

Reforms of Public Services

**Experiences of Municipalities and
Regions in South-East Europe**

**Friedrich Ebert Stiftung
Zagreb Office
Zagreb 2003**

Publisher:

Friedrich Ebert Stiftung
Zagreb Office
Medveščak 10
Zagreb

Printing house: Smjerokaz 2000.
Zagreb, December 2003

CIP Katalogizacija u publikaciji
Nacionalna i sveučilišna knjižnica - Zagreb

UDK 35.08 (4-12)
352 (4-12)

REFORMS of public services:
experiences of municipalities and regions in
South-East Europe, Zagreb: Friedrich Ebert
Stiftung, Zagreb Office, 2003

Bibliografske bilješke uz tekst. Kazalo

ISBN 953-7043-08-8

431201071



*This activity is funded by the German
Government within its contribution to the
Stability Pact for South Eastern Europe*

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Foreword

The regional office of Friedrich Ebert Stiftung (FES), in Zagreb in cooperation with the Budapest office of FES, organized in Budapest in October 2003 a workshop on the issue of public services on the local and regional level. The results are presented in the publication *Reforms of Public Services: Experiences of Municipalities and Regions in South-East Europe*. During the workshop experts of various countries from South-East Europe compared and discussed different approaches in the region for the provision of public services to citizens on the local level. In the process of reforming the societies, all of them are transforming their economies based on market mechanisms and decentralizing public functions. In the course of this process, the central governments shifted several responsibilities to local governments. The new responsibilities, now under the control of local authorities, include services like water, waste, heating, basic education, health, and social care. However, in many cases the central government did not provide the necessary funds to local authorities in order to enable them to cope with the new tasks. It seems that in this relationship a proper balance has yet to be found.

In the context of analysing the quality of public services, the principle question was whether state-owned or private organizations are better qualified for meeting the requirements of citizens. Of course, in reality there are different ways to organize public services in this respect. It was interesting to see during the workshop how the approaches differed from country to country. Public services on the local level are important not only because they satisfy the essential requirements of human beings, but also because citizens assess the quality of municipal services as an indicator of the quality of the local government itself. In this sense, the question of public services becomes a highly political issue. In some cases, where economically deprived groups in society have difficulties or are not able to pay for public services due to an existing pricing system, even the question of human rights is raised.

The workshop on public services on the local and regional level is the ninth activity of a series of workshops of the project on “Local Self-Government and Decentralization in South-East Europe”. The project started in early 2001, when Friedrich Ebert Stiftung initiated, in the context of the Stability Pact for South-East Europe and in co-operation with national institutions, a regional project to analyse the situation and the reforms of self-government and decentralization in the countries of the region. The

i *Local Self Government and Decentralization in South-East Europe. Proceedings of the Workshop Held in Zagreb, 6th April 2001*, Friedrich Ebert Stiftung, Zagreb 2001.

ii *Financing Local Self-Government. Case Studies from Germany, Slovenia and Croatia*, Friedrich Ebert Stiftung, Zagreb 2001.

iii *The Interreg Model. Practical Experience in Cross Border Co-operation*, Friedrich Ebert Stiftung, Friedrich Ebert Stiftung, Zagreb 2001.

iv *Citizens Participation in Local Self-Government. Experiences of South-East European Countries*, Friedrich Ebert Stiftung, Zagreb 2001.

v *Decentralizing Government. Problems and Reform Prospects in South-East Europe*, Friedrich Ebert Stiftung, Zagreb 2002.

project covers the countries Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Macedonia, Romania, Serbia and Montenegro, and Slovenia. Based on the analysis and discussion of experts on different experiences in implementing reform steps, and the preparation and distribution of publications resulting from different workshops, the project aims at the stimulation of public discussion with policy makers, researchers, and experts at national and local levels. Since the start of this project in 2001, several international workshops with the group of regional experts have taken place on various topics of local self-government. The results of the workshops have been documented in publications, which are listed in the footnotes. In the meantime, some of the publications or single articles of the publications have been translated and published in national languages as well.

Zagreb, November 2003

Rüdiger Pintar
Head of the Regional Office Zagreb
Friedrich Ebert Stiftung

vi *National Minorities in South-East-Europe. Legal and Social Status at Local Level*, Friedrich Ebert Stiftung, Zagreb 2002.

vii *Executive and Legislature at Local Level. Structure and Interrelation in Countries of South-East Europe*, Friedrich Ebert Stiftung, Zagreb 2002.

viii *Economic Development on the Local and Regional Level. Initiatives in South-East Europe*, Friedrich Ebert Stiftung, Zagreb 2003.

Organizing Public Services at the Local Level

Introduction

Public service management is heavily influenced by four basic factors:

1. the general transformation of the state
2. the scale and form of decentralization in the public sector
3. changes in public service delivery
4. the development of national and local government regulatory functions.

This paper summarizes key elements of these four components of reforms that have been implemented in transition countries during the past decade. It is based on the presentation delivered at the workshop, “Public Services on the Local and Regional Level” (Budapest, October 17-18, 2003)¹.

1. Public Sector Reform

Public sector reform is influenced by the following critical factors: changing functions of the modern state; structural and institutional conditions of reforms; emerging market environments and decentralization. New functions of the state have been developed during the past three decades as a response to the “neo-conservative” reforms, introduced in the early 1980s. Main characteristics of these changes can be summarized as the development of an *enabling, facilitating role* of the state and gradual improvements in the governments' *regulatory functions*. These two aspects of the transformation can be shortly described by the terms “stick and carrot”, as complementary elements of this reform process.

The first group of changes (“the carrot”) is characterized by extended *privatization* and changes in the ownership structure of the public sector. These changes led to the

¹ Statements and arguments are discussed further in other papers of the same author. For details and further readings, please check the references of these studies or contact the author at (peterig@pontes.datanet.hu): Péteri, G. (Editor): *Market - Competition - Contract. Management and Financial Methods in Municipal Communal Services*. LDI Foundation, Local Government Know-How Programme, Budapest. 1996.

Péteri, G.: Alternative Service Delivery, Chapter 10 in: Nemec, J.-Wright, G. (Eds): *Public Finance. Theory and Practice in Central European Transition*, NISPAcee, 1997.

Péteri, G. (with others): *Allocation of Local Government Functions: Criteria and Conditions*, Fiscal Decentralization Initiative, EDI, The World Bank, 1998.

Péteri, G.: *City Management: Institutional Component of SNDP*, Paper written for the World Bank Subnational Development Program (SNDP) - Hungary, Strengthening Local Government Management Capacity, Budapest, 1999.

Horváth, T.M., Péteri G: Regulation and Competition in the Local Utility Sector in Central and Eastern Europe, in: Péteri, G.-Horváth, T.M.: *Navigation to the Market*, OSI-LGI, Budapest, 2001.

separation of basic public functions by disconnecting the responsibility for service provision and the actual delivery (production) of services. New forms of service delivery were based on market related incentives and tools (profit, taxation). Later, the widely used privatization and the alternative service delivery arrangements raised the claim for compensation for reaching social purposes, like the equity and affordability of basic public services.

The “stick” components of the transformation were gradually developed as a response to the emergence of market based mechanisms. The national and local governments had to set the competition rules for taming the new monopolies. In the diverse market environment the significance of setting the service standards was increased. Other techniques of legal control (e.g. for entering the market) were gradually evolved as part of the new regulatory framework.

2. Assignment of expenditure functions (decentralization)

Both types of changes in public functions have been supplemented by government decentralization. In transition countries, the creation of elected local governments has been critical for improving service management. Beyond its political significance, decentralization is a major step in reforming public service management. It is a move from sectoral dependence because it destroys bureaucratic control and the centralized allocation of public funds. As a result of this decentralization, local and regional authorities can gradually build capacity and public trust, elements that were missing under the previous centralized systems.

There are three typical ways in which public functions can be assigned to lower levels of government: by delegation, devolution and decentralization.

1. *Delegation* simply means the allocation of functions (competencies), primarily for administrative reasons. In these cases, local governments implement general public functions (e.g. population registry), because local governments are close to citizens.

2. *Decentralization* of public functions is used when national priorities have to be followed in service provisions. For maintaining the equity of services or for stabilization purposes, the unified national level legislation sets the rules. There are several local government functions that are provided on behalf of the national government: social services, unemployment benefits, etc. There is limited local discretion over these services and general national principles and standards are followed.

3. Real *devolution* means the clear separation of nationally set general regulations and local authority for providing and managing services. 'Functions of local significance' are those services, where efficiency can be realized by connecting service benefits and costs. Education and urban services are the most typical examples of decentralized services.

The process of the reassignment of public functions was implemented over a relatively long period. Some transition countries have transferred only competencies without funds to the local level. Wider decentralization was the outcome of the 'learning by doing' process, when, gradually, planning and coordination roles are

transferred to local governments. Block grants and tax sharing mechanisms provide the revenue base for autonomous municipal services. This lays the ground for decentralization by devolution, when, together with increased political power, the assignment of functions is combined with the transfer of property, the development of new national government roles and the increase capacity of local service management.

Criteria of expenditure assignment

The governments' primary function is to ensure *equity and fairness*. This can be achieved by income redistribution and the provision of public services. This factor is always behind the allocation of public functions, especially in those countries, where the minimum level of services has to be provided. The lack of basic amenities requires strong public involvement, and it is usually the only well-organized service provider. When the private sector has an increasing role, there is even a higher need for this government function. The national fiscal policy is able to achieve this by several different instruments. Not only the reallocation of functions, but also changes in taxation might support equity and fairness by modifying income redistribution.

The relationship between central and local budgets is influenced by the government's role in economic *stabilization*. The national fiscal policy has to control local spending and public debt, so for many years local government revenues remained unchanged. This was regarded as the only instrument for controlling one quarter of public spending in a period of fiscal restrictions. A decrease in government debt was the primary objective for economic stabilization.

The third factor behind changing expenditure assignment is to realize *efficiency* gains. The allocation of public functions should be directed to that level of government that is able to provide the services at the least cost. This is a complex criterion, as local public service delivery is influenced by economic and political factors.

These three sets of equally important factors influence expenditure assignment. They *complete* each other or sometimes *compete* with each other. The fragile results of a new local government system can be easily destroyed if only one allocation factor is on the political agenda.

There are four major groups of specific assignment criteria, which should be considered by policy makers: I. economic efficiency, II. equity and fairness, III. political accountability, and IV. administrative efficiency. There are several sub-categories under these assignment criteria, which make these general aspects of expenditure assignment operational².

Economic efficiency

1. *Economies of scale*: Unit costs change with the size of the local government or service organization. When no further cost savings can be realized by enlarging the population or the geographical size of a municipality, then the service is provided at an

² This categorization of criteria is based on *Governmental Functions and Processes: Local and Area-wide*. Advisory Commission on Intergovernmental Realtions, A-45, Washington D.C., 1974.

efficient level. Empirical research shows mixed, sometimes contradictory results on this basic principle. Most frequently the average unit cost curve is 'U' shaped, meaning that services both at small and large municipalities are more expensive. Declining unit costs appear mostly in capital intensive services, which depend on technology and specialization. In the case of labor intensive services, high management costs and expensive communication increases average unit costs.

Research in European countries has shown that in some countries, at the population of 5,000, efficiency gains can be realized. However, there is no optimal size of local government, because the appropriate size is different in the case of each service.

2. Public sector competition: This classical argument of public choice theory focuses on the voter-consumer of public services who chooses the community that best satisfies his/her preferences. Empirical research does not support this model, because there is always a mixture of services available and social factors play an important role in individual choices. This assignment criterion exists for numerous small local governments, especially in the case of services that are not part of economies of scale and where externalities do not exist.

3. Public pricing: Economic efficiency can be achieved only if there are clear indicators for resource allocation and guidance for defining service levels. User charges work as prices in the private sector and have some advantages to taxes. Non-users of a service are not penalized by paying general-purpose taxes, costs are put on all the users and public pricing may support rational use of public services. A public pricing criterion is not connected to any specific size or level of local government, but it can be used mostly for regional utility services. There are administrative and political advantages to general purpose taxation, as it clearly connects revenues and expenditures.

Equity and fairness

1. Economic externalities: When the costs or benefits of a service spill over to others, then they are not internalized by the producer and the consumer. An external consumer has a subsidized service and the producer is faced with the problem of free riders. Despite this clear principle, empirical research has shown that commuting and migration do not generate only costs, but also benefits for the local government providing the services with spillovers. Economic externalities have a clear consequence on assignment: local governments should be large enough to internalize costs and benefits. Alternatively inter-municipal arrangements or centralized financing will solve the problem of spillovers.

2. Fiscal equalization: Vertical equalization in income distribution is primarily a national function. It affects local governments, where disparities among localities are subjects to equalization policies. In the allocation of functions there is a need for adequate fiscal capacity for financing municipal public services. Intergovernmental transfers are needed for equalizing the differences in capacity.

Political accountability

1. Access and control: Influence on government actions can be achieved through various institutions and procedures. Not only do party politics and different

forms of representation help access and control public services, but interest groups and referenda are also important means. In smaller municipalities, representatives and leaders might be more responsive than in large ones, so this raises the claim for lower level representation. But, in large local governments, minority political interest is served more effectively.

2. *Citizen participation*: Direct contribution to local government operations, popular support, and better relationships with bureaucracies helps the implementation of public policies. The other side of participation is whether ordinary citizens have the time, capacity or desire to be involved in public actions. Often direct participation is less representative and consequently, the quality might be lower and not as durable as party-based representation. Citizen participation is crucial for decentralization and it counter-balances bureaucracies. Its role might be different in larger localities, where participation has an advisory role and it focuses on problems of specific groups and areas. So, the form of citizen participation varies with size and is only weakly related to assignment of functions.

Administrative efficiency

1. *Legal adequacy*: Local government cannot implement its functions without legal authority. This increases accountability and creates a better division of labor between different levels of government. The consequence is that clear legal authority helps to avoid confused local and intermediate (area-wide) functional assignments. This is also required to respect the interests of other units of government. Legal adequacy is needed for any type of local governments.

2. *General purpose government*: The advantages of general purpose local governments compared with special governments are the ability to balance interests by making trade-offs in the priority setting, and the capacity to broaden citizen interest in government operation. Multiple purposes and need for allocating funds among services prevents the development of functional monopolies. General purpose governments work in a coordinated way, and effectively, at any size of jurisdiction. So, there is no direct impact on the assignment of functions, except that they operate more efficiently than single-purpose governments.

3. *Intergovernmental flexibility*: Local powers should be shared among different levels of government, as this increases the flexibility of the system. These cooperation arrangements should be fixed, but periodically checked, otherwise there is a loss in accountability and an increase in the diffusion of responsibilities.

4. *Geographic adequacy*: Local government boundaries should support the durable assignment of functions by enhancing the ability to determine social conflicts, providing a sound economic base and popular control over public programs. There is no consensus on the appropriate size, as natural service delivery zones are different and there is no clear evidence that small or large governments provide more efficient services.

5. *Management capacity*: Technical professionalism is needed for managing the assigned functions. This means the capacity to define goals, consider alternative means, and to evaluate the implementation. This is the least quantifiable aspect of

expenditure assignment, as the service output depends on citizen satisfaction. In general, highly technical functions should be administered by larger units.

Due to the complexity of public services, decentralization is also a multi-dimensional process. Two examples below show the most important components of intergovernmental relations in a decentralized environment. In reality, the decentralization of public education and utility services is a combination of national and local functions, assigned to the central, regional and local levels. Some of these functions might be even delivered by non-public entities, as well.

In *public education*, the first set of issues are related to personnel. The decentralization pattern is a combination of authorities over-funding the salaries of teachers and non-professional school staff, setting employment rules and being responsible for teacher training. The content of the service (curricula) is determined by the standards, textbooks, equipment and training materials. School infrastructure (capital investments, operation and maintenance) and student enrollment regulations are also important components of decentralization. The most critical elements are, perhaps, the system of quality control (monitoring and evaluation) and education finances.

In *utility and communal services*, the most important sets of components in expenditure assignment are as follows: ownership rights, organizational forms of service delivery, licensing, service financing mechanisms, price setting mechanisms, funding capital investments, ensuring quality control and providing consumer protection.

3. Changes in public service delivery

Transformation of traditional methods of public service delivery was started by the changes in the *market environment*. This was a relatively short period in the CEE countries, sometimes only a few years in the 1990s. Not only is this learning period different in these countries, but also the existing market institutions differ very much. There are four main elements of the market environment that have influenced public services:

- private organizations provide services;
- private organizations are involved in the production of public services;
- market mechanisms (user charges, tenders, contracts, etc.) are more often used in the public sphere
- the need for establishing civil society: decision making processes and the institutional setting of public administration and government structures have been modified.

Government expenditures are continuously increasing, as national, state and local governments take over more and more responsibilities. This was especially true in the CEE countries, where the socialist state centralized most of the public services. Obviously it was impossible to finance this level of public expenditures, so public sector reforms started to transfer various government functions to the private sector. The privatization of public enterprises, the development of private pension funds and other welfare schemes, and private education are all examples of the fundamental changes in the public sector.

In many CEE countries this privatization process has changed only the legal character of service providing entities. Direct influence on state owned enterprises was changed by indirect methods of ownership control. This privatization created a new relationship between the government (politics) and the commercial unit with majority or exclusive state ownership. Real privatization started only during the second wave, when capital was raised by these state owned commercial units.

Private entities are involved in the production of public services. That is, the government takes the responsibility of providing public functions, but the actual delivery of the service is done by private organizations. There are various schemes for how private organizations might participate in public services. The best examples are from the public utility sector, but many communal and human services are also run by private or non-profit organizations.

Transformation of traditional public sector mechanisms is pushed by methods developed in the private sector. The purposes of these changes are to express the cost of public services for the consumers, to introduce higher motivation in the public sector, and to increase the responsibility and transparency in the decision making processes of public bodies.

The costs of public services are indicated by *user charges*. Fees, user charges, and tariffs work as price mechanisms for public services, where the actual costs are not always calculated, so they are not expressed towards the consumers. 'Free' services are never utilized efficiently, which have also increased public expenditures. Pricing services not only makes consumers' decisions more rational, but also increases public revenues.

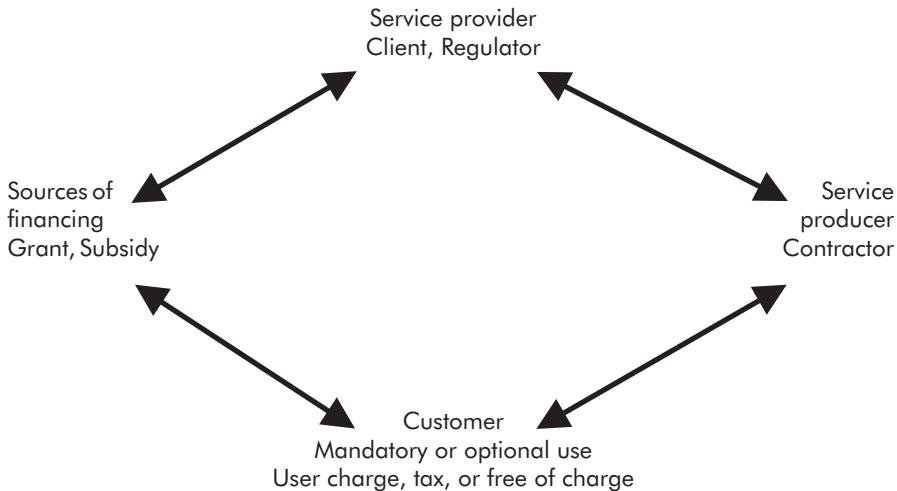
As most of the public goods and services were heavily subsidized, introduction of charges was not easily manageable. There are various methods, how control over prices were changed with new mechanisms. The most frequently used method is the simple decentralization of the charge-setting authority. As public services were transferred to local governments, charges on water, sewage, district heating, waste collection, rents, etc were also decentralized. There are nationally defined regulations for calculating the prices (e.g. maximized percentage of profit) and national government subsidies still exist (in the water sector, or for capital investments).

Cooperation with private entities has modified the operation of public organizations. First of all, political mechanisms should be adjusted to the requirements of the public sector. In order to have clear *contracts* with private service providers, the objectives and specifications of the services should be carefully designed. Sometimes it was not easily manageable for the governments, as service characteristics were simply the inherited outcomes of former decisions. Transparency of public decisions raised the claim for the proper selection of private contractors, so *tendering procedures* are also crucial elements of the changing market environment.

Local autonomy in service delivery modifies the functions of municipalities and their relationship to service organizations. For improving service efficiency, the primary objective is to create the enabling environment for public service management and to split the client and contractor roles. The privatization of public utilities and the emergence of alternative service delivery arrangements are gradually changing the

internal decision making of localities. The emergence of new roles and functions are summarized in Chart 1 below:

Chart 1. Actors of public service management



This transformation of service functions and responsibilities can be best characterized by the example of public utilities. Public utilities and communal enterprises used to be owned by the state in former socialist systems. They were in monopolistic positions, although these monopolies were relatively weak in comparison to the state-owned companies in the manufacturing sectors. Consequently, priorities in the development of public services only followed preferred ambitious political programs on the forced increase of production in heavy industry, mining, etc. Therefore, monopolies of public services were not really strong in relation to other sectors of the economy, but their behavior was typically monopolistic within their own sectors.

In most of the infrastructure sectors, service provision was divided among large enterprises, combining production, transmission, distribution and other related activities. Some activities were also connected to the basic services, like the operation of sports clubs, networks of social care institutions, financing a relatively wide range of exclusive services for employees, and so on.

