hungarian budget cycle; 3) the program is not focused on only one local government, rather it is aimed at reaching a wide range of municipalities, and 4) it will be based and developed on feedback and homework assignments completed by the local government officials. Mr. Hegedüs then concluded by introducing other participating and resource experts present at the workshop.

Following the introduction, Mr. Philip Rosenberg (consultant to the Urban Institute) gave his presentation on fiscal indicators. He stressed the importance of fiscal indicators and trend analysis for local governments. He gave the example of a local government wanting to take a loan for infrastructure development. The current budget structure does not provide adequate information about local government revenues or ability to pay back a loan. It therefore becomes important to examine the revenue trend of the municipality during the last four years. Mr. Rosenberg drew a chart of a hypothetical city (shown below), and pointed out that based on this example it is clear that the city is becoming less dependent on central transfers as a component of total revenues, but that the own local revenues is inadequate to pay back a loan. The city is extremely reliant on revenues from asset sales which is not a sustainable situation and in fact bad government practice. Thus given this scenario the bank would not like to invest in this city.



A. Training Session 1

The first exercise built on the fiscal indicators introduction given by Mr. Rosenberg and involved evaluating the financial condition of a hypothetical city: Freebee. Participants were divided into three groups - A, B and C, each group having a minimum of two trainers to act as facilitators. The groups were given 1 hour for the analysis, after which each group made a presentation of their group discussion (see the relevant case study in Annex A). The response of the 3 groups to the case study was as follows:

Table 1
Responses to the Case Study: The City of Freebee

Groups	Questions		
	Question 1: Indicators of Immediate Concern		
A	17 (Liquidity)	7 (Uncollected Property Tax)	13 (Fringe Benefits)
B	7 (Uncollected Property Tax)	17 (Liquidity)	16 (General Fund Balance)
C	7 (Uncollected Property Tax)	12 (Fixed Cost)	19 (Long Term Debt)
	Question 2: Indicators to be Addressed Over the Longer Term		
A	12 (Fixed Cost)	14 (Operating Deficits)	6 (Property Tax Revenues)
B	12 (Fixed Cost)	5 (One Time Revenues)	19 (Long Term Debt)
C	6 (Property Tax Revenues)	12 (Fixed Cost)	32 (Property Value)
	Question 3: Three Additional Indicator Trends		
A	8 (User Charge Coverage)	2 (Restricted Revenues)	36 (Business Activity)
B	20 (Debt Service)	26 (Level of Capital Outlay)	36 (Business Activity)
C	9 (Revenue Shortfalls)	26 (Level of Capital Outlay)	35 (Employment Base)

***Question 1**:*

Group A identified liquidity as the main indicator of immediate concern. They also suggested that it was important to gain additional information on the structure of fund reserves. All three indicators selected by this group were specified to get a better understanding of how the city could achieve the goal of reducing its debt. For group B, uncollected property taxes needed immediate attention, since it was the main source of revenues for the city and was not being adequately tapped. The three indicators identified by group C are closely linked to access the general liquidity of the city - which they identified as the main problem. However, it was interesting to note that according to this group, the city was not undergoing a financial crises, since the budget was not in deficit.

***Question 2**:*

All three groups stressed that it was necessary to reduce fixed costs in the long term, and each group pointed out the problem of economic decline in the city. Group A selected their 3 indicators to judge if the proposed tax rate was justifiable (however, they did not consider an increase in the tax rate as being tragic). Group B made their selection to ensure improvement in the liquidity situation. For group C, the trend of increased reliance on one time revenues should be reversed.

***Question 3**:*

For group A it was important to examine personal incomes in the city, since their main concern was to justify the tax raise. For the other two groups, capital outlay was very crucial. Group B felt that analysis of this indicator would help avoid excessive expenditure and over estimation of revenues. Group C considered this indicator important in estimating program creation.

While moderating the presentation of the different groups, Mr. Rosenberg stressed that there were no fixed set of answers which were “correct”. Different elements of the economy could be stressed depending on the perception of the group of discussants.