Under these circumstances, the first step of transformation was the re-structuring of monopolies. Practically this meant the preservation of monopolies in another structure in order to prepare them for real changes in the system of ownership and the establishment of a market environment. In the second stage of transformation, privatization was implemented in all of the possible service areas.

The content of these changes is different in the case of services according to their character as natural monopolies or mixed goods, because the role of the public sector

cannot be defined in the same way as in a market economy. This difference is shown by Table 1 below:

Table 1: Stages of transformation in public utility and communal services

	Public utilities (natural monopolies)	Communal services (mixed goods and services)
First stage RE-STRUCTURING	<ul style="list-style-type: none"> modest breakup of state-owned monopolies (devolution of assets) modest unbundling establishment of an independent regulatory authority 	<ul style="list-style-type: none"> rationalization establishment of a competitive environment
Second stage PRIVATIZATION	<ul style="list-style-type: none"> privatization of competitive assets (de-monopolization) development of a regulatory function liberalization 	<ul style="list-style-type: none"> de-monopolization management of public shares privatization

In water services, three basic models were followed. In Hungary and Poland, the former large state-owned and regional water works were fragmented, and several hundred small service organizations were created by local governments. The organizational forms are various: budgetary organizations, companies, and private businesses that provide water services. This model was not followed in Slovakia, where still a few state enterprises operate the water system and privatization is exceptional. Only the large and probably the best companies are taken by private investors. Romania has its own way by splitting the large national companies into semi-public forms of '*regie autonomes*'.

District heating services were transferred to local governments in Hungary and Poland, which led to some privatization and the slow amalgamation of these municipal service organizations. The other extreme case is Latvia, where heat production is still part of the national energy system and only a few cities have received assets and set up their own company. This 'random municipalization' was combined with the national government bail-out of indebted companies.

The transfer of public state property to the local government, followed by privatization is most typical in municipal solid waste management. Local ownership is typical in several countries, slowly creating joint, economically rational-sized companies for waste disposal and collection. In Poland and Slovakia, different methods are used for waste disposal and collection, such as creating larger service organizations for disposal at regional levels, while at the same time supporting competition in collection. In Slovakia, strong administrative measures were used for closing sub-standard landfills.

Organizational models in communal services are determined by the country's characteristics and they are, in general, decentralized. In Hungary and Slovakia,

multi-purpose urban management service organizations were fragmented; separating some revenue-making and market-oriented activities from the rest. In Poland and Latvia, where the privatization of social housing stock is lower, multi-profile companies provide combined services.

Based on the examples from the studied countries, there are four major stages of transforming local public utility service organizations:

- (i) *communalization*, i.e. the transfer of state-owned property to local governments. This is combined with some form of 'unbundling';
- (ii) *corporatization*, which is the transformation of budgetary organizations into arms-length corporate entities operating under company law;
- (iii) *privatization*, by inviting foreign or domestic investors and attracting external capital in different forms of alternative service delivery (contracting out, concession, and Build-Operate-Transfer {BOT});
- (iv) *regulation* as a key precondition of full liberalization in the utility and communal sectors.

These steps do not follow each other in this sequence, but they were used mostly in those countries that started decentralization in the early 1990s.

(i) The first stage of transformation, when the monolith state enterprises were dismantled into relatively independent units, is an important step towards realizing the efficiency gains of decentralization. Despite the lack of information on the transformation of local public service organizations, all the potential forms of 'unbundling' were implemented in the six studied countries. In the case of communal service organizations, and sometimes in public transportation, only accounts and functions were separated within the large entities. This helped the local governments to realize the total cost of services and to identify the subsidies needed for specific activities. Cross subsidies are still prevailing and they are widely used for minimizing the corporate income tax burden.

The vertical separation of service organizations was typical in the energy sector, where local heat distributors (and sometime generators) were transferred to local governments. In the water sector, state owned enterprises still operate some parts of the national networks, but often the regional and urban companies are 'municipalized', i.e. they are transferred to local governments.

(ii) Creating new entities under corporate law is the next significant stage of transformation. Service providers, client local governments and service producers, and contracting organizations learn the new rules of management and control. They operate under quasi market conditions when service performance indicators and forms of financing are more or less determined. Obviously, the service organizations are more directly connected to their clients with one, or a limited number, of local government owners and under the supervision of local councilors, than in the case of privatization.

However, the clear assignment of responsibilities could make this form of operation beneficial for both parties. Local governments and service users do not have to pay for the profit in the service charges for private owners. Service companies with municipal support might be operated as market entities and their market position can be

improved (for example by receiving guarantees from the owner local governments for capital investment loans).

(iii) Real changes in economic incentives are expected only after privatization. Rules on the transfer of state ownership to local governments sometimes does not allow for the privatization of networks, so only operational assets can be used as municipal equity in the privatized companies. Local governments often keep the ownership of key components in service delivery (e.g. landfills in municipal solid waste management).

The impact of privatization on service delivery greatly depends on the contractual relationship between the client local government and the service contractor. The selection process of partners, performance specification, the agreement on price setting, service monitoring and renegotiations are the key elements of this contractual relationship.

The obvious consequence of this sequential transformation is that these stages should be supplemented with stage four:

(iv) Regulation in a broad sense should include the rules for how the market can be entered, what functions and responsibilities remain at the level of local governments and in what type of financial environment should these service organizations operate. These components will be discussed in the following section.

4. Regulatory functions of governments

Market based service delivery mechanisms claim new forms of control and methods for municipal service management. The regulatory environment is based on generally accepted international principles that are gradually built into domestic regulations and procedures. The regulatory framework is partially defined by national laws (e.g. company law, taxation rules, licensing), but local conditions also matter (especially in price setting, sectoral planning, and consumer protection).

Various elements of regulation influence local public utility service delivery to different degrees. These components are as follows:

- a) Legislation on organizational forms and taxation rules;
- b) Licensing, service permits;
- c) Sectoral planning and strategic decision-making;
- d) Capital investment financing schemes;
- e) Contracting and tendering regulations;
- f) Setting service user-charges and prices;
- g) Forms of consumer protection.

a) Legislation on organizational forms

Services might be produced by local administration departments or by different forms of budgetary organizations. These local government institutions are under the control of local governments, but their property rights and autonomy in managing their own finances are different. They are usually part of the local budget, except in Slovakia, where 'contributory organizations' establish a net fiscal relationship with the

municipal budget. In this case they collect their own revenues, enjoy higher discretion in employment and they are allowed to keep operational surplus.

A mixed form of operation is the 'municipal enterprise'. These enterprises are public sector entities, but have some characteristics of businesses. This was a typical solution for transferring the former state owned companies to local governments, whose possibilities as owners were limited. Sometimes these organizations were transitional forms, when a deadline was set by the national legislation for deciding whether they will operate as budgetary or business entities.

The third group of service organizations is comprised of business entities under company law. These are the traditional forms of joint-stock companies, limited liability companies, partnerships, or some form of public purpose (not-for-profit) companies. They might be owned exclusively by the local governments, or by different owners with different proportions of the shares.

b) Licensing

For providing local public utilities, any type of the above mentioned service organizations should go through the licensing process. Permissions are based on various pieces of sectoral legislation that supplement service licenses: technical standards; environmental protection requirements; employment rules; and financial criteria.

There are also new fields within the licensing process, for example the energy sector, after the privatization and devolution of some responsibilities to local governments. District heating is an example that should fit into the changing institutional environment. First of all, the competencies of the central and local governments have to be specified. They should be harmonized with the requirements of consumer protection, involving such components as: access to information; justification of costs; managing complaints, etc. Conditions for issuing licenses of heat generation are regulated in great detail, specifying also the rights and duties related to heat transmission and grid ownership. A contractual relationship has to be established between the heat generators, the transmission, and distribution companies on one hand and between the distribution companies and the customers on the other. Critical elements of this relationship are the metering and restriction on the service delivery and payments of user charges.

It is a different issue about how these new rules are to be enforced; which level of government and what organizational form is responsible for their implementation. Typically, sector oriented regulatory bodies are established. Control of other local public utility services is organized according to the public administration system of a given country. These regulatory and licensing functions might be part of the higher (intermediary) tiers of sub-national government, which also implement central public administration functions (districts, regions). In other countries, local and regional units of central government agencies are responsible for licenses, the control of technical standards and procedures (decentralized units of water, environmental, public health agencies, etc.).

c) Planning

Beside licensing and permit procedures, there are other ways and indirect means of influencing local public utility services. Depending on the scope of decentralization, different levels of local governments are responsible for planning and strategic design. Local government environmental protection programs (affecting municipal solid waste management, communal services, and so on), plans for energy and heating supply, and water sector development strategies are the most direct forms of influence. They might be assigned to the lowest level of elected local governments or a hierarchical relationship might exist between municipal and regional government plans and strategies.

Other public utility services are designed as a part of the physical planning process. Land use planning is the most obvious form of local planning competencies that have an impact on public utilities. They might create favorable conditions for the development of public utility services.

d) Capital investment financing

Without sufficient financial resources, these planning competencies have only a limited influence on public utility services. There are various capital investment financing schemes in each of the studied countries, providing funds for those local capital investment projects that are in line with the national development policies.

The most targeted forms of capital grants are designed and allocated by the central budget. Other preferred forms of allocating targeted subsidies are the funds and special appropriations that are managed by sectoral ministries. They might be controlled by the general budgetary policy or often they enjoy even greater independence as separate funds, allocated by the relevant ministries (e.g. water management, environmental protection, and transportation). The amount and spending on extra-budgetary funds is obviously controlled by national fiscal policy (through the Ministry of Finance) to a lesser degree than subsidies through other centralized appropriations. On the other hand, these funds support sectoral development policies and programs more efficiently. Often sectoral ministries manage and allocate subsidies through international donor and assistance programs. These sources of capital investment can be significant to EU accession countries in various environmental and regional development programs.

Modern forms of public-private partnership schemes in local utility services are less developed. Concession is the only widely used technique, but not all the local public utility services fit into framework of concession laws. Other BOT (Build-Operate-Transfer) techniques are developing slowly because of underdeveloped banking services, the lack of professional experience and management capacity on the local governments' side and sometimes because of an incomplete local regulatory environment (e.g. price setting, forms and scale of owners' influence).

e) Competition rules

Contracting and tendering for public contracts are parts of the broad regulatory framework. In typical cases, public contracts are made between the local government

entitled to provide the service and the service producers. Here, the local government as a public authority establishes a contractual relationship with the service organization. It might be an in-house unit or an arms-length entity, partly or entirely independent from the municipality. The content and format of these contracts is regulated mostly by sectoral laws or, in specific cases (like the concession agreement), by separate laws. Contracts are also made between the customers and service producers, which are mostly regulated by the civil code (water services, district heating, waste collection, etc.).

This raises the first problem, whether citizens should accept the service organization that is selected and designated by the local government. In the case of Hungary, where citizens have the technical possibility to choose among different service producers (for example municipal solid waste management, or chimney sweeping), the mandatory use of the service was set by the law. So, the citizens have to use the benefits of the locally organized service (that is, they have to pay for it), and the contracts have to be signed with that specific service organization, as selected by the local government.

Other problems of the contracting process were related to tendering and public procurement. The basic principle of the tendering regulations is that if public contracts are made, then the general rules of public procurement have to be followed. This rule is often under pressure or not adhered to, because formally the contract is signed between the individual customer and the service organization assigned by the local government. Formally, no public money is used during the contract because customers pay directly to the service organization. This process results in various misinterpretations of the public procurement rules. The fact is that in this relationship, the local government acts on behalf of all the local citizens and represents the community.

Public contracts should be awarded through public tenders. Public procurement legislations were among the new laws that were approved in the early stage of preparing a developed market environment in transition countries. Following international standards, thresholds of public procurement and procedures were set. Public entities, including local governments and their budgetary institutions have to follow the general procurement rules.

f) Price formulation

Price setting is the critical component of the regulatory system. In the market environment, user-charges should reflect the total cost of the service and at the same time indicate the demand for the public utility service. Both of these requirements were new for these countries, where consumer prices were heavily subsidized and service companies were compensated for their lower revenues. Social policy considerations determined the price levels and preferences, so they did not indicate the real needs for a particular service. During the transformation of the public utility sector, each country went through a similar process, only the speed of changes was different. The basic factor behind these changes was the cut in state and other government subsidies on public utility services.

The present price-setting authority follows the characteristics of a utility service. The more connected the service provision is to networks and the greater chance of monopoly, the more regulated and centralized is the method of price setting. User charges are often defined as official prices, calculated at different levels of government. The greatest likelihood of centralized price setting is in the energy sector (district heating).

Price setting mechanisms and related regulatory institutions are also underdeveloped in the region. Prices are approved or controlled by some national agencies (ministries and boards), but they are usually calculated on a cost-based method. Modern techniques of price capping, or profit rate regulations, with some exceptions (e.g. Hungary), are not introduced. This fact does not support privatization and structural changes in the energy sector. Government subsidies and various forms of 'bail out' still exist. All these factors have an unfavorable impact on those local utility services that are dependent on all, or part of, the energy sector.

Price setting methods are influenced by the broader economic environment. Primarily the cutback in national government and local subsidies forced the changes in service financing. There are some generally accepted principles of price calculation that must also be followed. Based on the principle of 'equality of services rendered and prices paid', volume based pricing has to be accepted. This system sometimes, however, excludes the differentiation between various groups of customers. It may also increase the costs of the service, if the metering is expensive.

The design of user charges is highly influenced by metering techniques and the possibility for cost allocation among different customers. Large social housing estates were built in the era of subsidized low public utility services, when the individual metering and control of individual consumption was not required. In these housing blocks, options for installing metering equipment is expensive or technically infeasible. The old one-pipe district heating systems need huge investments for redesign, and tenants of these social apartments cannot afford the installation of any type of metering equipment (for example individual meters and cost allocation devices).

Methods of price setting and the calculation of price increases are usually regulated. There are typically cost-based techniques for designing user charges (cost factors are weighted and extrapolated according to generally accepted principles and reflected by agreed multipliers). Sometimes, general principles are followed: 'prices should cover the costs and profits of efficient service providers', in the case of energy prices in Hungary. In Poland, a general rule is centrally set for regulating municipal rents: they should not annually exceed the 3% of replacement costs.

Local governments are simultaneously the owners and regulators of municipal utility services. In addition, councilors, as local politicians, are faced with social problems created by decreasing subsidies and the transformation of utility services. These three conflicting functions also create tensions in the local price setting decision.

However, the price formulation function is an emerging and efficient component of regulation. The assignment of the price setting authority and the allocation of competencies to influence the methods of designing user-charges, is part of the public administration and local government reform process.

g) Protecting customers

Demand for consumer protection was raised immediately after the traditional state institutions lost their influence on production and service provision. When organizations 'protecting the public interest' did not exist any more and private property became the dominant form of the economy, new forms of consumer protections had to be designed. Several new areas of legislation provided basic conditions for supporting the consumer's relations to producers. Anti-monopoly and competition laws, acts of price setting, and contracting regulations are all passive ways to ensure a balanced relationship between buyers and providers of a service. Some additional general requirements on goods and services (e.g. labeling) were also part of the newly formulated consumer protection acts in all the studied countries in the very early 1990s.

In the area of public utility services and contracts, there is a need for more active forms of consumer protection. For example, free access to information is a critical condition for protecting consumers' rights when local public services are contracted by the municipality. Also customers should be involved in the regulatory process, when service standards, conditions and prices are determined.

In some sectors, regulatory agencies might have a stronger influence on service provision so that they indirectly have more means to protect consumer rights. Especially in the case of district heating, energy regulatory agencies are involved in price setting, which is the critical component of the consumer-producer relationship. In Hungary, the public utility contract is also subject to a consumer protection procedure.

Another question is what means are available for consumer protection agencies to enforce their clients' interest. Generally legal procedures, in some cases penalties and fines, are the only available measures. They are not a very efficient means for influencing the specific actions of the service producers.

Trends in local government regulation can be explained by the case of Hungary. Table 2 summarizes the most important regulatory steps introduced in the early 1990s. They are presented here by the four major local government functions: 1. public administration, i.e. legal and authoritarian functions; 2. human services (primary and secondary public education, health care and welfare services); 3. public utilities (including communal services); and 4. regional development (local economic development, together with infrastructure). All these service areas are influenced by a fifth element, fiscal management methods, which are presented separately.

This list of major steps is far from being complete, but it reflects the way that management issues have been regulated in the past decade. The first general characteristic is, that *legal regulatory aspects* dominate management. The second general characteristic is the strong influence of *sectoral legal regulations*. The general framework of the local government system was established before any changes in the centralized system of public service delivery. The liberal values of local government structures had to be harmonized with the demand of sectoral laws: equal access to service, hierarchical control, supporting professional standards, etc. Basic local government institutions were interpreted through sectoral laws that were sometimes contradictory to the original concept of decentralization in the public sector.

Table 2: Trends and major steps in local government management by service areas in Hungary

Public administration	Human services	Utility services	Regional development	Fiscal management
Constitutional changes, functions and competencies (1991) Regulations on civic and public employees (1992) Public administration offices: legal control and coordination (1991, 1994, 1997) Minority local governments (1993) Urban authority: child protection (1996), building permits (1997) Forms of cooperation, associations (1990, 1997)	New sectoral laws: social policy (1993) public education (1993), vocational training (1993), and culture (1997) Limited revenue raising, enterprise activities Centralized cash management practices (optional local treasury, 1997) Postponed reconstruction, capital investment Education: demographic wave (decline) Health care: failed 'rationalization', selective bail-outs Welfare policy: decentralized adjustment	Eliminated central subsidies, transferred authority to the local level (1990) Concession (1991) 'Municipalization of utilities (1991 -) Commercial entities in communal services Privatization with foreign direct investment: MSW, MW-MWW Public procurement (1995)	Municipal ownership after the privatization of SOE Limiting local participation in enterprise activities / investments Local economic development: employment through investments Local tax exemptions Infrastructure deals with investors National network of R&D (1996): County based Corporatist approach Decentralized grant allocation Law on Environmental protection (1995) Increasing social consciousness (high arrears)	State Audit Office (1989) Government information network (TAKISZ, 1991) Unified accounting (1991) Deficit grant (1991) Matching and addressed grants (1992) Budgeting procedures (1992, 1995) Budgetary institutions (1996) Property registration: physical indicators (1992) Certified local audit (1994) Bankruptcy regulations (1996) Coordination of appropriations, extra-budgetary funds (1997) Compulsory feasibility studies of capital investments (1998) Week interest representation (lobbying)

Laws, government decrees and ministerial bylaws regulate the functions and competencies of local governments (councils, committees, mayors, chief executives, and municipal employees). The number of different regulations reflects how detailed are these rules. The example of Hungary shows (Table 3), that there is an overlap between these legal rules. There is a high number of regulations and amendments, which proves that the various concepts and legislative policies do affect local governments.

Table 3: Number of legal regulations on local competencies in Hungary

Sector	Number of regulations
Health care and social services	58
Administration (interior)	42
Agriculture	42
Industry, commerce, tourism, and price-setting	35
Administration (justice)	34
Transportation, telecommunication, and water management	33
Finance, fiscal management	31
Environmental protection and regional development	30
Labour	27
Culture and public education	21
Local government and minority government operation	8
Defense	3

Public administration at the local level requires unified and equal practices. Lawful procedures and the professionalism of decisions should be ensured both for discretionary local cases and for decentralized public administration matters. Various attempts in this area were directed towards an increase in the level of professionalism of local actions and to guarantee the equal treatment of local public administration employees (e.g. regulations on employment, centralizing child care and building permits issued at urban authorities). Administrative expenditures are 15% of local budgets, but miscellaneous small expenditure items are usually accounted under this function.

Human services are the largest expenditures at the local level. Public education, health care, social services, culture and sports are almost two thirds of the local government budget. These functions were always local services, but the economic and regulatory environment changed in the early 1990s. It took two-three years before the sectoral laws on these activities were designed and approved. A sensitive balance of central control on service quality and the allocation of functions to municipal and county local governments had to be achieved.

The general trend in human services is that sectoral legislation is not in harmony with the principles laid down in the framework law on local governments. The allocation of

service institutions to certain types of local governments, the control of service performance, employment and salary regulations, and the increase of specific normative grants (e.g. in education) all have a strong impact on local government structure. In the period of fiscal austerity, the minimum level of service provision was always, prior to decentralization, laid down by early local government legislation.

Fiscal management regulations and forms of organization and management that were developed in the traditional budgetary sector of human services supported unified and controlled service provision. Budgetary organizations had limited revenue-raising autonomy, and consequently, their 'enterprise' activities were scaled down by laws. This was somewhat different from the general attitude developed in the 1980s. At that time, the entrepreneurial spirit of public service entities was supported. The positive consequences of those changes were that local government units learned autonomy in their daily practices, and methods of how to counterbalance cutbacks in grants. The negative side of the entrepreneurial character was that the shift from the main activities of the service organizations towards revenue-raising was sometimes too radical.

Parallel to these nationally-initiated changes, local governments also developed new forms of fiscal management. Centralized cash management in local government budgetary (contributory) institutions was introduced as local 'treasuries'. They copied the techniques designed by the national treasury system, decreasing the idle cash of the service organizations. More precise planning rules and the use of appropriations decreased the former wide autonomy of these service institutions.

Public utilities and other communal services, including housing, also went through a major reorganization. The first steps in these service areas were the immediate elimination of national budget subsidies and the transfer of the price (rent) setting authority to local governments. There are two exceptions in the water sector: water and sewage charges above a certain level and the collection of liquid waste from septic tanks are subsidized (by flat rate).

Local governments became the owners of public utility networks and service companies. The water, sewage pipes, and wells became local government core assets that could be sold only by the council's decision (property with limited negotiability). The service companies and the operating assets were 'privatized' to local governments. The former state-owned water companies and the county water companies were transferred to the local governments that owned the network. These local governments have created many new service organizations and operating companies (more than 250).

Limited attempts were made in 1995, when solid and liquid waste collection, and disposal, and chimney sweeping were declared to be mandatory local services (for property owners). Parallel to this legal obligation, compulsory competitive tendering was introduced. This legislation was misinterpreted by some ministries and also by several local governments. The Ministry of the Interior sent out a circular in which only the new (and not the prolonged) contracts were subject to tendering. The local governments' argument was that it is their constitutional right to define how municipal service is provided, so there is no need for tendering. The lack of an administrative

capacity with which to manage competitive tendering in utility services was partly behind this reluctant behavior of local governments.

Regional development has always been regarded as a local government function with high priority. For mayors it was an even more significant local task than some traditional local public services. Local government involvement in business activities is partly inherited from the soviet-type local government system where local authorities had direct responsibilities for production and services.

This attitude was reinforced in the modern local governments for two reasons: (i) through the privatization process they became (minority) owners of former state-owned companies and (ii) fiscal austerity measures forced them to increase their own sources by business related revenues. Local government participation in enterprise activities is limited by law. According to the framework act, local governments are allowed to take ownership in commercial entities only with limited liability (via a joint stock company, or limited liability company). Another measure to protect public funds was to allow local governments (and their budgetary organizations) to make financial investments only in securities with state guarantees. Even these measures, however, could not prevent losses in municipal property. Recently, in the period of declining stock markets, some broker companies misused municipal portfolios. These were frauds, because local governments did not properly control their portfolio management contracts.

Changes in local government finances and *fiscal management* were introduced through the legislative processes of the late 1980s. There were various experiments to increase revenues, to launch a unified, non-discretionary capital investment grants scheme, and to establish joint fiscal management units for fragmented budgetary organizations. A significant transformation of intergovernmental transfers was introduced in the fiscal year 1990, before the major political and administrative changes took place.

Financing Public Services on the Local Level: Charging Development Costs, User Charges and Supporting Low Income Groups

Introduction: restructuring the public service sector

This paper¹ will deal with the financial issues of local public (communal) services² after transition in post-socialist countries. The transition of the countries in the region from a centrally-planned economy toward a market economy has turned out to be a very complex and long process. Fiscal decentralization is the key to most of the reforms needed in transitional economies. The assignment of expenditure responsibilities among the different levels of government is a very important step in this process. The decentralization of the responsibility and authority to provide and regulate services and to manage and/or promote local development can lead to better services and an improvement in local conditions. The expectation is that placing the authority and responsibility for certain public services in the hands of local elected officials will lead to decisions regarding the quantity, quality and mix of services that most closely match the preferences of local service beneficiaries. The process of decentralization, however, has not offered an easy solution for these countries.

One of the general problems that local governments had to face was the issue of “un-funded” mandates. Un-funded mandates means that central governments, in the process of decentralization, “pushed down” several responsibilities without providing proper financial resources to fulfill the requirements of public services. There are several examples when the un-funded mandates caused major trouble for local governments. However, we should understand the other side as well, as the central government also had “un-funded” mandates. Post-transition economic decline forced central governments to narrow the services that they finance or to restructure the public sector. From this point of view, the fair solution would have been to share the political cost of restructuring between the central and local governments, but, in most of the cases, short-term institutional interests blocked that type of solution.

The basic question was who will be responsible for the structural changes needed to move toward a more efficient economy and a democratic society. Structural

¹ The paper is based on the presentation at the expert workshop on “Public services on Local and Regional Level” organized by Friedrich Ebert Stiftung, Zagreb Regional Office in Budapest on 17th -18th of October.

² In this paper I deal with local public communal services and issues of the social and human services that have several common elements but need to be analyzed differently.

adjustment at the local level means that under fiscal pressure local decision makers have to decide how they bridge the gap between the expenditure needs and revenue possibilities of their community. There are several possible ways to increase revenue and decrease cost, like increasing user charges or local taxes, or cutting services (either the level or the scope of the services). However, the most difficult and efficient way to manage fiscal pressure was to initiate changes in the public communal sector including reorganization, contracting out, and privatization.

The keys to the success of the structural adjustments were the *institutional settings*. Did the newly formed local governments have the legal possibility to make necessary changes and did they have the incentive to carry them out? Most observers and experts are willing to forget about the condition of “incentives”, and focus only on the legal environment and problem of technical capacity, which explains why most of the technical assistance programs in the region stressed these elements. However, we know that without proper incentives local governments³, no matter how trained they are or how much legal possibility is open to them, will not make any changes.

The institutional settings, that is, the structure of local functions and responsibilities varies from one country to another and certain elements of responsibilities for regulation are shared between the different levels of government, which leads to different institutional structures. There are two extremes: 1. the centralized model, where the service utility company is basically a de-concentrated unit of the central government, and the 2. the decentralized model, where the utility companies are accountable to the local government. The central government includes the sector ministries and the central public agencies under the control of the parliament or government. The existing institutional settings can be placed between these two extremes. The control of different elements of the responsibility can be shared in very different ways.

In this paper, I will focus on the relationship between the financial issues of the local public sector and the institutional settings (e.g. responsibilities, incentives, etc.). In the *first* part we introduce an explanation for the “public sector decline”. I will attempt to show that without proper decentralization the macroeconomic discipline supported by international agencies could lead to a general decline in public sector services. This decline could take place under “good” macro fiscal indicators that are parallel with quite good macro performance. The *second* part deals with the problem of user charges (tariffs) in local public services and with related economic, social and political issues. The public communal services (like water, waste disposal, housing, district heating, etc.) should be financed basically from user charges. However, in socialist economies the “price” of public services used to be very low, and had nothing to do with the economic cost of the services. After the transition, the local governments had the task of introducing a new financial regime⁴, where the user charges play a

³ When we are talking about local governments, we should not forget the complexity of local government systems (the executive, elected council, the decision makers at budgetary institutions and local government owned companies).

⁴ The energy sector belonged typically to the central governments, so their responsibility was to set the energy price.

significant role in financing these services. The *third* part of the paper deals with the problem of low-income consumers. This is a curtailing question in the region, where 30-40 % of households live below the poverty level. The problem is, how can the price be increased if a substantial part of the society cannot pay for its level of consumption.

The decline and the decentralization of the local public service sector

Un-funded mandates

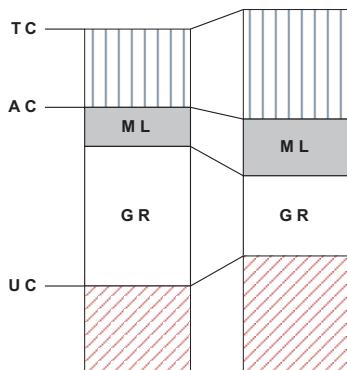
As a consequence of the macroeconomic fiscal pressure on governments right after the political changes of 1989/1990, the central government tried to “push” the deficit down as a part of the reformation of intergovernmental fiscal relations and the decentralization of the state sector. Typically a huge “gap” arose between the expenditure assignment and revenue capacity at the sub-national government level. There is a debate about the nature and size of this gap. For example, the gap had increased even before the transition, as obsolete public service equipment (deteriorated buildings, overused pipes, run down vehicles in public transportation, etc.) used to be part of the service sector in socialist times. There is a discussion among experts about how much of the increased gap was the responsibility of the new regimes. Nevertheless, most of the countries realized that the gap was increasing at a sub-national level, and they had to react to it. The structural adjustment describes the process of local governments trying to manage this gap (or deficit).

The mechanism of “public sector decline”

The first and most direct consequence of the economic problems of transition was “public sector decline” (e.g. no continuous water service, cuts in electricity, no proper waste collection, no road repairs, no maintenance of public schools, etc.) One of the most important statements of this paper is that improper decentralization, or the lack of it entirely, led to a deepening of the public sector decline. What is more important is that the policy to force macroeconomic fiscal discipline on the governments without proper decentralization (which was a consequence of the policy, especially in the first period, of international agencies such as the IMF, etc.) hid the size of the problem, because macroeconomic indicators seemed to prove that the economy was on the right track.

Let me describe the process with the help of a figure. Column TC represents the expenditure needed for a proper service. We can see that even in the beginning, the actual cost of the services was lower than what was needed, that is $TC > AC$. It illustrates that before the transition there was not enough money for proper operation: it was known as “deferred maintenance”. We knew that in most of the services, user charges cover only a small portion of the actual cost, and less than the total cost UC (user charge), so the UC/AC was less than 30 %, and UC/TC was even smaller. In Hungary, for example, rent covers 30 % of the actual cost related to maintenance and operation, but it covers 20 % of the cost that would be needed for proper maintenance.

Figure 1: The process of public sector decline



TC: total cost: the “ideal one”

AC: actual cost: deferred “maintenance”

ML: loss because of managerial problems

UC: user charge

GR: grants

UC/AC is increasing, but $TC - AC = \text{deferred maintenance}$ is increasing

ML is increasing

Conclusion: the efficiency and level of services is declining

The services were subsidized, so the difference between the actual cost and the user-charges was provided to the service provider (the subsidy was equal to $AC - UC$). We knew that a certain part of the cost was due to managerial problems. In the public sector there were endless lists to illustrate this phenomenon, like “inside unemployment”, waste with material cost, etc. Most of these losses were connected with the lack of autonomy and incentives. The managers of service institutions needed incentives and autonomy to make proper changes, provided they are accountable to the local community directly or indirectly through the elected local government bodies. The local public sector decline can be explained with the lack of local autonomy and incentives. The central governments, and in the beginning even some of the international agencies, were against decentralization. There were several arguments supporting this policy, among them the most powerful were 1. the lack of capacity to manage local affairs, and 2. the danger of corruption. We know cases where central governments could not demonstrate the superiority of their capacity to manage public issues, or when corruption was more dangerous and harmful than at the local level. But these questions are beyond our topic.

So the typical expectation for the service provider is to increase user charges and decrease cost, so that $AC' < AC$ while the subsidy will decrease because of the higher user-charges and/or lower cost. To increase the user charges is very problematic, because there is no change in the level of services or they may even deteriorate, as the actual cost is decreasing. If managers did have limited autonomy, they would have to keep the same number of workers with lower salaries (sometimes service providers do not pay salaries for a while or pay less than earlier), and/or neglect maintenance, saving on material cost, etc. The loss because of managerial problems is increasing, again because the service providers do not have the autonomy and incentive to make changes. The service level is decreasing, because less money is spent on maintenance and operation, and even the number of workers is lower. However, the macroeconomic perspective is fine. The sector used less money ($GR' < GR$) and the households paid more, and the $UC'/AC' > UC/AC$. But the level of public services has

declined. To conclude, cutting costs (without expenditure autonomy) will result in further losses because of the inflexibility of management, and as a consequence, the level of services will further deteriorate. The problem is that the policy to increase user charge coverage (UC/AC) may be accompanied by the lower level of services⁵.

User charges: setting the price of public services

Price setting mechanisms

In a market environment, user charges should reflect the total cost of the service, and, at the same time, should signal the demand for the public utility service. Both of these requirements were new for transition countries, where consumer prices were heavily subsidized, and the demand and actual use did not indicate the real need for a particular service. Prices were set centrally, so no regional production cost differences were reflected in the local prices.

After the transition, the price setting mechanism had to be changed in order to give room for local service providers to adjust. Subsidies were cut drastically in most of the countries. In some countries, this was accompanied by the decentralization of price-setting competencies, parallel to the devolution of service ownership and management functions.

Pricing in an economic sense means the setting of the value of a product (service) on the per-unit basis that is used in the settlement between the suppliers and consumers of the product (service). In reality, pricing is used in a way that is much broader than this economic definition, as in the region it is not unusual for the quantity of a service not to be susceptible to measurement. In such cases, prices are indirectly related to consumption, thus coming much closer to the condition of benefit taxation.

The institutional setting of the sector has an effect on the pricing mechanism. The legal decision is a key element in pricing. Most of the countries in the region have delegated pricing functions to local governments, but the real influence depends on several other things. The price of the service depends very much on the price of inputs, like energy cost. If the energy price is centrally defined, but the local government has the right to define the service price, its freedom could be quite limited. Another example from Hungary is that regional water works owned by the central government transfer water for distribution to companies owned by the local government at a price set by the central government. In this case as well, the room for local government is limited.

The procedure of pricing is very important as well. It is a one-sided decision making process, with no room for possible appeal processes. In some countries in the region, the local government units have the right to set the tariff, but they have to be approved by the central government or by the central government agency. There are some cases when the central government gives a subsidy proportional to the tariff to the service provider. In this case, the right of the central government to give or withhold its approval, that is, sharing the responsibility for pricing, is understandable. The service

⁵ We know that the extreme case is when companies (service providers) exist but they do not provide services, e.g. district heating in Azerbaijan or limited water services in Ukraine, Albania, etc.

companies need security, especially if they make long-term investments, because they can make losses if the service is under-priced. The law defines the procedures or accounting rules which again - depending on how enforceable the laws are - could limit the manoeuvring room for an organisation with price-setting rights.

The present price-setting authority follows the characteristics of utility services. The more connected the provision to the networks and the greater the chance of monopolies, the more regulated and centralized is the method of price setting. User charges are often defined as official prices, calculated at different levels of government. The energy price formulation is well established in many countries, where energy regulatory bodies were established. In Poland and Romania, for example, user charges for district heating are defined by the central regulatory agencies, mostly after consultation with the competition offices or boards. In Estonia, the price for heat is inspected and approved by the Energy Market Inspectorate with respect to companies that sell more than 50,000 MWh per fiscal year. Local governments have the responsibility to set the price for the smaller companies. There are now 18 separate energy regulatory bodies in the region, most of which have tariff setting competency and experience. In the Estonian water sector, municipalities have the right to set the prices in cooperation with the service companies.

District heating is the subject of subsidies in, for example, Romania, where the “national reference price” is set for consumers. This price is driven by the costs of the large national energy companies and it is accompanied by a subsidy to local governments, where the local price is above the national reference price.

Price-setting mechanisms and related regulatory institutions are rather underdeveloped in the region. Prices are approved or controlled by some national agencies (ministries and boards), but they are usually calculated on a cost-based method. Modern techniques of price-capping, or profit-rate regulations, with some exceptions (e.g. Hungary), have not been introduced. This fact does not support privatization and structural changes in the sector. In Slovakia, the Regulatory Office for the Networks Sector is responsible for price control, which uses a price cup regulation method (Slovakia Intermediaries).

Government subsidies and various forms of “bailing out” still exist. All these factors have an unfavorable impact on those local utility services that are dependent on or part of the energy sector. However, the price formulation function is an emerging and efficient component of regulation. The assignment of the price-setting authority and the allocation of competencies to influence the methods of designing user charges are part of the reform process of public administration and local government.

User charges and capital investments

The mechanism of setting user charges has an effect on capital investment finance in the public service sector. The question is that local capital investment is financed through a “pay-as-you-go” strategy, where the resources of investment expenditures come from previous savings (at the central or local level). This also means that capital costs are not built into user charges. The other option is the “pay-as-you-use” strategy, which means that the investments are financed by “future savings”. Usually the financing of these improvements is provided by loans with a maturity that equals the

lifespan of the facilities. If the maturity of the loan is shorter, you can roll over the loan costs, and the capital improvement is paid back by user charges or future taxes.

Experts from many countries note the importance of properly reflecting the investment component in the tariffs. Investments imply the acquisition of fixed assets, intangible assets, corporate rights, and securities in exchange for cash or property rights, as well as the return on such investments. The investor can recover his capital costs through: 1. depreciation; 2. return; 3. “tax for development” (Romania). The sources of capital investments include: internally generated cash (self-financing), borrowed capital and shareholder capital.

In those systems where prices are controlled by central (quasi independent) regulatory bodies, investment decisions are more complicated, as the future price increase as the source of investments is difficult to predict.

Without sufficient financial resources, these planning competencies have only a limited influence on public utility services. The investment needs are huge in the region. The dilapidated and obsolete equipment as a consequence of public sector decline are the most critical elements of the service sector because they lead to high losses and high service costs. There are various capital investment subsidy schemes. The most targeted forms of capital grants are designed and allocated by the central budget. Earmarked subsidies from the central budget to local investment projects (e.g. in Romania) are the traditional form of capital grants. In a more decentralized local government structure, targeting is achieved through matching grant schemes (e.g. in Hungary).

Other preferred forms of allocating targeted subsidies are the funds and special appropriations managed by sectoral ministries. They might be controlled by the general budgetary policy or often they enjoy greater independence as separate funds, allocated by the relevant ministries. The amount and spending of extra-budgetary funds are obviously controlled by the national fiscal policy (Ministry of Finance) to a lesser degree than subsidies through other centralized appropriations. On the other hand, they support sector development policies and programs more efficiently.

External funding might be provided through national budget loan schemes or by ensuring direct access to international financial institutions and commercial banks. The World Bank, EBRD and pre-accession funds, like ISPA, have an important effect on the sector in the region. Not only because the size of the capital, which is sometimes substantial, sometimes less important, but because of the institutional changes accompanying the investment. Donor agencies want guarantees to ensure that new assets will be managed efficiently, and they believe that the private sector would be more successful. The results are sometimes conflicting. Private financing is possible if cost recovery is guaranteed in the sector, and political influence does not jeopardize predictability. Again, this shows how important the overall economic policy is, especially with respect to privatization and liberalization.

Regulation and price setting after privatization

Privatization had an effect on the pricing mechanism as well. Public utility services as natural monopolies are subjects of large-scale privatization. Generally speaking,

large-scale privatization means breaking up monopolies of large state-owned firms and putting them into private hands. This step can be made in at least two ways. One is to transfer assets to private ownership without making any crucial changes. In this way, state-owned property becomes a private monopoly (for example in the Russian energy sector, including gas and electricity). The other route is to transfer ownership to competitive companies, whilst preserving the necessary public functions under public control. This is more complicated and requires political commitment, along with more time and deliberation.

This process already started in several countries in the region, however, the results are sometimes contradictory. Privatization typically led to a higher price, more investments, more efficient service, but less employment. The regulators' capacity to monitor the service providers is generally limited, which gave room for the service providers to make good profits. However, the political instability may have negative effects on the service performance.

The problems of arrears and social policy considerations

Collecting charges

According to the practices of developed countries, service providers should achieve at least 95 percent collection rate on current accounts. That is, no more than 5 percent of the current charges for billed services should be delinquent. In this region, there are countries where the collection rate is less than 50%. It is not because of the technical problems related to collection, but rather the collection and “charging” methods influencing the financial performance of the service sector.

Achieving this collection rate depends on local economic conditions, including the unemployment level, and on the aggressiveness of the collection effort.

Service charges are collected in one of two ways: at the point of sale (such as a rental charge for the use of recreation equipment) or on a periodic basis for the service used (such as a monthly statement for the quantity of water consumed). While the first approach in principle eliminates the problem of delinquency, it is usually more costly to administer relative to the amount of revenue collected. Periodic billing of users yields the largest portion of revenue from service charges. However, managing accounts receivable creates many of the same problems a private firm encounters when it extends short-term credit to consumers. One of the advantages of a billing system is that the cost of administering each account declines as the number of accounts increases. Local governments typically economize even further by piggybacking several utility and related service charges onto one billing system. For example, the charges for water, sewer, solid waste (refuse) collection, and electric power may be listed on one statement.

For example, in Kiev (*Kiev: Case Study*, MUNEE) the fee collection system was changed. Before 1998, collection was organized by the housing maintenance companies that were replaced by a single billing and accounting center. As a result, the collection increased from 70 % to 85 % (from 1997 to 2000).

The collection problems could relate to the issue of metering. Before the transition it was not typical to meter the consumption of services. However, after the general

increase of the service prices, metering became an important issue and a precondition for households to adjust their consumption to their financial possibilities. Introducing metering has been quite difficult for multi-unit buildings, so in most of the cases metering is organised according to the buildings, not apartments. Willingness to pay is lower when individual consumption cannot be measured, which increases the possibility of arrears. This is the reason why municipalities responsible for service provision set up subsidy schemes that give incentives to introduce individual meters for consumptions. In Lviv (*Lviv: Cases Study*, MUNEE) the users with individual meters had a 20 % discount (later changed to 10%) on the heating tariff. However, the service companies have no short-term incentives to foster the use of individual meters because it decreases the consumption, and frequently the efficiency, of the companies. In the long run, however, they have to realise that helping consumer adjustment is the only way to keep their consumers. In Hungary, because of the competition on the “heating” market, houses cut themselves off from the district heating system and installed individual boiler systems instead, forcing the district heating company to change its policy toward the consumers.

Improving the collection of current charges must begin with the design of the statement, which should communicate clearly to customers the amount owed, the basis for determining that amount (quantity used and rates), and the payment due date. If a discount is offered for early payment, this should also be indicated on the statement. However, evidence suggests that discounts do not significantly improve collection rates, and that their costs do not justify their benefits to local governments. One of the greatest challenges confronting those responsible for managing accounts receivable is keeping mailing addresses current. At a minimum, local governments should request notification of changes of address from the postal service.