B. Training Session 2

Community trends in Hungary: an application of financial data was presented by Mr. József Hegedüs and Robert Kovács of MRI. This session was based on the homework completed and returned by local governments after the initial seminar on June 27, 1996. Local governments had been asked to send back detailed data on certain expenditures, revenues, and statistical element from 1992 to 1995. This was used by Mr. Hegedüs and Mr. Kovács to discuss trend analysis and possible interpretation of the data. Mr Hegedüs started by defining some key fiscal indicators and stating their purpose and possible use for future analysis. He then did a cross city fiscal trend comparison based on some key indicators. Mr. Kovács's presentation was focused on the city of Szombathely. He did a detailed analysis of different indicators, and based on results made some general observations and conclusions.

The three groups then moved on to the next case study: "Financial analysis of average city." Groups had to specify 3 - 5 new indicators and do a short analysis on the city. Following are the responses of the three groups.

***Group A**:*

Group A defined the following "new" indicators for the city, and gave their trend for the last 4 years:

- Normative subsidy/total operating expenditure; decreasing trend
- Debt portfolio/assets ratio; slow increasing trend
- Municipal employment/1000 persons; steady trend
- Total health expenditure per capita
- Revenue from asset management compared to capital

The analysis for the city: the real value of revenue decreased in 1993, with a further substantial decrease in 1995. The proportion of central grants decreased for the city, and there was an increase in the debt portfolio, since the proportion of loans increased. The city also had increased asset sales. The increased revenue was allocated to investment and operating expenditures.

***Group B**:*

New indicators defined:

- Total operating expenditure per capita; increasing trend
- Public works expenditure per capita; steady
- Business tax/total labor tax; increasing trend
- Proportion of normative subsidies from total central government subsidies; decreasing trend
- Sales income from assets/total value of assets; increasing then decreasing trend

Analysis: the proportion of central transfers in total revenues are decreasing. The debt portfolio of the city is increasing as is the business tax. The ratio of asset sales is also high and thus the city must be cautious to prevent a complete sales of all its assets.

***Group C**:*

New indicators defined:

- Normative subsidy/total operating expenditure; decreasing trend
- Social security expenditure/total expenditure; increasing until 1994 then decreasing
- Ratio of income from the sale of assets/total assets
- Management of assets, loans and subsidies/amount spent on capital investment

Group C laid out the facts on the city and then did a humorous analysis to explain all the facts: this is not an average Hungarian city at all. The population is steady and so is the expenditure on health and education. There is an increasing trend in the business tax since 1992, but the number of business licences issued is decreasing. The total employment is decreasing, but the number of municipal staff employed compared to the total inhabitants of the city is very high. Explanation: Intensive business in the community is probably encouraging migration into the community, but also creating an environmental and health hazard. Thus the effect of increased migration is not seen, due to the high mortality rate among the active age population. The high municipal staff can then be explained by the fact that more staff is needed to find increased space in the graveyard to absorb the high death rate.

II. September 13, 1996

The second day of the seminar started at 9.00 a.m. Participants were more relaxed and friendly with each other compared to the previous day. Several had spent the previous evening reading the material and case studies which would be discussed on the second day. The introduction to strategic planning and community data was presented by Mr. Blue Wooldridge (consultant to the Urban Institute) and Ms. Katalin Pallai (Hungarian trainer). Six major phases in strategic planning were outlined, and then the objectives and importance of strategic planning as an input to the budget was stressed. The presenters specified some community data which could aid the development of a strategic plan, and then gave concrete examples of some municipal goals and objectives.

A. Training session 1

The practical application of developing a municipal policy and goals and objectives for a community was experienced by the participants via the case study of Center City. This city was a hypothetical example of a Hungarian city with specific information on its demographics, education, health, housing, public safety, municipal planning and land use, environment, parks, recreation and open space and economic development. Based on their understanding of the strengths, weaknesses and opportunities and threats facing this city, the three groups were asked to identify a municipal policy for the community.

***Group A**:*

"The city should be the economic, commercial and logistic center of the region, providing a better quality and healthier environment, and a wider range of education opportunity for the community members."

***Group B**:*

This group identified a short, medium and long term municipal policy for the city: 1) Short term: "Stop any further decrease in indicators and stabilize the situation of the city." 2) Medium term: "Restructure the institutional system and increase efficiency. Also improve public safety." 3) Long term: "Prevent the collapse of the currently aging housing system; develop an educational and college center and also a cultural and recreational center; increase the (population) retaining ability of the city; and, increase the standard of living of the town."