Some governments have found that contracting out the collection of utility charges is more cost effective than performing the task internally. This will more likely be true where the local government provides only one utility service and has few opportunities to piggyback a number of charges onto one statement.

Companies may bill the consumption at stated intervals (monthly, every second month, twice a year, once a year and so on). The following payment methods are available: 1. direct payment to the fee collector; 2. payment directly to the companies by check; 3. payment by transfer.

In Romania and Lithuania, consumers pay directly to the companies that provide the public services. Other systems for the collection of payments also existed earlier, but the current system has proved to be the most efficient. In Budapest, there is a company responsible for the collection of the public utility services' charges (including water, sewage, rubbish, gas and district heating, but not including electricity). In Hungary as a whole, consumers pay directly to their local supplier.

The problem of low income consumers

During the past decade, the development of public utility services has been influenced by different factors. The first set of factors focuses on the improvement of service performance, demanding capital investments, and the raising of the technical

standards of services. The next set of factors relates to financial requirements, because the necessary resources have to be made available. Efficient service delivery and modern financial techniques are the necessary conditions for internal and external funding. The third set of factors includes the social policy aspects of utility and communal services that have tended to set priorities. However, these social considerations have to be balanced with technical (capital investment) goals and financial (efficiency) objectives in the development policies. In the case of local public utilities, all these three aspects of transformation should develop jointly.

One form of ensuring social policy objectives is to establish customer protection mechanisms. This is a crucial condition for developing a modern regulatory system. Independent and professionally sound regulatory institutions automatically protect the interests of the consumers. They have an impact on service performance through licensing, and the monitoring of service delivery. They might prevent customers from a major breakdown of utility services by guaranteeing professional standards and financial disciplines in the service organizations. By controlling price setting, regulatory bodies may ensure the principles of lowest cost pricing, fair methods of price adjustment formulae, and the curbing of unjustified increased cost pressure from service organizations. This influence on the price setting mechanism is extremely important in an inflationary economic environment, which was typical in almost every transition country.

However, countries in transition were not prepared to set up efficient "customer protection mechanisms". There are several conditions that could guarantee that the transition will not "hurt" the needy population. First of all, official income has been a weak indicator of neediness, and the indirect indicators such as age, family status, and occupancy make targeting a critical issue. To build up the capacity to manage efficient social protection takes time, money and a strong political will, which are scarce in the region.

The cost of an inefficient protection system is high in the economy. The example of the energy sector shows that keeping prices at an artificially low level will lead not only to economic inefficiency, but also to unexpected social consequences. Low energy (or any other utility price) or lower VAT tariffs will provide more subsidies to large consumers, who are probably better off than the poor customers. This will also lead to economic distortions and import dependent sectors for high budget subsidies. The preferred privileged status of these public service providers might also lead to monopoly situations, which further accelerates inflation. Accordingly, the present practice of flat low-utility prices in many transition countries should be moved towards market-based prices. This shift should be combined with targeted social policy measures, with means tested subsidies and other social policy measures. But again, efficient targeting methods require important conditions such as reliable information provision and certain norms and attitudes toward the public sector.

The basic issue that the public service sector faces in the region is clear: most municipal utility services are under-priced. They are being de-capitalized due to political pressure to keep utility service prices too low. Efficient economic policy requires sound economic pricing which forces politicians to address the needs of

vulnerable populations. Governments best deal with the needs of vulnerable populations: utilities are not good deliverers of social welfare but can sometimes do this through tariff adjustments. Regulatory bodies can play a key role by establishing economic tariffs that allow for the financial sustainability of the municipal utilities.

This is highly evident in the extent of poverty and the limited ability of some households to pay for even the most basic of provisions, such as utility services. Indeed, the problems of low-income households can be seen as a barrier to various reform initiatives, such as eliminating or reducing cross-subsidization, tariff reform, and even privatization.

There are three solutions to the problem of low-income households. One is the “tariff solution”, when the structure of the price indirectly provides advantages for low-income groups. The second option is to target the subsidy directly to the needy households, and the third option is to increase the end-use efficiency. The tariff solution is used widely in the region, because it appeared to have lower administrative cost and complexity. In the second group of solutions, the focus is on assistance to either individual households or specified groups of households. This assistance may be provided in two ways: via tariff discounts (lower prices) or via income support (higher incomes). The third solution is end use efficiency, which reduces the use of public services (water, electricity, gas or heat) and which has a long-term social impact by reducing the waste and consequently the cost to the poor, as well as others.

These solutions however are not mutually exclusive

The countries in the region have used a mixture of the above-mentioned options. The efficiency of the solution depends very much on the institutional structure of the services and the incentives of the different organizations having responsibilities in the service sector.

The “tariff” solution is the simplest one. Basically, the low tariff is used before the transition can be interpreted as a “solution”, but rather a very inefficient one. Another specific case under the “tariff solution” is the arrears, when households do not pay the charges and the service provider does not disconnect the non-paying consumer. This is a very common and complicated problem in the region. The examples shows that the willingness to pay / payment discipline depends very much on both the legal framework and the incentives for households and institutions. Sometimes the service providers themselves are not very interested in collecting arrears, if they can charge the loss on the government or on the “good payers”. The incentives of the municipalities are equally important. If they own the companies, and there is no possibility or hope of receiving additional central subsidy, they are forced to make decisions to increase the collection rate or cross subsidize the services. The practices are very mixed even in one country. For example, in Hungary public housing management companies typically realize a 50 % collection rate, which is extremely low. But because of the small size of the sector, it is rare that the municipality takes the political risk to enforce payment or evicts non-paying households.

The typical tariff solution is either the “across-the-board price subsidy” or “life line” tariffs. These are considered the easiest to implement, but their efficiency from the

point of view of targeting is questionable. The service providers and sector ministries prefer these solutions because funding seems simple (because of budget subsidies or overcharged “good-payers”).

There have been a lot of attempts for targeted programs. One type is the price discount for certain consumer “classes”. A typical example is providing free public transportation for elderly people. In Russia, Ukraine and countries with ethnic conflicts, other special categories of privileged households were also defined (e.g. veterans, or victims of Chernobyl). The more common solution is the “housing allowance” type of program, which tries to target assistance to the really poor households. The programs (Russia, Ukraine, Hungary, etc.) depend on the procedures of their implementation. In Hungary, for example, the municipalities have to use their own resources to provide assistance, and they have the right to define some of the conditions. As a consequence, the total cost program is quite limited. Typically, it is not a general-purpose transfer, but an earmarked transfer to pay the bills of the service providers.

End-use efficiency is very important as well. As we showed in the first part of the paper, the public sector decline may lead to much higher cost (a less efficient system). The right incentives and properly designed (investment) subsidies could stop this process. Without improving service sector efficiency, the tariff solution or the targeted solution will not be sustainable.

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Local Government Responsibility for Public Services

Introduction

Slovenia has not yet completed reforming the local self-government system, since the question of regionalization still remains unresolved. According to the Constitution, municipalities are the basic socio-economic, political and administrative units, responsible for the development of the local economy and social services in their territories. In 1995, Slovenia introduced a single-level system of local self-government with the intention of later upgrading it with a second tier. As a result of the reform of the local government system, the number of municipalities has tripled since 1991, increasing from 62 communes to 147 municipalities in 1994, to 192 in 1998, and to 193 in 2002. Slovenian municipalities range from 400 to 276,000 inhabitants. However, most municipalities are rather small and often lack the financial resources and administrative capacity to perform their functions successfully.

At the moment, no official political and administrative entities exist at an intermediate level between the municipalities and the state level, and although municipalities may join regional associations to regulate and pursue local matters of wider interest it has not been common practice to do so. Still, municipalities cooperate regularly in certain areas of public services, especially within the territories of ex-communes that were divided into smaller municipalities. Since some systems of public services have greater economies of scale their production is jointly organized for a number of municipalities together.

Local government responsibilities

In accordance with current legislation, the municipalities are responsible for three sets of tasks:

- their own local public affairs (which can differ from one community to another),
- local public matters defined as such by the central government through sectors of national laws;
- tasks that have been transferred to them from the competence of the state (thus far, none).

The Law on local self-government defines certain basic responsibilities. However, the responsibilities at the local level are defined in detail by the laws of the different sectors. These specific laws set the requirements for the provision of particular public

services. For example, public services are defined by laws in the field of education, health care, culture, social care, energy, traffic and communications, municipal and water management, management of other natural resources, and environmental protection, as well as by other laws regulating public services. These laws may stipulate that a certain service is to be performed as an obligatory public service.

In sum, municipalities are responsible for:

- the provision or development of all kinds of social services and activities:
- preschools, kindergartens and nurseries (all children have a right to a place in a public program),
- social care and family support services (the provision of services for the socially underprivileged, the disabled, and the elderly),
- the provision of social housing,
- the regulation and maintenance of water and power supply facilities,
- the protection of air, soil, and water resources,
- the protection against noise,
- the provision of waste collection and waste disposal in urban municipalities,
- the preservation of natural and cultural monuments of local interest,
- the provision of public transportation (where feasible)
- the construction and maintenance of local roads and public spaces,
- the management of community assets,
- the provision of favorable conditions for economic development, etc.

Urban municipalities have some additional responsibilities:

- the regulation of local public transportation,
- the provision of public health services and the administration of hospitals,
- the administration of a network of primary, secondary, and vocational schools as well as higher education,
- the support of cultural activities (theatres, museums, archives),
- the administration of public libraries,
- the option of performing regional administrative functions (in agreement with other municipalities), etc.

Some functions are solely the responsibility of the municipality, while for others the responsibility is shared between the municipality and the state. When responsibility is shared, programs are very often developed in close co-operation between responsible state and municipal institutions. The municipality has to participate by co-financing programs (for example: adult education, public work programs, local development programs, etc.)

The division of functions between the local and state level is the following:

Exclusive municipal functions:

- education (preschool),
- general administration (fire and civil protection),
- social welfare (kindergarten, nursery school and family welfare services),
- the environment and public sanitation (refuse collection and disposal),

cemeteries and crematoria),
urban and economic development (town planning and local economic development),
public utilities (district heating and water supply).

Shared functions with the central government:

education (primary and adult),
social welfare (social housing and social security),
health service (primary health care),
culture, sports (theatres, museums, libraries, other cultural facilities, parks and public spaces, and sport facilities),
the environment and public sanitation (sewage, environmental protection, consumer protection),
traffic and transportation (roads, transport, urban road transport, ports, etc.),
urban and economic development (housing, spatial planning, regional planning, and the promotion of economic development),
public utilities (gas).

Organization and supervision

The tasks of the local administration in the area of public services, the organizational forms of their implementation, and relations to the providers of public services are defined in the laws on administration, public institutes and public utilities. Organizational forms of public services are:

public institutions for social public services when there are one or more public utilities provided, which due to their nature cannot be provided as profitable, or if this is not their goal;

an administration office, when it would be uneconomical to establish a public company or grant a concession due to the small volume of a service;

a public company or public commercial institution for public utilities (e.g. public waterworks, public sewerage, waste disposal, the maintenance of municipal roads, etc.);

granting concessions to the persons of private law; and

joint companies by investing public money into the activities of private organizations that provide certain public services.

Two additional general laws are important for the regulation of public services. In the area of utility public services, the Law on public utility services regulates their production, organization and management in great detail. For the regulation of the public institutions that are most common in the different social services, the Law on public institutions applies.

In the area of public utilities the municipality is obliged to form a special committee of citizens as an advisory board to the municipal council. Quite often the committee is composed of representatives of local communities or villages. The committee coordinates interests of different local communities and villages and makes

recommendations to the municipal council and the council has to react to its comments. The protection of the rights of individual consumers is also legally guaranteed. If a provider of services does not act in accordance with the contract, a consumer may complain to the competent municipal or national authority. This authority decides on the consumer's complaint and can order the provider or contractor to act accordingly.

In the management board of public institutions or companies, there are representatives of founders as well as representatives of users of certain public services. For example, in the school board, a representative selected by the parents' board represents their views and interests. In kindergartens and schools a special parents' council must be formed to act as an advisory board and meet regularly to discuss issues and make recommendations to the director.

Otherwise, local administrations, together with the mayor and council, have an obligation to supervise the performance of public services in their area. The municipality also makes decisions about prices, the volume of production, future investments and the use of profit, if there is any. If the provision of service is shared by the state, the state participates in these decisions.

Municipal infrastructure (roads owned by the municipality, waterworks, hot water supply, gas supply, etc.) and municipal services are still mainly in the public sector, although the situation is slowly changing. Some municipalities have decided to make concessions to private or foreign firms and, additionally, different NGO are more and more active in the area of public service provision.

While the quality of most public services is quite high, there is still much room for improvement, especially in the areas of management and efficiency. In some areas of public service there is a need for the proliferation of different types that will better respond to the needs of citizens.

Financing of services

The provision of services is financed from different sources:• the municipal budget,

- the state budget (shares services and the co-financing of municipal investments),
- user fees,
- municipal communal rates,
- donations,
- user financial participation for non-standard activities, and
- credits.

Municipalities are entitled to state co-financing of municipal investments (such as elementary schools, kindergartens, road construction, infrastructure for public utilities, etc.), which they receive in the form of special grants from individual ministries. The share of state co-financing ranges from 10 to 70 percent of the value of the investment and it is in detail defined by law. The share depends on the economic standing of a municipality, so that poorer municipalities receive a greater share of

funds for investments.

The law on the financing of municipalities makes a provision for the access of local authorities to capital markets. According to this law, municipalities can borrow from national credit institutions for the financing of investment expenditure, but not without the approval of the minister of finance. The minister has to respond to the municipal request for the approval of a credit 10 days after receiving it. Based on law, the amount of municipal borrowing is limited to a maximum of 10 percent of the revenues for the previous year. In addition, the yearly repayment of the loan, including capital and interest, should not exceed 5 percent of the revenue of the previous year. Only for the financing of housing, water supply and waste disposal can the limit be exceeded. The interest payments, however, may not exceed 3 percent of the total revenue.

The same applies to municipal companies and institutes, which can also rely on borrowing. However, municipalities can only guarantee the loans contracted by municipal companies up to a maximum of 5% of the revenue for the year in which the guarantee is given. All loan guarantees given to municipal companies and institutes count towards the allotted 10 percent yearly limit.

Education

Within the education system, preschool education is the responsibility of the municipality while elementary education is a shared responsibility with the state. Financing is shared by the state so that municipalities provide a proportion of the resources for elementary school education (investments, maintenance and part of equipment expenses), elementary music education and pre-school education. Elementary music schools and pre-school institutions are also financed from parents' contributions. The amount of parental contribution depends upon their financial possibilities and the costs of the program. The cost of kindergartens includes education, care and food, and parents pay between fifteen and eighty-five percent of this price. The difference between the contributions and the total cost is covered by the municipality. In elementary music schools, parents cover the cost of materials for the curriculum, while all other expenses are covered by the municipality. In elementary schools, parents contribute for above-standard activities that are offered but are not obligatory (like summer and winter schools, additional excursions, etc.). However, schools can obtain a state contribution towards all non-compulsory and non-standard services. Everyone unable to pay for reasons of social status is subsidized by the state. Elementary schools also offer to all pupils an opportunity to borrow textbooks from the school, provided that they pay a certain amount of money.

Health care

The provision of health care services is a shared responsibility of the municipality and the state. Health care legislation defines that primary-level health care services and medical prevention are a municipal responsibility. Municipalities are the founders of public health care centers and must provide financial resources for their functioning (when needed) as prescribed by the law and funding acts. Health centers often have

their smaller units in specific settlements to provide services closer to users. Special services are provided for school children, women, etc. In this area, also, private initiative is developing, so there are private providers of health services and some doctors provide needed medical services to the local population in public or private health care facilities on the basis of concessions that municipality has given them.

Social care - Family welfare services are a municipal responsibility, while social housing and social security are shared functions. Systems in the area of social care have been developing based on quite developed systems of social care during the socialist area. They are evolving according to new needs and new standards. Different private and non-profit organizations are also entering the field, providing services to special groups (drug abusers, abused women, elderly, etc.), very often receiving co-financing from the state and municipality. When providing services, the local government has a special duty in relation to the socially underprivileged, the disabled and the elderly. When users of services are not able to pay for them due to their financial situation, the municipality may subsidize such services. Municipalities may also provide additional benefits not prescribed by laws.

Water, heating and waste collection and treatment are municipal responsibilities, however building infrastructure can be co-financed by the state under the conditions that apply to special grants (from 70% to 10% of the value of the project). Municipalities often provide services in these areas together, as they have decided not to dismantle the public companies that provided these services for the much larger communes before the reform of local self-government. The provision of services can take different forms, as described above for public utility services.

Water is supplied to almost every household. Some villages have their own systems of water supply that are owned and run by them as cooperatives. It is quite common, however, that they want to join the municipal public system because of its higher quality in relation to water supply, water control and maintenance.

Waste collection and treatment is provided for urban areas. In rural areas, however, it is being expended quickly during the last years. Many municipalities are introducing recycling as an important element of waste collection and treatment. From an environmental point of view, there is still a lot to be done.

Public heating is provided in urban areas, and the number of users is increasing due to convenience, acceptable costs, high quality, etc. In rural areas, heating is mainly individual, although some smaller settlements are starting to invest in heating systems based on biomass (wood, etc.).

Consumers pay user-charges for services. Evasion of payment, however, is not a big problem, because even the poor can rely on a social subsidy system developed at the municipal and state levels.

Public Services in Hungary

The scope of public services and related legislation

In Hungary, the term *local public services* is connected to several types of deliverable services to the public. These services include social welfare services, education and health services, environmental protection and local development, transport and public utilities.

Local self-governments have specific functions connected to the delivery of public services. Since Hungary introduced a three-tier governmental system, which is based on local self-governments, county self-governments and the central government, there are different responsibilities divided among these tiers.

The central idea behind the reorganization of the public services delivery, later discussed in detail, was that since the local level has the most accurate knowledge about local needs, it can therefore steer the delivery of services to the most appropriate level.

The right to define the range and scope of service delivery is established in paragraph 8 of the Law on Local Self-Governments passed in 1990. However, on the list of the 27 so-called “particular” duties of local self-governments, the regulation also names those services that are compulsory local responsibilities. These responsibilities include: the provision of kindergartens and primary education; basic health and social services; assuring the rights of minorities; and, in communal areas, the provision of healthy drinking water, public lighting, and the maintenance of local roads and cemeteries.

In the case of the capital and its districts, some further obligatory performances are defined by law. The state assures the completion of its mandatory tasks by allocating financial tools and allowing the local self-governments to impose local taxes and borrow money.

According to paragraph 43 of the Hungarian Constitution, the Law on local Self-Governments is not the only regulation that may prescribe duties that are to be performed on the local level. These are the sector laws and the so-called “Competency Law” that set further obligations, such as the operation of public libraries, or, in other areas, depending on the size and population of the settlement, the different levels of obligatory social service, health and education service, and waste disposal.

This means that the main framework of the definition of public services is the Law on Local Self-Governments; however, the definition of “particular” duties of local governments may be extended and specified by other regulations as well. The situation gets even more complicated considering that local governments may take

over any duties they prefer to perform for their inhabitants, provided that this does not affect the completion of their obligatory services nor violates any legal regulations. Therefore, besides the mandatory duties, the majority of municipalities in Hungary also perform public sanitation, solid and liquid waste disposal and ensure the cleaning of the roads and parks of the settlement. In case a municipality is unable to carry out a “voluntary” task, it may pass it on to the upper tier, namely the county self-government which is obliged to take it over according to the regulation that says that certain services have to be carried out only by a minimum size of settlement or number of inhabitants.

Overview of the reforms related to public services

The transformation of the socialist state raised the question of the new division of public and private services. Decreasing state property (utilities were transferred to the local municipalities along with the flats, roads, and buildings in which administrative work was done), and the lack of resources for financing the previously extended public services, resulted in the decrease in public spending on public services. Consequently, this spending had to be reorganized and, finally, decentralized to the local level.

Additionally, there were several motives for decentralization, such as local accountability, (and the higher public participation and control, that it was designed to achieve) and the local articulation of needs and decisions on services matched (see Hermann, Horváth, Péteri, Ungvári 1998).

As a result of the transition, the assets of the public utilities that were formerly owned by the councils were transferred to the local self-governments. Or, for example, in the case of water companies, the operating parts were kept and reorganized separately or were soon privatized or otherwise refashioned by the municipalities themselves.

The fact that assets were directly given to the municipalities created a completely different set up of required actions and in a few years some changes needed to be introduced to the public service regulations. According to the law, municipalities are not obliged to perform certain tasks (e.g. secondary school education) below a given number of population (secondary school education is only binding for the districts of Budapest and the cities of county rights) and therefore the municipalities gave back the task to the counties they could not finance. However, they did not hand over the necessary assets related to the task, which actually made it impossible to carry out the assignment. Therefore, the regulation was modified and from then on (in the case of educational tasks, since 1993) the municipalities had to transfer to the councils not only the duty, but also the capital, that is connected to the given task in the case that they turn out not to be capable of fulfilling that operation. On the other hand, in the case of some services, which were considered as particularly important for the community (e.g. the existence of secondary schools that were considered an important tool to stopping the emigration of inhabitants), local governments are reluctant to shift this service to the county despite the financial burden it imposes upon them.

Since the responsibility of public service delivery is on the local level, municipalities

have to raise their own resources to cover the costs of services for which they do not receive enough grants or targeted subsidies. One of the most important steps of the reform was that local self-governments may impose local taxes and use the revenues, e.g. from the local business tax, for their own purposes.

Residential consumption prices were kept on a very low level and the cross-subsidizing of services was a common tool for equalizing the low revenues and high costs of services. After the transition, the need to rationalize public services had to be combined with the social implication of reorganization and a price increase as well.

Ownership types (private, public) and the main characteristics of public service companies

The transfer of assets to municipalities immediately launched a change in the ownership and operation types of the services. In the case of water utilities, there was a great fragmentation of the previously quasi-monopolistic water service sector. The provision of public services takes on significantly different forms in the different sectors. While the social services (e.g. education health care and social care) are typically provided through budgetary institutions, housing related services (e.g. water, sewage, and heating) are usually provided by companies.

The property structure of service providers can be categorized as follows:

Budgetary institutions

In the case of municipally owned companies, service companies may take the form of a limited company, a joint-stock company or a non-profit organization. These companies function actually as budgetary institutions, and the supervisory board or organ of these firms are normally composed from the members of the assembly. In the case of public utility provision, all cities with county rights have such companies, as do 66% of larger cities and 33% of settlements.

Some companies have mixed ownership. Local governments choose such joint ventures when they lack the resources for capital investment and they allow private entrepreneurs to obtain a share of ownership to cover such investments. This alternative normally is accomplished with a majority stake held by the municipality and a special voting share, which is separately defined in most cases resulting in more control by the municipality than its share would represent. In the report of the State Audit Office of Hungary in 2002, from 480 explored settlements 4,1% of the municipalities had an ownership rate of more than 75%, 6,2% had more than 50% and 7,2% had more than 25% ownership in public utility companies.

Some municipalities have established concessions whereas their control on services is kept to a maximum.

There are also private companies and NGOs that are contracted for the provision of certain services.

According to a sample-survey conducted in the period of 1996-1998, service providers in public sanitation, water, and sewage treatment operated in the following

ownership-types:

Table 1: Distribution of public service companies according to ownership type

OWNERSHIP TYPE	%
Budgetary institution	37,8%
Joint-stock company	11,42%
Limited company	30,31%
Private undertaker	11,02%
Limited or unlimited partnership	1,97%
Non-profit organization	4,33%
Other	3,15%
Total	100%

Source: Horváth, Kristóf, Valentiny 2001

The above scheme of the variety of operation alternatives demonstrates the permanent conflict that municipalities must face: the clash of interests between the regulators, owners and institutions that politically depend on inhabitants' support and the municipalities' statutory responsibility to deliver services.

Financing public services on the local level

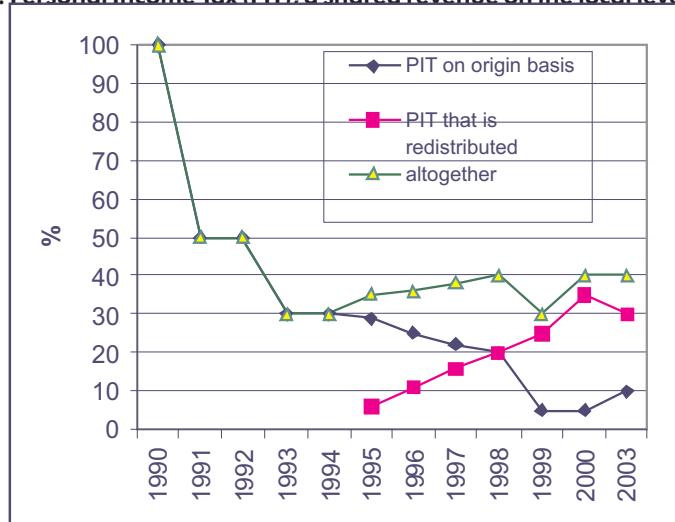
According to the Budget Law of Hungary, local governments receive normative grants for a variety of tasks related to social, educational and health services. For the tasks defined, the central budget allocates targeted grants mostly for infrastructure developments and waste disposal improvements. Targeted normative subsidies can be received for liquid waste treatment purposes as well (8-10% of all central subsidies, 26,6% of the local revenues). Municipalities with resource deficits (in 2000 more than one third - 1227 - of the municipalities), receive additional subsidies.

Local governments receive 40% of the collected personal income tax altogether for the abovementioned purposes, of which 10% is allocated on the basis of origin and the rest, 30% is used for financing grants and targeted grants (however, the actual amount always refers to the numbers of 2 years prior). In 2000, 70% of all central funds were used to support mandatory services, and normally it is not taken into account how much the performance of the given task would cost when defining the sum of the subsidy.

Additional resources are 50% of all collected duties. This amount should provide for the operation of the related administrative agency (1-2% in the local budget). 100% of all local vehicle taxes remain on the local level (0,5% of the local budget). Personal income tax related to land borrowing also stays on the local level. Penalties from environmental violations remain at 30% in the municipality. 100% of penalties related to infractions that belong to local competencies also make up the local budget's

revenue source (1,5% of the local budget in 2001).

Figure 1: Personal Income Tax (PIT), a shared revenue on the local level



Source: Balás, Hegedüs 2001, Budget Law 2003

Local governments also have their own resources: local taxes (the local business tax, communal taxes, tourism tax and property tax, amounted to 14,3% of the total revenue in 2001), operation charges (1,8%), and the profits of operation and capital.

The charges for local utility services are defined in two stages: the official price setting and the local statute have different areas of relevancy. Setting the charges for communal solid and liquid waste removal is a local competency, whereas the supply's price of drinking water is set centrally in the case of regional providers.

The size of expenditures related to public services varies to a great extent. The largest amount of spending is related to actual costs (including personal wages) and to approximately 25% of the local budget capital expenditures. When we take a look at the distribution of expenditures by different sectors in 1999, it is education (33%) and health care (19%) that are on the top of the list. Administration is in third place (13%), social welfare is fourth (with app. 7%), and housing, water, transportation and communication represent altogether only 7%.

This means that due to the organizational set-up of public utility provisions, the spending of local governments remains very moderate. However, subsidies may be steered toward companies that provide service.

Monitoring the public services sector

According to a survey conducted in 1998, local self-governments only rarely monitor

provided services, according to indicators. Instead, they mostly rely on written reports and public opinion, and 15% of them do not collect any data concerning service delivery at all. The improvement of public service delivery due to the outsourcing and out-contracting of services is therefore not proven, although anecdotal resources may state it (Zupkó 2001).

Normally there are different commissions that oversee the operation of services that are provided by a company of the municipality or the municipality itself. When service delivery is supplied by a joint venture, representatives of the municipality have control of the price setting and management of the companies.

The State Audit Office of Hungary also prepares the monitoring of Hungarian local self-governments. However, there rarely is reliable data on the expenditure side according to sector. The revenue collected from different resources for voluntary tasks are often not programmed and therefore there is no reliable data available about the efficiency of the grants of public services and their operation.

The sector laws prescribe the minimum level of deliverable services and establish an administrative body as supervisor.

There is another issue related to the control of service provision on the local level. As mentioned above, local governments may provide additional financial assistance to companies that take over duties. According to the Competition Rules of the European Union, this means that there is an influential behavior upon the distribution of public funds to firms. The role of regulator, owner, and maintainer often leads to cross-subsidizing of different public services, which is not going to be possible after EU accession.

Case study of the water sector transformation in Hungary

Before the transition, the water sector was operated in a centralized, state owned system: there were 33 regional state-owned companies under the control of the Central Water Agency and the fee for water and sewage was determined centrally. As a part of the decentralization process of the early nineties the ownership of water utilities was transferred to the municipalities. Additionally, water supply became a mandatory responsibility of the municipalities and the municipalities have the authority to define water and sewage fees. The Ministry of Water and Environment Protection operates a subsidy system for those water companies that have higher expenses. Current regulation specifies that the revenue that originates from these fees must cover the justified expenses. At present, however, no central price-setting formula has been defined.

As a result of the decentralization, the water sector became fragmented: 377 water companies operated in 2001 of which five regional companies are still state owned. The sizes of the water companies vary significantly, which is represented by the fact that 92 companies provided 96% of the total amount of water supply in 1998.

The new owners have the right to choose among different service provision forms including different forms of privatization.

Only in the case of larger cities did commercialization and/or privatization occur.

The reasons for commercialization are political and organizational. From the side of the municipalities there was big pressure not to raise water fees significantly. Therefore the companies were forced to rationalize their operation in order to avoid producing losses. However, only big companies had the experts and knowledge to meet the new requirements and adopt such mechanism as would assure efficient operation. As a result of restructuring and the introduction of modern management techniques these companies could reach greater autonomy. In the case of smaller companies, one of the biggest problems is the lack of competent experts that (aside from the more direct political influences) prevent such companies from getting engaged in the commercialization process.

Debrecen, the second largest city in Hungary, is a good example of successful commercialization without privatization.

Water companies were privatized in six large cities and in one smaller region. However, the privatized sector covers about 20-25% of the water supply of the Hungarian population. The main privatizing actors were mostly foreign professional investors who established concession contracts for 15-25 years. The water utilities as such remain in municipal ownership and the foreign companies obtained a share in the operating companies. Under the current regulation the municipality must retain the majority ownership of water companies. Nevertheless, generally the representatives of the foreign companies dominate the management boards.

There is no central policy for water privatization, the municipalities themselves have to decide on the form by which water companies are operated.

The revenue from privatization was not spent on sector improvement. However, significant developments are needed to meet EU requirements.

In the case of some privatized water companies, problems emerged that raised the question of the transparency of the privatization process and the negotiating ability of municipalities.

Regarding the structure of the sector, it seems that the smaller water companies will be integrated, as there is large professional pressure towards this direction. The EU requirements will push more and more companies towards more professional and efficient operations that also could result in forward privatization. Future privatization will not necessarily be completed by foreign investors as some positive examples of domestic investors (e.g. the Szolnok case) can foster domestic investments into the sector as well.

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Current and Future Developments of Public Services in Romania

1. Sectoral, terminological and legal frameworks

1.1 Conceptual Issues

Public services represent useful activities designated to meet a social need. Laws and regulations empower public service activities without indicating the motives for these services.

Public services, understood in a broad sense, represent ensembles of people and things that are created in order to satisfy a public need under the authority and control of a public community.

The diversity of social requirements necessitates making a distinction between public services and services of public interest. The primary distinction is that a public service is organized by a state organization and the service of public interest is accomplished by a non-state organization.

Beyond state services (central and external), in various countries there are services provided by intermediary communities (regions, departments, provinces, and counties).

For a public service, there should be a public authority in charge of its organization. Organisation means the following: determining the rules of organization and operation, assignments, the right to exploit, and the control on conditions for exercising this right.

Some services can be adequately delivered on the local level, others on the central or intermediate level. Urban services and services for distribution (water, gas and electric power) are better suited for local responsibility. The large networks of transport, social insurance, and energy production, however, are under national competence.

1.2 Legislative framework

Law on Local Public Administration no. 215/2001

The Law on Local Public Administration no. 215/2001 represents the general framework of regulation for local public services. Section 2, chapter IV of this law provided for “public services of commune, town and own specialized body of local public administration authorities.” It emphasizes two categories of local public services:

- Public services organized by local public administration authorities;
- Public services subordinated to local public administration authorities.

The first category comprises public services organized as autonomous regies, trading companies or other public or private forms that deliver a public service to a commune or town.

The second category comprises only those public services from the organizational chart of the local council. Only in this situation does the local council approve regulations for the organization and operation of public services. Additionally, it establishes the competence and salaries for the staff, under the conditions stipulated by law.

According to the Law on Local Public Administration, the local and county councils may, under the terms of law, contract works and services with public utility up to the limit of the approved local and county budget.

At the same time, local public administration authorities may decide on concession or renting services of local interest, as well as participation with registered capital or goods in trading companies, in order to achieve works and services of local public interest, under the terms of law.

Law on Local Public Finance 189/1998

Law 189/1998 ensures a large amount of local autonomy in public finance, aiming to solve the following shortcomings:

- Insufficient financial resources, as compared with necessary expenses.
- The inability to stimulate local public administration authorities to discover new resources aiming to increase local revenues and to rationalize expenses.
- Deficiencies in the administration of local budgets, specifically regarding the late approval of state budgets and consequently, the transfer to local budgets.
- The inadequate criteria and means for the quality, efficient, and effective management of the public services sector.
- A lack of specialized staff (tax, technical etc.).

First, the law aims to develop the role of local public administration authorities according to the principles of local autonomy and the mechanisms of the market economy. Second, the law aims to establish financial resources for local public administrations in order to comply with the obligations of the administration.

Law on the regime for concession 219/1998

The law ensures the regulation and organization of the regime of concession for:

- a) Goods in the public or private ownership of the state, county, town or commune;
- b) Activities and public services of national or local interest.

Concession is based on a contract that states that the conceder transmits (on a period of no more than 49 years) the right and obligation to exploit goods, activities or public services to the concessionaire, who acts on his own risk and accountability in exchange for a fee.

The law stipulates the object of a concession, namely the goods, activities or public services from the following fields:

- a) Public transport;
- b) Highways, bridges, and tunnels with pay-tolls;
- c) Road, rail, harbour infrastructures and civil airports;
- d) The construction and exploitation of new water power stations, including those under preservation;

- e) Postal services;
- f) The range of frequencies and networks for the transportation and distribution of telecommunication;
- g) Economic activities related to natural and artificial waters, works for water administration, power plants, equipment for hydrological, meteorological and water quality measurements, and fishery endowments;
- h) Lands in public ownership, beaches, quays and free zones;
- i) Transport and public distribution networks for electric and thermal power;
- j) Transport networks by pipes and distribution networks for oil and gas;
- k) Transport and public distribution networks for drinking water;
- l) The exploitation of mineral deposits and solid and fluid substances;
- m) The exploitation of thermal sources;
- n) Natural resources of maritime economic zone and continental plateaus;
- o) Sport places, entertainment places, and professional institutions for shows;
- p) Medical-sanitary units, including laboratories and auxiliary medical services;
- q) Economic activities related to historical monuments and sites;
- r) Collecting, depositing and the turning into account of waste;
- s) Any other goods, activities or public services that are not forbidden by special organic laws.

The concession represents a modality to attract budgetary funds, as the fee is considered revenue to the state or local budget.

The concession of a good, activity or public service is achieved by public tender or direct negotiation, according to the provisions of law. The concession contract represents the key element of management delegation.

Law 213/1998 on public ownership and its legal regime

The Law stipulates the following: the right of the public ownership of goods that belong to the state or administrative-territorial units; goods that are of public use or interest, according to law or by their nature; the state or administrative-territorial units hold, use, or dispose of those goods that form the public domain, under the limits and conditions of law.

The law stipulates the modalities for obtaining public ownership, namely:

- a) Naturally;
- b) By public procurement, under the conditions of law;
- c) By expropriation, for the cause of public utility;
- d) By acts of donation or legal acts accepted by the Government, county or local council, if that good is in the public domain;
- e) By transferring some goods from the private domain of state or administrative-territorial units to the public domain for the cause of public utility;
- f) Other modalities stipulated by law.

The legal feature of the above goods is regulated; they are inalienable, non-perceptible, non-prescriptive.

The goods in the public domain may be given to autonomous regies, to prefectures, central and local public administration authorities, or other public institutions of national, county or local interest.

Other laws for local public services:

Law 326/2001 on public services of communal housing

This law stipulates provisions related to the following principles governing local public services:

- Sustainable development;
- Local autonomy;
- Decentralization;
- Accountability and legality;
- Citizen participation and consultation;
- Inter-communal association and partnership;
- Correlating requirements with resources;
- Protecting and preserving the natural or built environment;
- Efficient administration of public goods and administrative-territorial units;
- Ensuring a competitive environment;
- Publicity and free access to public information;
- Universality
- Security;
- Fair charging;
- Service quality, established by competent public authorities;
- Effectiveness;
- Democratic control, transparency and accountability;
- Coordinating all of the involved factors.

The general responsibilities for providers and beneficiaries of public services related to those of central and local administration are as follows:

Involved parties	Responsibilities
1. Central public administration	<ul style="list-style-type: none">- to formulate national policy on local administration- to formulate, and propose for approval, laws on local public administration- to establish economic and technical standards- to ensure the application of laws and regulations- to ensure counselling for local authority- to control local public administration
2. Local public administration	<ul style="list-style-type: none">- to formulate local policy and to establish strategic plans for the long and short term, according to current laws- to formulate strategies, programmes, and guidelines to create public services and to plan the development of public services- to approve local norms, regulations, and development studies- to ensure the financing of public services

	<ul style="list-style-type: none"> - to establish taxes and charges and to approve or validate tariffs for services under local authority - to enable collaboration with providers of public services, stimulating competition in order to obtain the best-rate quality/cost of services - to monitor how public services are ensured - to administer the contracting and authorization of public services - to control the public services
3. Service providers	<ul style="list-style-type: none"> - to ensure services at the qualitative levels established by the local administration - to observe laws and norms - to observe the basic principles and rules of public services - to deliver services according to regulations and contract clauses - to maintain and develop the services, according to the delegation and approvals given by the governing authority - to efficiently manage the human, financial and material resources - to fulfil contractual obligations - to inform local authorities quickly and fairly - to respond promptly to beneficiaries' complaints and to solve their problems in due time
4. Beneficiaries (consumers)	<ul style="list-style-type: none"> - to observe the law as well as the decisions of the local administration - to be informed about new regulations - to pay in time for the services provided - to maintain and supervise one's own equipment for service - to enable service providers access to the required equipment

2. Administration as service, citizens as clients

2.1 Public administration reform

Remark on the above-mentioned legal framework, we notice that the main laws were recently issued, due especially to the central role played by public services in the prioritisation of public service reform.

The current strategy of public administration reform is comprised of clear objectives for reforming public services:

Profound restructuring of central and local public administration

- the modernization and adaptation of public administration to the realities of the Romanian economy and society, meeting at the same time the

exigencies of the European Union and maintaining the valuable traditional elements of the Romanian public administration;

- reducing governmental expenses;
- developing the management capacity of local authorities;

Changing the essence of the relationship between the administration and citizen

- strengthening and extending the framework for civil participation in decision-making;
- improving the transparency of administrative acts and the effective communication with citizens.

Decentralizing the public services and strengthening administrative and financial local autonomy

- decentralizing the public services and ensuring that local authorities overtake the tasks of administration and financing for some activities;
- transferring the relevant activities and resources from the state budget to local public authorities for the financing of public services for local communities: health, culture, community police, firemen, and civil defence;
- reorganizing the system of local taxes and charges.

Gradually demilitarizing community services

- transferring the population registry to local and county councils.
- transferring to prefectures the activity of issuing and registering simple passports, and organising this activity as a community service;
- organizing community services for emergency situations (fires, floods, earthquakes, etc), that will undertake the current tasks of firemen and civil defence;
- setting up the community police for public order at the level of each administrative unit by undertaking specific assignments from Police Offices.

2.2 Modernizing the public services

The strategy for the modernization and development of public services is based on the following key objectives:

- decentralising public services and improving the accountability of local authorities for the quality of public services delivered to the population;
- extending the system of basic services and increasing the degree of access to those services;
- restructuring the mechanisms of social protection for less-favoured persons and reconsidering the relation price/quality;
- promoting the principles of a market economy and reducing the degree of monopolisation;
- attracting private capital for financing investments in local infrastructure;
- institutionalising local credit and extending its contribution to financing communal services;
- promoting measures for sustainable development.

3. Providers of public services - actors of change

3.1 Types of ownership and the main characteristics of public service companies

a) Autonomous regies

By Government Decision 597/1992, autonomous regies and trading companies with total state capital are under the authority of the local councils, providing public services of local interest. Ordinance 13/1993 provides measures for restructuring the activity of autonomous regies in order to make them more efficient, to observe financial discipline, to manage the goods in public domain, and to regulate the relations between authorities and regies.

Law 135/1994 (to approve the Ordinance 69/1994) establishes the number and object of the activity of autonomous regies of local interest.

The Emergency Ordinance 30/1997, on the reorganization of autonomous regies, provides for the establishment of public services of local interest that will be under the authority of administration in the respective territorial administrative unit.

b) Trading companies

The following are features of trading companies under the authority of local councils:

- The decision of the local council sets up the trading company, stipulating: the legal form, name and headquarters, subscribed registered capital, and structure.
- The decision stipulates also the approval for the statute of organization and operation of a trading company.
- The main aim of trading companies providing services is not to obtain profit, but to develop the quality and quantity of services for citizens.

c) Public institutions

- A public service is organized and operates as an institution with distinct legal status related to state or local communities. In other words, it represents a public law entity, created specially to ensure the meeting of general interest. Therefore, public institutions have their own patrimony, budget and may conclude contracts on their behalf.
- The establishment of public institutions is subordinated to principles of administrative law, thus the public institutions of local interest are set up by decision of the local council (county/municipality) and public institutions of national interest are set up by the Government.

d) Specialised economic agencies

The local public administration authorities may ensure the delivery of some services by agencies set up in a special field.

In this respect, the Law on local public administration stipulates: “ Local or county councils may decide to set up, under the terms of law, trading companies, associations, and agencies and may organize other activities aimed at achieving works of local interest, with registered capital, comprising the contribution of councils or other legal and individual persons”.

Key features for creating economic agencies:

- agencies are set up under the terms of law;
- agencies may be set up in order to achieve some works of local interest;
- agencies are operating with contributions of registered capital provided by local councils;
- specialized economic agencies are set up by local/county public administrations.