Group C*:*

"Through a regional centers increased role in education, health and environmental protection, the modernization of the industries will be accomplished. A results oriented social policy will solve the housing and aging problem."

After hearing the municipal policy developed by the three groups, Mr. Wooldridge concluded by saying that the case study showed how symptoms of decay and stagnation in the city can be turned around, and a positive vision emphasized for the community. He specified the interrelationship between a policy statement and resulting activity via the following diagram:

Policy statement

Strategic goals

Program objectives

Activity

If activities were to diverge in different directions and not contribute to a policy statement, the city should rethink its expenditure on the specific activity. It is important to fund and prioritize expenditure on those activities which contribute to the municipal policy statement.

B. Guest Speaker

The guest speaker at the seminar was Mrs. Hajnal from the Hungarian State Treasury which funds and administers the local government subsidy system. Following is a brief summary of her speech.

The state treasury started operation in January 1996. Its objective is to finance and administer institutions which are maintained by public funds. There are 4 budget system in Hungary: 1) the central budget (approximately 4000 billion forints); 2) special segregated state funds (the employment fund and road fund); 3) health and insurance funds, and 4) local government budget (approximately 1000 billion forints). In 1998 local government institutions which are financed by public funds will also come under the treasury system.

The state treasury system will lead to the following changes: 1) from 1997, institutions governed by the treasury will not be allowed to use public debt for operating expenditures; 2) the treasury will keep track of any obligations made by the institutions, and spending will take place only after a reduction in outstanding obligations; 3) all institutions will start using a central or similar/compatible computer system.

Currently, approximately 75 percent of the local government budget is covered by transfers from the central government - redistributive transfers and the personal income tax, normative funds, and health and social security funds. At the end of each month, local governments get their financing (only for operating expenditures) for the next month from the central government. After 4 - 5 days, the local government return to the center the central government share of personal income tax and health. Thus local governments get additional funds from the rate of interest earned on approximately 1000 billion forints for the 4 - 5 day gap.

The treasury will start a system of net financing whereby local governments will only receive funds which they keep in its entirety. The state treasury will deduct the relevant funds for public debt and health, before giving the balance to the local governments. This will terminate cash transactions between the central and local governments, and save on transaction costs. These new measures do not violate the independence of the local governments. The state treasury has no intention of taking over the accounting and payroll activity of the institutions under the local governments. This new system has already been initiated in the city of Békescsaba.

The only uncertainty associated with the new system is its capacity to deal with approximately 10,000 institutions at the local government level. Even if the treasury were to monitor accounts with a break down of only 5 - 6 items, the number of institutions is so large that it creates a problem of managing the accounts. Perhaps a solution would be to have voluntary attachment to the treasury by the local governments. An incentive would be the access to “bridging loans” from the central government. Some local governments currently do not have access to loans due to insufficient collateral. However, one of the seminar participants pointed out that local governments who currently have a bank account would not need to turn to the state treasury to obtain loans for their liquidity problems. Thus the incentive would be effective only for local governments specifically requiring bridging loans.

Finally, Mrs. Hajnal commented that the Hungarian National Bank would be used as the local branch of the state treasury. There would be 8 branches, one for each county.

C. Training Session II

In the afternoon, Mr. Blue Wooldridge and Ms. Katalin Pallai returned to the topic of goals and objectives. Following their presentation, the three groups returned to the case study on Center City and developed goals and objectives based on the municipal policy they had specified earlier in the day. Following are the goals and objective developed by the 3 groups.

***Group A**:*

Goal: A healthy environment and peaceful life for the citizens. Objectives: 1) decrease the production of environmental hazards by increasing sewage treatment by 50 percent. 2) increase investment in parks and recreation by 2 percent by end 1997.

Regarding the first objective, Mr. Wooldridge pointed out that increasing sewage treatment was merely a means, the end result (the objective) could be improvement in the quality of water from X to X percent by year end.

***Group B**:*

Goal: A restructuring of institutions to decrease unemployment via two programs. Objective: 1) Save 70 percent of the amount spent on training employees in 1 year. 2) set up a new vocational training center which will retrain 500 people per year. Therefore the city will catch up with unemployment in 5 years.