3.2 Public - private partnership

The advantages of public service delivery by private companies are obvious:

- the reduction of necessary expenses from the local budget for the organization and delivery of public services;
- the improved efficiency of service delivery and reduction of costs;
- achieving investments, and developing endowments on the expenses of the private sector;
- the ability to regulate the private sector by norms issued by public administration (quality standards, licenses, facilities for those that are making investments in the public domain etc);
- the ability of the local public administration to withdraw public service management if the provider does not achieve its obligations.

4. Financing public services on the local level

Legislation in this area is comprised of the following:

- Law 189/1998 on local public finance
- Law no.500/2002 on public finance
- Government Ordinance 61/2002 on collecting budgetary receivables
- Government Ordinance 36/2002, republished, on local taxes and charges

The financing for current and capital expenses of local interest is ensured:

- entirely from the local budget (depending on subordination)
- extra-budgetary incomes and subsidies granted from the local budget, and
- entirely from extra-budgetary incomes

Individual revenues may derive from charges, rents, cultural events, studies, projects, turning out products, primary or auxiliary activities, service delivery and others.

Financing the local public service is different, depending on the organization and type of service.

Public services with state features are financed generally from the local budget, the urbanistic public services and commercial public services are self-financed, while for the public services providing cultural activities there is a mixed approach.

5. Monitoring the public services sector

In order to improve the monitoring process of public services, we should take into account the following issues:

- The elaboration of secondary legislation necessary to implement the new law of public services.
- Setting up commissions to give licence to providers.
- Stimulating measures for the re-organisation and re-grouping of agents-providers.

At the same time, civil society participation is encouraged to service delivery, especially by transferring the activities of monitoring to volunteers (ex. citizen consultation groups)

Various types of information for service monitoring are important. Some of these information types are now developing:

- Client information -surveys, focus groups, consultation
- Management information
- Information about the controlling bodies - recently, high attention has been paid to audit activities.

6. Case study - the public service of social security

6.1 The Romanian legislative system on the public service of social security

Law no. 705/2001 on the national system for social security promotes the strengthening of social cohesion by developing the spirit of social solidarity in the community for the most vulnerable categories of persons, according to *Council Recommendation 92/441/EEC on common criteria for sufficient resources and delivery in the social protection system*. This law creates one unique framework aimed to organise and co-ordinate the area for family, children, elderly, and handicapped persons' protection. At the same time, the objectives proposed by law orient the social policy, aiming at harmonisation with EU key objectives, stipulated by *Council Recommendation 92/442/EEC on the convergence for social protection objectives and policies*.

Additionally, we have legislation for social aid, emergency aid, birth allowance, state allowance for children, additional allowance for families with more children, social security granted to aged persons, as well as for stimulating the involvement of civil society in achieving some actions of social security for the community.

6.2 Organizing the public service of social security by the local council of the Galati Municipality

The actual social security system in Galați Municipality (fig. 1), supported by the Local Council (LC), comprises the following departments and offices:

- (1) Department for Social Aid and Emergency Aid
- (2) Department for Tutelary Authority
- (3) Department for Social Security for the Elderly
- (4) Department for Monitoring, Re-socialisation, Security
- (5) Office for Partnerships and Conventions with Civil Society

(1) Department for Social Aid and Emergency Aid

A. Assignments

1. Receiving and recording the demands for awarding social aid for families and persons without or with low incomes;
2. Receiving and recording demands for awarding emergency aid to families or persons in case of *force majeure*, due to natural disasters, fires, accidents or other causes, soundly justified
3. Receiving and recording demands for awarding birth allowance, starting with the second birth;
4. Receiving and recording demands for awarding state allowance for children;
5. Receiving and recording demands for awarding additional allowance to families with children;
6. Recording and solving related correspondences.

B. Documents elaborated by Department for Social Aid and Emergency Aid

- Provisions concerning the establishment, change, suppression, and cessation of social aid;
- Provision on rejecting the right to social aid;
- Official releases on the establishment, change, abolition, and cessation of social aid;
- Official release on rejecting the right to social aid;
- Responses to petitioners who submitted their letters to Galați Municipality Mayor or other state institutions, requiring various aids;
- Certificates, issued on demand for persons, necessary to other institutions;
- Provision concerning the right to birth allowance for mothers, starting with the second birth, accompanied by table annex;
- Social investigations grounding the right to social aid;
- Social investigations establishing the right to grant emergency aid.

(2) Department for Social Security for the Elderly

A. Assignments

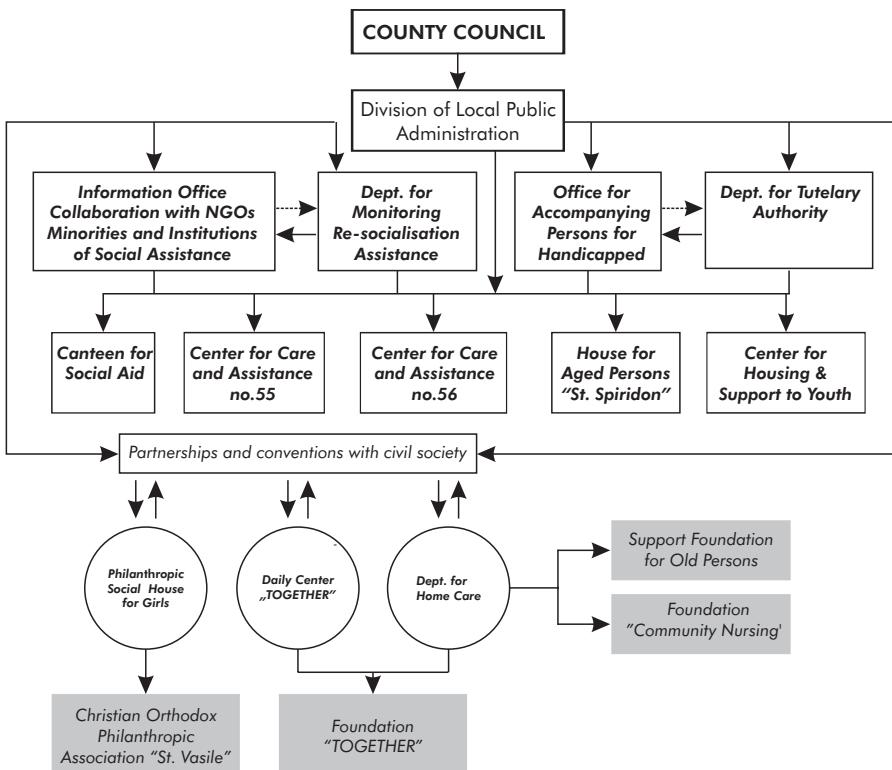
1. It receives and records the requests of aged persons in the area of the Galați Municipality, aimed to conclude a legal act to alienate with free or onerous title his own goods for his care and keeping;
2. It draws up social investigations, after field research, and checks for aged persons for granting social security;
3. It issues responses at the received requests, before the deadline stipulated by law;
4. It discusses with the citizens within the framework of the established work programme;
5. It collaborates with the Department for Tutelary Authority and Department for Social Aid;
6. It ensures links with the Ministry of Work and Social Solidarity, Ministry of Health and Family, Courts and other bodies that provide activities in this specific area.

7. It applies measures for social security, social-medical and medical security to persons, evaluated according to a national grid for assessing aged persons' needs.

B. Documents elaborated by the Department of Social Security for the Elderly

- Social investigations for aged persons, on the basis of data concerning:
 - Diseases that require special care;
 - Capacity for managing the household and complying with the adequate requirements of daily life;
 - Conditions for housing;
 - Effective or potential incomes considered the minimum to ensure the achievement of life's needs.
- Social investigations aimed to ensure the protection of aged persons.

Figure 1: Relationships between social security services under local council authority



7. Recommendations for Future Changes

Decentralization and *privatization* represent two key issues within the framework of public service reform.

Decentralization is often considered a way to improve the effectiveness and quality of public services. Communities choose to privatize the services under various forms, mainly due to insufficient financial resources.

Some specialized studies reveal the importance of de-engagement or decentralisation by market mechanisms (except for political, administrative and budgetary decentralisation). De-engagement or decentralisation by market mechanisms means to assign some functions to a public person or a private or non-governmental institution, aimed at serving the public interest, and with public participation. It involves service sub-contracting, deregulation or total privatization.

Privatisation of public services:

The term *privatization* is associated with the transfer of assets - ownership, management, resources, and control - from the public sector to the private sector. Strictly, it means the selling of goods from the private domain of state or local communities.

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Reforming Public Services in Romania

The legacy: management of shortages

A brief overview of the tasks set forth to public authorities at the beginning of the transition period unveils the necessity to focus on changing the structure, funding and diversity of services provided to the public. By 1989, the last year of central, authoritarian rule in Romania, the economy functioned according to the “*central tap*” principle. This means that the central government controlled the resources and regulated consumption by the mere flip of a switch. The consumer had no ability to adjust or regulate what was delivered, since the constant shortage of goods and services created a constant hunger for more. Therefore, if anything was available, it was consumed in a compensating quantity, to cover the fact that in other domains the tap was totally dry. Since the consumer has much experience in coping with shortages, such as electricity, gas or urban heating cuts, the dominant demand towards the administration was to open the tap wider and give a more generous share of the known services, regardless of efficiency, quality, or price. This is especially true because the payment for goods and services was more or less small and subsidized. The post-Communist public administration was challenged to put an end to the “management of shortages” and to be rather generous with the tap. Only in the last 5-7 years has the responsibility for controlling the tap started to be transferred to the local government, which, in turn, tries to share this responsibility with the consumer and thus ensure a more or less rational flow.

A second feature of the services area in Romania, inherited from the system in place until 1989, is the *narrow range* of available services. “Few for the many” would be the adequate description of how services were organized and provided. The government lacked interest in this “non-productive”, “third branch” of the economy, stressing in all possible ways that the productive domains have pre-eminence when comparing with the needs of individuals. The reverse side of this attitude is that there was a lack of interest in developing services and a lack of managerial thinking in dealing with the service sector. The direct effect of this development, relevant for the transitional period, is that there is a wide disparity between the expressed needs of the population and the available services (this being the basis for a rapid, even spectacular, development of services), as well as a lack of experience on the part of consumers to pay adequately for the provided service (this being the limiting factor for expanding the sector).

Thirdly, it must be mentioned that the post-Communist administration inherited obsolete equipment and systems. On a closer look, the picture was rather gloomy: huge losses in water sewage and heating systems, polluting waste management etc.

Thus, the main task of administration for the current period was, and still is, to modernize, expand, and bring efficiency to the service sector, to meet public expectations but also allow for new services to be developed.

Tasks of the reform

Whenever discussing reform, the Romanian central government, the Parliament and local authorities agree that the main tasks for changing the situation of communal services are:

- Strengthening the local autonomy (and rendering the responsibility for most services to local authorities);
- Decentralizing public services;
- Narrowing and regulating the monopoly on resources and services;
- Sharing responsibility with the consumer;
- Ensuring the quality and continuity of services;
- Ensuring the efficient management of public/private property linked to the provided service;
- Promoting competition;
- Encouraging inter-communal co-operation;
- Correlating demand with the available resources;
- Ensuring the sustainable development of the sector.

These “ten commands” of transition can be identified in almost any law, regulation, or program regarding the services sector, whether it is seen globally or on its components. Since the reform is under progress, local authorities face a large range of tasks, sometimes declaring themselves overwhelmed with the burden. The main difficulties in dealing with taking over the services from the central government and developing them arise from:

- a) Insufficient training of the personnel employed in the local government to attract, develop and monitor investment in the sector;
- b) A lack of technical assistance;
- c) Ambiguous, shifting legislation;
- d) Financial dependence on the national budget;
- e) The excessive fragmentation of local authorities.

These weak rings in the chain of reform slowed down the transformation of the analyzed sector. While constantly asking for more competences to be transferred to them from the central government, local governments had an enormous difficulty supporting and providing quality services in the first years when entrusted with the responsibility.

Support for change

The reform, as stated above, is in full progress and the change in the status of public services is due to a large range of factors. With an ever-growing demand for more diversified and qualitative services, reform is possible due to:

- a) The development of *national legislation* (leading, sometimes, also to new approaches regarding the service). E.g. environment regulations, the transfer of responsibility for central heating, the transfer of ownership and responsibility for schools, hospitals, social care, etc.
- b) *International programs* on the EU level, such as PHARE, SAPARD or ISPA, on bilateral, intergovernmental levels or state guaranteed loans.
- c) Local initiatives. E.g. municipal bonds, issued to finance specific services, local taxes introduced to develop services, etc.
- d) The development of international environment. E.g. The development of e-governance provided the impetus in Romania to implement vanguard services such as tax-payment through the Internet, e-offices, front-desk services through Internet, info-kiosks, etc.
- e) Niches for new businesses. E.g. waste management, housing improvement, public order services, etc.

Reform of urban heating in Romania

One of the very sensitive problems in communal services concerns urban heating. 251 Romanian municipalities had in 2002 centralized heating systems, out of which only 179 were in use. Regarding the production and distribution of central heating, 101 municipalities used a provider organized as a public service under their direct control, 34 bought the heating agent from other providers, 24 of them from the centralized national company “Termoelectrica”, and 44 combined the two sources (subordinated providers and national companies). The number of beneficiaries of this type of heating is estimated at 6.9 million citizens (approximately 3 million families), mainly in the urban area (71%). The main characteristics of the infrastructure for producing/distributing urban heating were:

- Obsolete equipment (over 20 years old);
- Losses in the system up to 30-35%.

Eight bigger and more resourceful municipalities (Bucuresti, Cluj, Timisoara, Ploiesti, Buzau, Fagaras, Oltenita, Pascani) undertook steps to modernize these systems, using up to the year 2002 approximately 135 million USD.

Since the consumer is limited in his ability to pay the real price for heating, even though this is a vital service during winter, the difference between the price of the produced heating and the one the consumer actually pays is covered through subsidies, split by law among the central and local budgets, leading to constant complaints of the local governments that the burden is too high. By way of comparison, the selling price for heating was set by the Government Ordinance 1303/27.12.2001 at 575,000 lei/gcal (VAT included), while the price for production was 795,000 lei/gcal. Thus, the annual cost for producing and distributing central heating was 20,904 billion lei, out of which the state subsidy (according to Law 743/2001 of the state budget) amounted to 4780 billion lei. Large debts constantly are recorded at the end of the winter season. At the beginning of the year 2002 the debt for 2001 was over 5,444 billion lei. This debt was split among the local governments,

which did not pay for the service, and institutions and citizens who failed to give their share of the payment. (Source: *Governmental strategy for modernizing urban heating services*, Bucharest, 2002).

The difficulties in restructuring the central heating systems arose mainly from:

- a) The organization of production and distribution capacities. The model adopted in 1972 promoted huge central production of heat to satisfy the necessities of a large number of consumers. Such systems are not flexible and so they cannot adjust their production to the real balance between the demand for heat and the quantity of the produced heating agent. Additionally they have low efficiency, not making the connection between the bill a consumer pays and the provided service. Consequently, these systems are difficult to re-model (expand or shrink).
- b) Technological constraints. The equipment is obsolete, and does not allow proper gauging, do not have monitoring systems, to ensure proper control over the functioning of the system.
- c) Constraints resulting from housing. The quality of housing in Romania is rather low. Exterior walls permit an exchange of heat between the inside of the house and the outer atmosphere, the window panes and doors do not offer proper insulation, and the heating devices do not allow for gauging the consumption at each beneficiary level (apartment).
- d) Constraints resulting from external factors, such as the global price increase of natural resources (gas, oil, other combustibles used to produce heat) and from the enforcement of new, environment-friendly regulations.
- e) Financial constraints. These result from the high cost of producing and distributing heat, the accumulation of debts (since a large number of consumers fail to pay for the service), an inefficient subsidy system, and the loss of consumers who voluntarily give up a service for which they cannot pay (thus diminishing the clients of the provider).
- f) Social constraints. Out of the 2,938,000 families who live in blocks of flats connected to the central heating system, 1,495,000 had in 2001 incomes under the threshold of poverty (1,400,000 lei/month/family member), thus qualifying for subsidies. Many medium and small municipalities are affected by large unemployment, with the collateral effect of the high costs of central heating and the massive renouncing to heating services due to the incapacity to support the costs. Further, reports point to the fact that public health is affected because citizens resort to improvised heating devices that increase the risk of fires and building deterioration. Consequently, during wintertime, many houses are abandoned.

This dark picture is the reason for attempting to accelerate reform so as to prevent further deterioration of public health and house property, reduce the burdens on the state budget, and put an end to an obviously inefficient, loss-generating system. At the same time, the target of reform was, and is, to ensure proper heating services for the beneficiaries at affordable costs, putting an end to the loss of consumers, promoting environment protection and ensuring sustainable development. The steps to reach these goals are:

1. Developing legislation, which includes a reorganization of the providers (decentralizing “Termoelectrica”, transferring heat-producing capacities to large municipalities, and promoting the necessary regulations to account for the changes in the system);
2. Ensuring investment (cash-flow) into the sector (via state guaranteed loans, policies to help recuperate state debts, and the privatization of the service on the condition that the new owners modernize the service, providing a more flexible approach to costs and tariffs, reducing the VAT for the heat provided to individual consumers).

To modernize the system of heat production and distribution, Romania would need approximately 453 million USD/year up to the year 2017. Obviously, the task is enormous. Therefore, an appeal was made to private capital, to foreign aid and loans, and to credits and programs in order to support such a difficult, costly reform. The present day government set as its obligation to finance such programs with 30 million USD/year (up to the year 2004) from the state budget, to attract from local budgets the same amount of money (including such sources as municipal bonds), to contract European grants and projects (PHARE, SAPARD, etc.) at the level of 200 million USD/year, to obtain from international banks (under state or local government guarantees) 140 million USD/year, and to attract private investment at a rate of at least 50 million/year. Such a program should have, governmental officials estimate, not only positive effects on the system itself, but also on the larger area of communal services, employment and quality of life.

Case study: Timisoara

Out of the 320,000 inhabitants of the city, 260,000-270,000 use the service provided by the central heating system, delivered to approx. 100,000 housing units (apartments or individual houses). Two providers offer the service according to the geographic location of the consumer: a heating capacity, built in 1920, using gas and oil as fuel (situated in the center of the city) and another one, built in 1980/1989, approximately 5 km from the city, using gas, oil and coal. These two capacities belonged, until 2002, to the “Termoelectrica”, state-owned company. They were transferred, along with necessary fuel supplies, to the municipality in 2002 after fierce negotiations with the Government and ministries, since the local authority feared the new budgetary burden. The difficulties proved to be hard, but:

- a) The services did not deteriorate due to the transfer;
- b) An economical use of resources has been achieved;
- c) Consultants from foreign companies elaborated feasibility studies, offering a large choice of solutions for improving the service;
- d) Local providers have been restructured
- e) Investment projects are being developed to modernize the production and distribution capacity and to reduce losses in the distribution system.

All in all, though the modernization is not yet complete, this can be considered a “success story” of the complex problem of modernizing communal services.

Lessons of the transition

The reform of public/communal services is a task that still must be carried on, despite being the subject of fierce public debates, and torn by conflicts and contradicting decisions. Of the problems that put the brakes on a swift development of the service sector, the most obvious in Romania are:

- a) The continual lack of interest in the topic, due to a lack of entrepreneurial thinking at the local government level, the confusion between the responsibilities of the provider and the consumer that traps the consumer in a web of prices, and competition between the providers and the campaigns of local authorities.
- b) Under-financed modernization, to be seen in the constant lack of financial means, conflicting interests between competitors to gain control over the service or reform of the service, length of time for envisaging the effects of the approved solution in reforming services.
- c) Dilemmas concerning the selection of a single model for organizing a particular service.

However, regardless of the problems, there is a basis for hope that all efforts are not doomed to failure. *Positive* developments hint that the reform of services will be a success story, due to:

- 1. *An increase of local autonomy and control over funds.* An ever more responsible local government cannot fail to provide better services and by no means can put the blame for poor services on the account of the “central tap”. The public administration has monthly become more clearly responsible for the well-being of citizens.
- 2. *Increase of financing/cash flow for services.* Banks only recently (2002/2003) opened up for crediting personal investment in improving housing conditions. Also, only recently has it become possible for municipalities to issue bonds and use this instrument for financing projects.
- 3. *Increase in the public awareness.* The general public became more interested in the topic, especially after introducing, in 2003, the law for public debates. No decision can be made by any public authority without first informing the public. This increase in transparency leads to a feeling that the responsibility for the development of projects is shared.
- 4. *Slow, but steady building of the responsibility on the part of the consumer (economy of resources).*
- 5. *Diversification of offers for improving services.*
- 6. *The “snowball impact” of reform.*

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Municipal Public Services in Bulgaria: Reforms have Started, Real Reforms are Forthcoming

The constitutional and legislative basis for reform: Development in the context of decentralization

1. There are several constitutional provisions that define the framework and the foundations of local public services in the country.

First. Article 2, paragraph 1 of the constitution defines the Republic of Bulgaria as a “unitaristic state with local government”. This structure presupposes decentralization on the grounds of a uniform legislative basis. The Parliament is vested with the exclusive power to define not just the competences, but the main forms of activities of local self-government as well, including public services.

Second. The territory of the Republic of Bulgaria is divided into municipalities and regions. A municipality is the fundamental administrative-territorial entity in which self-government is materialized. The 264 Municipalities, in which elections for local authorities, such as mayors and municipal councils, were held on October 26th 2003, have the right to municipal property and have independent budgets. These budgets include regular financial resources that are defined by law, as well as revenue from public services.