Mr. Wooldridge cautioned the group that an objective should be stated as a positive and not a negative. He suggested a statement which says "increase employment" not a double negative of decreasing unemployment. He also advised that it is not enough to train the citizens because they could be trained but still unemployed. Therefore a better objective would state that employment will increase from X to X percent by the end of 199X.

***Group C**:*

Goal: Decrease the health hazards in the community. Objective: 1) establishment of a regional association plant, 2) increase the efficiency of the water treatment equipment.

Again, Mr. Wooldridge cautioned the participants to be clear on the distinction between the "means" (or tools) and the "end" desired result. The establishment of a regional association plant is a means to achieving the result of improving the purity of water.

Prior to including this topic in the seminar, it had been debated if the concept of goals and objectives is really in the domain of notary's and finance officers (this is a political issue not under the control of these two officers). Usually the Mayor of the city specifies the municipal policy and sets the goals and objectives. However, the need for finance officers to understand goal and objective is crucial in helping them define different programs, sub-programs and activities. This training in this area was necessary before we broached the topic of relating municipal functions to program budgeting.

D. Technical Sessions

Mr. Philip Rosenberg discussed the relationship between municipal functions and the specification of different programs. He started by stating several characteristics of programs, and then presented various examples. He used the following pyramid structure to show the relevance of programs in a municipality.

The possible constraints to establishing a program are financial, political and the capacity to implement (i.e. system constraints).

Mr. Philip Rosenberg and Mr. József Keri then presented aspects of the budgetary process. This includes the calendar and samples of budget forms which can be requested from the different departments/institutions.

III. Background Reading

The binder handed out to participants included background or additional reading on various topics covered during the two day seminar. These were provided so that participants would have access to more detailed and specific issues related to the topics covered.

IV. Local Government Homework

Since the philosophy of the municipal budgeting program is to have an interactive and hands-on dialogue with the local governments, they are required to complete and return some exercises prior to the next seminar. Homework is based largely on material just presented and learned during the seminar, and partly on material which will be covered in the next seminar. The objective is for the trainers to have an idea about their understanding and approach to future topics.

V. Conclusions

A post mortem of the seminar was held the next day on September 14. It was attended by the following MRI staff, local Hungarian trainers and Urban Institute staff. From MRI - Mr. József Hegedüs, Ms. Judit Kálmán, Ms. Andrea Tönkő, and Mr. Róbert Kovács. The Hungarian trainers included Ms. Katalin Pallai, Ms. Marta Polinszky, Mr. Mihály Lados and Mr. András Vigvári. The Urban Institute staff included Ms. Katharine Mark and Ms. Ritu Nayyar-Stone, and the UI consultants Mr. Philip Rosenberg and Mr. Blue Wooldridge. The agenda for the next seminar on October 30-31 1996 was drafted, and the trainers and experts gave their feedback on the seminar just concluded. The following conclusions were reached on the basis of the discussion.

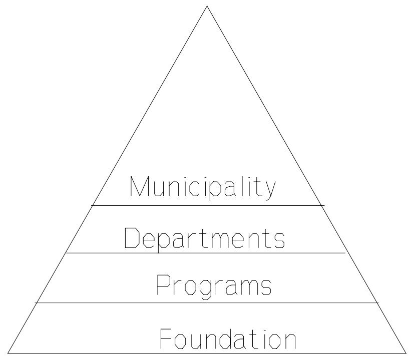


Table 1
List of Cities Participating in the Initial and September Seminar

No.	Cities	Population	June 27, 1996	September 12-13 1996
.	Baja	39,800	✓	✓
.	Budapest District VIII	40,042		✓
.	Budapest District XIX	78,400	✓	✓
.	Debrecen	24,900	✓	✓
.	Derecske	9,500	✓	
.	Dunavarsány	5,201		✓
.	Eger	61,400	✓	
.	Gyor	131,100		✓
.	Jászladány	6,100	✓	✓
.	Kistelek	7,900	✓	
.	Orosháza	34,600	✓	✓
.	Pécs	167,400	✓	✓
.	Püspökladány	17,000	✓	✓
.	Szentes	33,000	✓	✓
.	Szombathely	85,200	✓	✓
.	Szolnok	81,500	✓	✓
.	Zalaegerszeg	62,485		✓

ANNEX A