Third. The management of the 28 regions is performed by regional governors who are appointed by the government. In practice, public services are not provided at the regional level.

Fourth. Public services offered to the population reflect the balance between the central state power and the local authorities of self-government. Decentralized public government is materialized via the local bodies of the central government, as well as via the bodies of local self-government. These two forms should complement each other in the interest of the quality servicing of the population, which presupposes clearly defined legislative provisions. Otherwise, conflicts having direct impact on public services are created.

2. Local self-government has similar functions in almost all countries.

This similarity is preconditioned by certain common processes concerning the state of towns and villages, the environment, living conditions, the safety and welfare of the people, employment, etc. Each country, however, has developed specific practices regarding the form of the state system, the degree of decentralization of state power, the scope of self-government, etc.

The Law of Self-Government and Local Administration, which was adopted in the new Constitution of the country as early as September 1991 (the new Constitution came into force on July 13, 1991) and subsequently amended and supplemented many times, regulates the competences of municipalities via the right and obligation to act on issues concerning:

1. The property, enterprises, funds, taxes and fees, and administration of the municipality;
2. The structure and the development of the territory of the municipality, as well as the towns and villages included therein;
3. Education - pre-school, elementary and secondary education;
4. Health services - in and out patient health care, prophylaxis, medical and social care, and sanitary and hygiene activities;
5. Culture - public centers of culture, theatres, orchestras, libraries, museums, amateur art activities, rituals, local traditions and customs;
6. Welfare and communal activities - water supply and sewerage, electric power supply, central heating, telecommunications, road building and maintenance, public parks and gardens, street illumination, town planning, treatment of refuse, public transport, municipal hygiene facilities, hotels, parking facilities, and cemeteries;
7. Social benefits - social care and social benefits, social housing and other social activities of municipal significance;
8. Preservation of the environment and the sustainable exploitation of natural resources of municipal significance;
9. The maintenance and preservation of cultural, historical and architectural monuments of municipal significance;
10. The development of sports, leisure activities and tourism.

To a certain extent, the above ten points represent a mixture of both the content and the form of the competences. For instance, municipal property, municipal enterprises and municipal financial resources are the legal instruments of the municipalities to provide good and effective public services for the population.

On the other hand, in addition to the general formulation of the competences of the municipality, the Law contains specific definitions of the competences of mayors. The nature of these competences also represents a blending of characteristics. However, they include public services directly performed by the mayor. A mayor is responsible for: maintenance of public order, organization and execution of all activities aimed at the defense of the population in the event of disaster or accident, and functions of a public figure concerning the civic status of the population. Considering that mayors organize and implement all central state normative acts and are responsible for the implementation of the municipal budget, their role in the normal functioning of the system of public services is also significant.

Public services for the population provided via the municipalities can be systemized in several main groups:

- Assistance aimed at the state and quality of the living conditions of citizens with regards to welfare and communal activities;

- Public services concerning health care and social benefits, preservation of the environment, and the development of sports and tourism;
- Public services in the field of culture and education;
- Administrative and security services.

The first group of services outlines the responsibilities of the municipalities to provide favorable living conditions for the population. The municipal council develops and adopts general town-planning schemes for the territory of the municipalities or its parts, and the mayor of the municipality organizes their implementation. From the point of view of public services, the most significant are:

- Permits for development and construction;
- Water supply, electric power supply, sewerage and refuse disposal;
- Municipal transport;
- The maintenance and repair of streets, parks, gardens, etc.

According to the Law and municipal regulations, companies, private legal entities, municipal enterprises, as well as specialized units of the municipal administration can be commissioned to provide various services.

The second group of services, and specifically health and social care, depend directly on the decentralization of the competences of the specialized central institutions. At this stage, decentralization is in its initial phase. Practices of shared or entirely centralized competences prevail.

Health care institutions in the country are state, municipal or private, and the terms of their establishment and funding are regulated by law. The creation of municipal health care institutions requires a decision on behalf of the respective municipal council. However, this act does not create immediate legal consequences. A proposal is drafted on the part of the municipal council and an order of the Minister of Health Care represents the legal act. The managers of these municipal health care institutions are appointed by the regional structures of the Ministry of Health Care. The requirement that the municipality, via its budget, shall provide the necessary funds to sustain the activities and the maintenance of the municipal health care institutions is taken into consideration when the budget subsidies for the municipalities are allocated. In practice the financial responsibility of the municipalities is not backed up fully with the relevant rights.

Social care and benefits are linked with the competences of municipalities to a higher degree. The municipal centers of social care and benefits, social patronage, institutions for elderly people and underprivileged children, public canteens, and other forms directly offer services to the population. Some of these services are free, while others are provided either through municipal and state funding, a combination of municipal, state and private funding, or through payment on the part of the consumers.

However, a certain degree of inconsistency is observed in this area as well. The activities of the municipal social institutions are funded from the municipal budget, but their managers are appointed by the Minister. It is true that the revenue from income tax (50%) and corporate tax (10%) retained in the municipal budget constitutes more than half of all municipal funds. Additionally, the total amount of all

local charges and fees (for refuse disposal, the exploitation of market places, street pavements, etc, as well as for nurseries and kindergartens, elderly people institutions, etc.) in addition to the total amount of charges for civil servicing collected by the municipality for the municipal budget are extremely insufficient and cannot be increased indefinitely.

It seems in this case that we observe a phenomenon, which is contrary to the general trend: financial decentralization combined with strong municipal competences in the field of social welfare. The central power, however, continues to be vested with control via direct executive functions.

The third group of services, generally in the field of culture, also illustrates these tendencies and unsolved problems.

In the sphere of education competences are divided and shared. Kindergartens and schools are state, municipal and private. Municipal kindergartens are established and closed down on the grounds of a decision of the municipal council. The mayor of the municipality appoints the heads of the institution based on a competitive procedure. However, municipal schools are established or closed down with an act of the Minister of Education and Science after a decision is made by the municipal council. The heads of municipal schools are also appointed by the Minister. On the other hand, municipal budgets entirely provide the funds for material and technical equipment, as well for maintenance and all other costs of municipal kindergartens and schools.

It is true that general state requirements, contained in the relevant legal acts and regulative norms, are necessary in the field of education. But there is something inadequate in this type of decentralization under which municipal councils and mayors are responsible for leaking school roofs and broken windows on their territory without the competence to directly monitor the work of a school headmaster, who is at the same time the economic manager of the respective educational institution.

The development of culture in the municipal context includes a great variety of activities, which are in the competences of local authorities: municipal theatres and orchestras, cultural centers, amateur artistic activities, museums, libraries, etc. Cultural development depends to a great extent on local patriotism and initiative although market conditions often suffocate it via commercialization. Funds that are concentrated in the Ministry of Culture virtually never reach the municipalities. Years ago the Ministry of Culture initiated the so-called "theatre reforms", i.e. mass closing down of theatres. The entire public opposed this 'reform', including the municipalities, keeping in mind that in many places of the "deep country" people were deprived of any sort of cultural institution. The "compromise" made by the government at the time was to transfer the responsibility to sustain the theatres entirely to the municipalities. What happened in fact was they had to make the unpopular decision themselves in the context of reduced budgets, irregular payments of the state subsidy and insufficient municipal funds. As a result many theatres, as well as other cultural institutions were closed down, others struggled to survive with the help of sponsors and projects and the citizens were deprived of their constitutional right to have access to culture.

The fourth group of services can be defined by convention as administrative and security services. The state has delegated to the municipalities certain functions

concerning civic status, public order, the organization and the procedure of elections, defense and mobilization training, defense of the population in cases of disasters and accidents, etc. Often, via special legislative acts, mayors are assigned responsibilities, which exceed the competences defined in the Law on Local Self-Government and Local Administration.

Administrative services are typical for municipalities. And what is more, even the appointed officials in the smallest settlements, where mayors are not elected, perform certain tasks of an administrative and organizational nature servicing the population.

Main trends of the reform

1. Privatization and concession, based on the general laws on privatization, concession and public procurement, as well as on the specialized law on municipal property, created conditions for the involvement of private initiative in the municipal public services sector. A number of the services in the field of urban development and sanitation, health care, education and social care are already performed by the public, as well as by the private sector. Irrespective of the fact if the word goes about privatized facilities or companies of the municipality or about independent initiatives of private entrepreneurs, privatization in the field was and continues to be the main trend of modernization.

Although the traditions and practices in the field vary among European countries, the European community has undertaken efforts to combine them via “directives” subordinating the practices to a dual requirement - free competition on one hand and the defense of the interests of the citizens on the other. However, a founding principle of the market economy is that effective management presupposes interaction between the public and the private sector.

In this respect Bulgarian municipal practices vary. According to the law, every municipal council makes independent decisions to privatize specific facilities or companies observing the legally specified procedure. This does not mean: “everything is for sale”. There are services of an exclusively public nature and they are retained in the sphere of municipal competences. The essential element, as far as both privatization and concession are concerned, is that a municipality cannot entirely delegate its responsibilities concerning the provision of public services to the population. If privatization is aimed at higher quality services, this means that post-privatization control should guarantee this aim.

In this regard, it is understandable that municipalities prefer joint private-municipal companies and concession contracts for individual services. *Concession* represents delegated management for the purposes of a specific type of public service. A contract is signed with a private person or a company to provide a specific public service at their expense, with or without subsidy - thus obtaining the right to collect the respective fees and charges from the users of a specific service. For instance, in a number of Bulgarian municipalities, including the largest cities, refuse disposal is performed via concession contract. Gas supply, water supply and sewerage are the other most commonly given to concession services.

Although isolated, the practices of the Dobritch municipality are positive, where as a result of a tender and a concluded contract for a public property estate, the biggest private hospital in the country started functioning in the middle of 1999 together with a drug store and a depot for wholesale trade with medications and consumables.

In general, however, the results of the privatization and concession practices have been ambiguous. Evaluation on the national level reveals a greater number of negative impacts with regards to the quality and cost effectiveness of the services. It is obvious that criteria and guarantees have not been developed yet that could prevent the deprivation of the citizens of specific types of services that come as the result of ambitions for quick and large profits. The legislative initiatives, which should create the basis for effective control, are also unsatisfactory.

The efforts of the municipalities in this respect are rather the result of isolated initiatives than of a general common tendency. For instance, in the comparatively small municipality of Karnobat a project was developed with foreign financial support and several local medium-size partners that was aimed at the facilitation of access to current and plausible information concerning the status of each estate. This includes municipal property, the implementation of effective marketing strategies, the achievement of transparency concerning the management and privatization of municipal facilities and companies, the development of a strategy for the management of the municipal property, etc.

2. The modernization of services, including the introduction of electronic services, is another major aspect of the reform. Of great significance is the employment of the so-called “electronic government”, the start of which was announced on October 1st 2003. During the first stage four administrative services will be available including: changes of address registration, information about the insurance payments made on the part of the employer, information about company insurance, and company registration. As of 2004 administrative services will also be subject to concession contracts.

It is clear even now that development in this direction will require new legislative solutions with regards to the competences of municipalities in the field of public services. A new pattern of relations between the central government and the local authorities will also be developed within the framework of the “Electronic Government” project. There are two aims of this development that deserve special emphasis: considerable improvement in the servicing of the population; and keeping the possibilities for corruption to a minimum. But at this stage this type of modernization of the services does not have the potential to replace the “classic” model considering the fact that only 10% of Bulgarian citizens have access to the Internet and the amount of money necessary to obtain an electronic signature exceeds the average salary.

Some of the municipalities started earlier. By 1998 in Blagoevgrad licenses for the trade of wine and spirits and tobacco products, as well as the permits for coach and taxi transport, were issued manually. Later a database “Licenses” was created and it already functions; the servicing of individuals and companies is computerized and this facilitates the process and gives better options for control. In a similar way, the

evaluation stating the unsatisfactory quality of servicing, which was supported by a special sociological survey, resulted in the idea and the elaboration of a Catalogue of the offered municipal services in the Dobritch municipality, which includes the description and the specification of more than 100 services for the population. An information handbook and an information agency serve the same end in the municipality of Lovetch, for example.

The establishment of centers for services and information plays a significant role in the process of reforming the system of public services. These centers function in about 80 municipalities. They are quickly gaining a reputation as places for direct access to public services. At this stage, the most often used services are administrative acts on civic status and other documents that are issued by the municipality. Of great significance in this sphere, in addition to the professionalism of municipal officials, is work with modern computer systems and the updating of the database. Connecting municipal centers with smaller settlements via the Internet is forthcoming and this will facilitate the access of services to larger and larger sections of the population.

These centers provide the possibility (most of all for administrative and technical services) for the so-called “one-stop-shop servicing”. It is worth noting that this type of servicing results in a smaller number of complaints concerning their quality and terms.

3. The development of civic and other forms of control over municipal public services is another main trend in these reforms that is in direct relation to the protection of the rights and lawful interests of citizens. In addition to the control exercised by representative bodies, the court and the prosecution office, as well as the internal administrative control, the emphasis is placed more and more on the possibilities provided for individuals to control, and respond to, wrong and unlawful actions on the part of the administration in general, and the local administration specifically. Of all forms of control, the following three are relatively new and promising:

- (a) civic control;
- (b) judicial defense and control;
- (c) the 'ombudsman' institution

Civic control includes all initiatives and activities of civil structures, including the media. More specifically: organizations that are specialized in some civic sphere (such as those that defend consumers and have branches at the local level); critical publications in mass media; the potential of political parties (most importantly the parties in the opposition) to reveal and evaluate the activities of municipal authorities aimed at servicing the population, etc. Civic control has important social, informational, preventive, analytic and corrective functions, as long as local authorities respond to the attitudes, findings and proposals of civic organizations in an adequate and timely fashion. With this in mind, a number of European projects have been developed. For instance, in 1997 in the Veliko Tarnovo municipality a project was started and finalized that was aimed at the “Activation of the role of regional mass media for civic control over, and the transparency of work of, local authorities and regional administrations“ and gained popularity under the name “Civic Telephone”.

Citizens enjoy the right to contest the acts of municipal councils before the respective regional courts alongside with the possibility to appeal before the Supreme Administrative Court against unlawful acts of the Council of Ministers and the rest of the central executive bodies in case their lawful interests have been infringed. Recently on the initiative of individual organizations and even the initiative of individuals (lawyers) a number of acts of ministers resulting in higher charges for services (e.g. telephone and heating charges) have been reversed.

Citizens can also contest individual administrative acts infringing the rights or lawful interests of individuals or organizations such as construction permits, permits for trade activities, etc. Litigations can be undertaken administratively (before the higher administrative authority) contesting the unlawfulness, via a judicial procedure, as well as the lack of expediency of the act.

The Constitution of the Republic of Bulgaria of 1991 restored, after a period of 50 years, administrative proceedings as the most effective defense of the rights and the interests of citizens against unlawful acts of the administration.

Current practices are indicative of a particular intensity of judicial control and prosecution monitoring over some of the acts of local authorities concerning proceedings under the Law on Concessions and the Law on State and Municipal Procurement. Both laws provide the order for litigation in cases of the violation of the provisions regulating competition or tendering procedures, evaluation and selection criteria and procedures, conclusion of contracts, etc.

Without going into broad generalizations, one cannot but note that the public services sphere is charged with the danger of corruption. The practices of judicial and civic forms of control are sufficiently indicative of this. "Particularly serious is the problem of the non-regulated commissioning of public orders in Bulgarian municipalities," says the *Report on Corruption 2002* of the specialized non-government organization "Coalition 2000". Two fundamental measures are proposed to solve this problem: upgrading the administrative capacity of the municipalities with respect to the management of public funds and the intensification of the control (preventive and subsequent) over the procedures under the Law on Public Orders.

The ombudsman institution has already been legislatively regulated in the country. In addition to the election, competences and functions of this specific institution on the national level, the law contains a separate chapter providing the municipal councils with the possibility to elect a local ombudsman. Parallel with the general provisions, the specifics of the institution at the local level includes a number of special provisions with regards to financing (such as that it only come from the municipal budget and the prohibition to attract funds from anonymous sources) and status (the local ombudsman had the status of a public official, but without immunity).

Prior to the adoption of the Law on the ombudsman institution, a project was developed under PHARE-DEMOCRACY and preliminary preparations were undertaken in four municipalities followed by the introduction of the ombudsman institution in 1998. It was disseminated and made popular via the mass media and at meetings organized with the population. The role of an ombudsman is very complex, he needs the collaboration of the administration but at the same time, in order to

defend the citizens, he has to preserve his independence from central authorities as well as local authorities.

In conclusion, the reforms of public services have started, but real reforms are forthcoming. We are facing radically new solutions that will most probably turn the whole system upside down. Let's hope that these changes will be in the best interest of the people.

Public Services at the Local Level in the Republic of Macedonia

The scope of public services and legislation on local public services

Public services that can be carried out on a local level by local government units or municipalities and the City of Skopje as a community of 7 municipalities, are those that are derived from local government competencies, with some exceptions. According to the Local Government Act, which was passed in 1995, municipalities can have the following competencies regarding public services:

1. Local competencies according to the Local Government Act

1.1 Responsibilities mandated by law

The municipality shall:

- adopt programs arranging building zones within municipal territory;
- adopt a general urban plan subject to approval by state urban authorities;
- adopt a detailed urban plan and prepare documentation for the inhabited areas on the territory of the municipality after the approval of state urban authorities. These authorities are obliged to consult additional organs and organizations.

The municipality shall regulate and organize:

- the construction and maintenance of local roads, streets and other infrastructure facilities of local relevance;
- drinking water supply, drainage of rainwater and sewerage in conformity with the law;
- settlement cleaning and garbage collection;
- lighting.

The municipality shall regulate, within the framework of the law:

- the maintenance of parks, greenery;
- local transport;
- the maintenance of street and traffic signals;
- the maintenance of public cemeteries;
- the maintenance and utilization of riverbeds;
- the maintenance and usage of green markets;
- the cleaning of chimneys.

1.2. Responsibilities chosen by discretion

- Municipalities may establish secondary professional schools, etc.

Taking into consideration the former local government competencies, local units can perform public services by establishing enterprises for water supply, sewerage, street and road maintenance and construction, the maintenance of parks and greenery, the maintenance of cemeteries, etc.

The enterprises preparing urban plans (general and detailed) and urban documentation (for the villages) may be established only by central authorities or the Government of the Republic of Macedonia.

None of the municipalities have established secondary professional schools, probably due to a lack of finances. Therefore, public service of this kind has never been performed by local authorities.

The Government of the Republic of Macedonia has unlimited rights and opportunities to establish public enterprises (or public utility companies) providing all kinds of services. This means that in addition to enterprises that are within the scope of the central competencies, such as energy provision, railroad traffic, air traffic, telecommunications and posts, the government can establish the same type of enterprises as the municipalities can do, like those dealing with water supply, sewerage, etc¹.

Local government units (municipalities and the City of Skopje) that are in charge of carrying out public services through municipal enterprises have the following rights and duties:

The Council (as a representative/legislative body) shall:

- establish public utility companies² within the local government competencies
- appoint the members of their management boards
- adopt and finance programs for their work and financial plans

The Mayor (as an executive body) shall:

- appoint a general manager (director) of the public utility company.

2. Legislation

This matter is regulated by many laws. The systemic law treating this matter is the *Local Government Act* (1995) and (2002); more specific laws are: the *Law on Public Enterprises* (1996), the *Law on Communal Enterprises* (1997), as well as many others listed in the Bibliography chapter at the end of this paper.

Overview of reforms concerning public services

At present there are no operational reforms concerning public services.

¹ Law on Public Enterprises, *Official Gazette of the Republic of Macedonia*, Skopje, 38/1996

² According to the Law on Local Government (*Official Gazette of the Republic of Macedonia*, Skopje, 5/2002), “public services” including “public utility companies” and “public institutions” are non-profit organizations for performance of public services, it means activities of public interest of local relevance.

Ownership types (private, public) and the main characteristics of public utility companies

According to the law, local public services (communal activities) may be performed:

- a) through the establishment of a public utility company by municipal authorities
- b) by granting concessions
- c) by issuing a license for the performance of such services.

In the first case the public utility company can appear within two modalities:

- as a company established and run only by municipal capital
- as a company with mixed capital, invested in both by the municipality as well as other physical persons or legal entities, in which case the former company acquires the status of a “limited liability company” or “joint stock company”.

In the second case concessions can be granted only by the Government of the Republic of Macedonia.

In the third case license for the performance of public services of local relevance (communal activities) can be issued to both physical persons and legal entities by the Government of the Republic of Macedonia and local government units, or municipalities and the City of Skopje.

Financing public services on the local level

Public services on the local level have two regimes of financing:

1. Public services or facilities of the communal infrastructure that serve *individual* consumption are financed by the *prices of the communal services (user charges)*. These are the services of water supply, steam heating, local public transport, funeral services, etc., where consumers or citizens pay the whole amount of the services used.
2. Public services or facilities of the communal infrastructure that serve *common* consumption are financed by
 - a) *fees for the utilization of construction land* (for example, house owners pay annual rent for the utilization of land in urban centers) amount to 50% of the total fees collected on a particular municipal area;
 - b) *the prices of communal services*
 - c) *municipal budgets or the City of Skopje*
 - d) *other sources of revenues determined by law*

These are the facilities for the drainage of atmospheric waters, the depositing of industrial waste and harmful materials, garbage collection, lighting, etc.

The prices of municipal enterprises are proposed by municipal organs but are determined by the state and they have remained unchanged since 1995. Public utility companies cannot change the prices of the services they provide because they are “frozen”. In the period from 1995 to 2001, only 5 municipal companies have acquired the right to change the price of water. This concession was made in order to provide them with the opportunity to pay off their loans gained from the European Bank for Reconstruction and Development.

In the Republic of Macedonia, all categories of the population pay the same user charges to local public utility companies, meaning that the poorer, or more vulnerable

groups, do not have some forms of social relief or price discounts. The only exception is the Public Transport Company in Skopje, which provides some price discounts based on some population categories. Internally displaced people, or the people that have not gone back to their native places after the War of 2001, are free of fare charges for local transport, disabled pay from 0 to 50% of the price of local transport fares and the pensioners and students at all levels (secondary, tertiary) pay 50% of local transport charges.

Coverage of the services

Municipal services are not provided to the entire population in the Republic of Macedonia. Municipal public utility companies mainly operate in urban areas, not in rural ones. This is due partly to the fact that villages lack a lot of infrastructure facilities (about 40 % of the villages in Macedonia lack water pipes and about 95 % of the villages lack a sewerage system) and partly to unsolved problems about the price of service provision in rural areas (especially in the case of garbage collection). In addition, there are some minor parts of towns that are not covered by water supply services and much larger areas that are not covered by the sewerage system. Some of the areas uncovered by these services are illegal settlements built at the outskirts of cities and towns. Consequently, the service coverage, according to a study by the Economics Institute of Skopje is as follows:

- a) 65 % of the population is provided by water from the public utility companies;
- b) 45% of the population is provided by sewerage (including water drainage) services;
- c) the rest of the services (the maintenance of parks and greenery, communal hygiene services, etc.) are provided for 20-30 % of the population;
- d) steam heating is provided in the central area of the City of Skopje, covering about 10% of the population in Macedonia.

Monitoring (controlling) the public service sector

Until now, only municipal public utility companies have been established that are under full control of both the municipal organs (councils, mayors and municipal inspectors) and Republic (state) inspectors for municipal affairs.

More precisely, municipal control is exercised in several ways. Representatives (general managers) of public utility companies every year submit both programs of activities for the following year and reports on the activities performed and financial reports of the past year to the municipal councils. These councils have the right to approve the programs and reports (i.e. to agree with the activities performed and money spent on those activities or disapprove of either the programs or the reports). The latter situation gives them the right to undertake change in the programs and activities, the managing bodies of the enterprises (they appoint the majority of the members of the Managing and Supervisory Boards of the public utility companies), and to propose that the Mayor replace the managers of respective companies.

Mayors can exert control over the work of these companies, bearing in mind their right to dismiss managers with whom they are dissatisfied. In addition, both municipal communal inspectors and state (Republic) communal inspectors can exert control over the work of these companies and undertake punitive measures approved by the law against the companies.

Case study of a public service company that has been successfully developed on the local level

Public utility companies have not undergone any transformation in the last ten years. On the other hand, faced with a lot of problems and difficulties that will be described in the next chapter, none of them can be qualified as “very successfully developed”.

Functional aspects of the system

1. Public utility companies are legal entities and have some professional autonomy that can be seen in the fact that their leaders propose work programs, decide about staff hiring and the introduction and application of technologies and machinery within the limits of the revenues at their disposal.
2. The relationship between the municipal organs and the public utility companies' leadership is good and usually the municipal organs avoid interfering in the work of these companies, understanding and sympathizing with the problems and difficulties of the municipal companies.

Primary problems, difficulties and deficits in the functioning of local public utility companies

1. There is no strategy or well conceived policy for the development of communal activities or local public services in the Republic of Macedonia.
2. There are a lot of legal contradictions and inconsistencies between the local public services. For instance, there is not a clear distinction between “granting concessions” and “issuing licenses” for the performance of local public services on the one hand, and the municipalities do not have the right to grant concessions on the other. This situation has reduced the opportunities for the municipalities to be involved in performance of local public services. In addition, the Law on Concession does not allow for the granting of concessions for any economic or other activity of public interest.
3. The prices of communal services are determined at a low level and so they are more likely to achieve security goals rather than economic ones. More precisely, these prices provide revenues only for current activities and not funds for amortization. In addition, the pricing policy lacks flexibility, meaning that all prices for a specific service are the same and consequently some opportunities are missed for the collection of more revenue through the specialized pricing of some goods. For instance, drinking water can be provided at low prices, but the water that is used for watering gardens or cleaning streets can be provided for higher prices. Consequently, public utility

companies lack money for the amortization and investment both of their own equipment and the replacement of infrastructure facilities that are outdated and cause damages.

4. There is a lot of payment evasion of communal services by the local population and this situation makes the financial situation of the municipal enterprises even worse. Generally, the evasion rate is more than 60%, meaning that about 60% of consumers do not pay for the services of the municipal utility companies that they have used.
5. Although 56% of the general managers of public utility companies are people with university diplomas, many of them are appointed managers not because of their professional capacities but due to partisan criteria or nepotism. In that way, the level of efficacy of municipal enterprises drops down. In addition, the staff qualifications of these enterprises are not up to modern standards. Researchers have found that among analyzed enterprises, 37,2% of the total number of employees are unskilled or semiskilled workers, 22% are technically qualified or highly qualified, etc.
6. Through an analysis of public opinion, the barriers to the development of the public utility companies can be ranked. The highest barrier towards good functioning of the public utility companies is the low quality of enterprises' equipment, the lack of capacities for large-scale municipal activities and the lack of managerial capacities.

Possible recommendations for future changes

A lot of measures should be undertaken in many social fields, not only at the local level.

First, Macedonia needs a strategy of overall sustainable development that will improve overall finances, part of which can be intended for the local level.

Second, fiscal equalization schemes for narrowing the gap between the richer and poorer municipalities, or parts of municipalities, should be introduced.

Third, additional funds must be provided for some local services such as water supply, local public transport, etc. These can be provided either from municipal (or state) funds or through a more flexible pricing policy, in terms so that everyone who uses water for non-essential purposes should pay more for it than those who use water for existential needs.

Fourth, training is necessary, especially dealing with the managerial skills that are essential for enterprise development.

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Public Services in Bosnia and Herzegovina: Between Social Tools and Sustainability

The war in Bosnia and Herzegovina resulted in the immense destruction and devastation of the infrastructure, public services and utilities. With enormous help from the international community, most of the infrastructure and utilities have been renovated or new ones are in place.

The Dayton Peace Accord established Bosnia and Herzegovina as a state with two entities, ten cantons and about 200 municipalities. This complex structure is causing problems in the functioning, maintenance, financing and development of public services.

Local competencies

The competencies and responsibilities of the municipalities related to public services and utilities are regulated by Local Self Government Laws on the Entities level (The Republic of Srpska and the Federation of Bosnia and Herzegovina) with the following differences:

Public Services	Local Government in the Republic of Srpska	Local Government in the Federation BiH
Preschools	Responsibility and policy is on the local level and financing is divided between the local level Public Fund for the Protection of Children and on the entity level	Policy making and regulations are under cantonal authority, and the responsibility of financing is on the local government
Primary education	The local level is responsible for covering the material costs of schools. All other responsibilities and competencies are on the entity level	No competencies and responsibilities are on the local level
Secondary education	The local level is responsible for covering the material costs of schools and administrative work. All other responsibilities and competencies are on the entity level	No competencies and responsibilities are on the local level
Adult education	Under local government	No competencies of local government

Social welfare centers	Municipality competency	Financing only comes from the municipal level. All other competencies are under the canton or entity
Geriatric centers	Municipality competency	Financing only comes from the municipal level. All other competencies are under the canton or entity
Health protection	Local government responsibility regarding founding and management. Financing is under the entity level via the Public Health Fund	The municipality establishes authorities at the entity and cantonal levels
Culture (Theaters, Museums, Libraries)	Municipality authority, except for those that are of entity interest	Financing is a municipal obligation. All other responsibilities are on the cantonal level
Water supply	Municipality competency	Municipality competency
Heating supply	Municipality competency	Municipality competency
Sanitation	Municipality competency	Municipality competency
Sewage system	Municipality competency	Municipality competency
Local roads and transportation	Municipality competency	Municipality competency
Cemeteries	Municipality competency	Municipality competency

The previous outlook shows that there are important differences in the competencies for public services and utilities between the two entities in Bosnia and Herzegovina that must, in the future, be harmonized.

The present situation in some public sectors

Electricity supply

There are two electricity systems in Bosnia and Herzegovina managed by two companies.

Electricity supply is under the jurisdiction of entities and local communities that do not have any influence on development policies, prices, or the quality of supply. In the Federation of Bosnia and Herzegovina, the electricity company is completely state owned. In the Republic of Srpska, the electricity company is partly privatized (20%) through mass privatization.

The main problems in this sector are related to the bad quality of supply (in rural areas), underdeveloped networks and distribution systems, and the very low level of payment by citizens and companies (the payment rate is less than 60 %). Tariff systems differentiate between citizens and businesses, where businesses are charged 100% more than citizens.

There is no social tariff for low income groups such as pensioners and social cases. Electricity pricing policy is under entity government policy without any influence or participation in the policy setting process from public interest groups.

Telecommunications

Telecommunication services are the responsibility, and the monopoly, of entity governments and are performed by public companies. The consequence of this is the low quality of services and the highest price in the region. This sector is undergoing privatization and the regulatory framework for the sector is provided by the Communication Regulatory Agency, which is a completely independent body. Local governments do not have any influence or responsibilities related to development policy, pricing or service development.

Water supply, drainage and the sewerage system

Water supply systems are under the jurisdiction of local governments on the municipal level and managed by state-owned companies. The systems are in very bad condition and the quality of the water supply is at a very low level. Many of the municipalities experience the shortage of water supply, especially in the summer. Improving the water supply system is one of the priorities of almost all local governments, but there are no sources for financing its development.

Pricing policies are the same as in the electricity sector (double prices for businesses) and price levels are very low - below the economically determined level.

The payment rate for water is very low (under 40 %) and public companies that manage the system are surviving only through the budgetary support provided by local governments. In this sector there are few cases of innovative behavior in small municipalities where the international community donated and constructed water supply systems. These municipalities gave water supply system management rights and collection of payments rights to the private companies through competitive tendering procedures, but pricing policy and maintenance costs must first be approved by the local government.

District heating systems

District heating services are provided in big towns in Bosnia and Herzegovina only. All of them are in bad condition, underdeveloped, suffer from a lack of maintenance and need significant upgrading. These systems are managed by public enterprises in entity government ownership. The pricing policy is the same as in other two above-mentioned public services, and prices could not secure the economic sustainability of the service. The payment rate is very low, less than 50%, and there is no diversified pricing policy for low-income groups. Restrictions in supply are frequent and the costs of system functioning are subsidized by local and entity governments on an emergency basis.

Local public transportation

Organizing local public transportation is the responsibility of local governments. Almost half of the local public transport companies are privatized and private

entrepreneurs have developed competition in this sector. Local governments are more and more using transparent tendering procedures to get these kinds of services to the service provider with the best offer.

The maintenance of local roads, traffic signs, parks, cemeteries, greenery and garbage collection

These are probably the most advanced public services on the local level in the sense of the restructuring process. A significant number of public companies in this sector are completely privatized and public tendering and strong competition have resulted in good quality services. Financing comes from local government budgets and cemeteries and garbage collection are financed by service charges where pricing is under local government control.

2. Ongoing processes

There are a few processes that are important for the future development of public services in Bosnia and Herzegovina:

- a) The decentralization of responsibilities for public services from the central to the local level;
- b) The harmonization and unification of public service systems and responsibilities;
- c) The privatization of public utility companies; and
- d) Establishing a legal framework and regulatory bodies for monitoring, regulation and concession.

All these processes are standard transitional procedures that have to be done in post communist countries.

The process of decentralizing responsibilities and competencies to the local government level will be accelerated in Bosnia very soon as part of the accession process for potential EU membership that will also result in the harmonization between two entities.

At the same time, the reform of the public financing system is going completely in the opposite direction, where all tax revenues except land taxes are concentrated on the entity and state level. These unbalanced processes could lead the country into a position of slow transition.

The privatization of public utilities is a process that just started in Bosnia and Herzegovina and could be threatened by the bad economic situation, high unemployed rate, huge low-income population, and the nearly 60 % of citizens that live around the poverty line. This is causing a very low level of paying public services, which will be the main obstacle, and an enormous problem, for the successful restructuring, privatization, reconstruction and upgrading of public utilities.

Most of the legal and regulatory framework and bodies necessary for monitoring and regulating public utilities and the services sector are in place, but the slow transition and tempo of other activities has caused the situation where there are a lot of nice agencies working without substance.

Conclusion

Bosnia and Herzegovina succeeded in repairing almost all war damage in infrastructure and public utilities with the help of the international donor community. The level of services, however, is very low compared with other transitional countries and according to citizen needs. Society, the governments on all levels, and citizens have not yet decided whether the public services are social tools for keeping social peace or sustainable activities that must be paid for by citizens. This dilemma is causing a time delay in the transition and restructuring process of public services in Bosnia and Herzegovina, on their road to EU integration.

Public Services on the Local and Regional Level: Workshop Summary

By definition, public services are activities designed to satisfy a public need. In order to find out the extent to which public needs are being met, and determine the main problems and issues of transitional countries undergoing the process of decentralization, FES organized a workshop dealing with 'Public Services on the Local and Regional Level'.

For the purpose of comparing the situations in the various countries, participants presented an overview of several main public services (water management, heating, education, health care, social care, and waste management) according to the following questions that were deemed important:

- What is the role of local government in the public utility sector?
- What are the responsibilities of the local council in setting tariffs?
- What are the factors influencing the efficiency of public service?
- Does any kind of social tariff or social protection policy exist in the respective countries?

Water supply

In each country that was presented at the workshop, the care for water supply was transferred to local governments. There are different ways of managing water supply, and the quality level of the service differed from country to country.

In Bosnia and Herzegovina water supply is managed by state-owned companies. In most other countries it has been either transferred to the local level in the form of municipal companies without the involvement of the private sector (as in Bulgaria and Macedonia), the service has been partially privatized (as in Romania, with private/public enterprises), or water companies are fully privatized in the larger cities (as in Hungary). In Romania, 30% of the ownership of water companies remains in the hands of the local authorities to protect public interest, and the development of the pipeline network is determined on the county level, according to a national strategy. In Hungary, the decentralisation of the water supply fragmented the water sector, and the size of the water companies varies significantly between municipalities and cities. Some water companies on the regional level are still state-owned, and some have been completely privatized. This situation caused several problems, which are described in more detail in the paper, 'Public Services in Hungary' written by Nóra Teller and Eszter Somogyi.

Most of the countries have decided to privatize this service to some extent. On the other hand, Slovenian communities have opted for a different course of action. During the reform of the local self-government, many new municipalities were formed that

are smaller in size than before. Consequently, they have decided to provide the service together through public companies that provide these services for much larger municipalities. Some villages have their own systems of water supply that are owned and run by them as cooperatives. However, it is quite often that they want to join the municipal public system because of the higher quality of water supply, water control and maintenance.

The quality of water supply varies from country to country. Slovenia can boast the highest quality of service, where almost every household has access to water. On the other end of the continuum is Bosnia and Herzegovina, suffering from war devastation and from the division of the country into government entities that do not cooperate well. Other countries mostly have problems because of old pipelines that cause shortages in supply during the summer. There is a special issue in Macedonia with pipes covered with asbestos, which presents a serious health hazard. Usually, the quality of the service differs most notably between rural and urban areas, where, in some cases, villages are forced to dig for springs or simply suffer occasional shortages.

In order to improve the condition of the pipelines, local authorities have to find resources, because in all cases the local authorities have the responsibility to take care of the infrastructure. The Slovenian state provides municipalities with special grants (from 10% to 70% of the value of the project), and as a result, the delivery of the service has visibly improved during the last decade. Macedonia and BH have to rely on foreign donations for repairs of their pipelines, while in Romania, Bulgaria and Hungary investments are coming both from private investors and the public sector.

Pricing policies are usually set on the national level, either because of political pressure (as in Hungary), or because of the state-wide concern that the occasional private provider will set prices too high. In Romania, the provider can propose the price, but the state has to approve it, while in BH, the prices are below an economically sustainable level. While the governments of entities in BH usually cannot cover deficits made in such a way, the Hungarian government subsidizes water providers for whom the expenses for the delivery of the service are higher than the income from user charges. BH and Macedonia have higher prices for businesses. They also have the biggest problems with the evasion of payment, while in Slovenia that problem does not exist at all.

As for social tariffs in the region, they do not exist in the strict meaning of the word, but take the form of state subsidies for the purpose of lowering the price of water. In Macedonia, the underprivileged simply do not pay for the service, but the state does nothing to curb this behaviour. There was an interesting case in Hungary, where some water companies decided to try 'creative' tactics to encourage payment, such as publishing the names of companies and people with large debts, or banging on the pipes of non-payers.

Waste management

As a result of the reform of local self-government in the region, the care for waste management has been reassigned to local authorities that deal with this in several

different ways. In most of the countries, the service is either privatized or contracted out, even to foreign companies that cover whole regions, as in Bulgaria. Romanian laws allow for the privatization of waste management companies, but citizens have opposed this because of the fear of corruption and rising prices without any improvement in the quality of the service, which is what happened in Bulgaria. Macedonia also has exclusively municipal companies, because of the lack of interest of private investors, and the quality of the service delivered is very poor. Only one waste disposal site in Macedonia is built according to sanitation and environmental standards. Also, no villages are covered by this service. In BH, waste management is one of the most advanced services provided by the restructuring process, where public tendering and strong competition has resulted in good quality service.

Pricing policy is determined either on the national level, as in Romania and Macedonia, or on the local level. In Hungary, prices are determined by the provider of the service, but local authorities can negotiate the price to protect public interest. Evasion of payment is low in most of the countries because companies involved simply stop delivering the service. There are no social tariffs.

Heating

Heating service is mostly under the responsibility of local governments, with the exception of BH (state-owned companies) and Hungary (private companies). This service is almost exclusively offered in towns, and it is undergoing the privatization process with more or less success. Only in Slovenia is the number of users of public heat increasing, due to convenience, acceptable costs, and high quality. Other countries have problems with restrictions, low coverage, obsolete equipment, great losses in the system and similar deficits.

Bulgarian citizens have started refusing central heating because the prices are very high, even though they are set by the local government. In BH prices are set on the national level and the income of user charges is not enough to cover the economic sustainability of the service. In Romania, prices are partially subsidized by the government.

With the exception of Slovenia, all countries have problems with a high evasion of payment. In BH, since the governments of entities actually own the companies that are providing the service, at the end of each year they are faced with huge losses caused by the evasion of payment. Instead of refusing to provide the service, the governments cover their losses by taking money from the national budget, and the citizens simply continue not to pay for the service.

In several countries there are some methods of helping the underprivileged get access to this service. For example, Bulgaria has a voucher system for poor people to buy coal. However, they have problems with gypsies, who sell their vouchers because they need money. Slovenia offers a social subsidy system developed for the poor on the municipal and state level.

Basic Education

Models of providing the service of basic education are very diverse throughout the region. Elementary schools are mostly under the national authority, while the care for

kindergartens has been transferred in several countries to the local level. Mostly, local governments have to cover maintenance costs for the schools, while salaries for the staff are provided from the national budget. Local units in BH have to cover such maintenance costs, but sometimes they even have problems with covering those expenses. The situation is similar in Romania. Bulgaria has transferred the authority to local governments, but the law is not consistent, as Nora Ananieva describes in detail in her paper 'Municipal Public Services in Bulgaria: the reforms have started, real reforms are forthcoming'.

In Hungary, schooling is financed by normative state grants (grants for specific purposes in education, distributed on the basis of the number of children), with the addition of local funding. The size of the local community determines the scope of obligatory services that the community has to provide. In Macedonia, educational services are exclusively under the authority of the state. Slovenia has an interesting system of supporting good education from several sources, involving the citizens (parents), local government and the state. A more detailed description of the system can be found in the paper, 'Local Public Services in Slovenia' by Zlata Ploštajner. Most of the other countries also offer some kind of social tariff or subsidies for schooling. For example, in Romania, staying in kindergartens up to 4 hours per day is free of charge.

Although in some countries private schools are opening, they are under strict supervision by the government, especially concerning curricula. The existing utilities are not being privatized.

Health care

The provision of basic health care is still mostly in the hands of the state, especially in BH, Macedonia and Bulgaria (local governments cover only the costs of doctors and dentists in schools). Other countries have implemented models with shared responsibility between the state and local authorities. For example, Romanian basic health care has been privatized, and citizens have to enrol on the list of a doctor in order to receive health care, but the payment for the service is collected nationally in the form of taxes (7%). Additional treatments must be paid for. Local governments have to cover the costs of maintenance of the hospitals. In Hungary, basic health care is under the responsibility of the local government, depending on the size of the local community, and it can be transferred to higher levels if the community is unable to cover the costs. In Slovenia, primary health care is a shared function between the municipality and the state. Health centres sometimes have smaller units in certain settlements to provide closer services to users.

The quality of the service and coverage varies from low standards in Romania to high in Slovenia, with different levels of quality in between. In Romania, hospitals lack medication and have problems in providing for the basic needs of the patients. In the case of the unemployed, the hospital has to cover the costs of treatment, but it usually remains as a debt. There is a visible gap in the quality of the service between rural and urban areas. Parts of the population are not included at all in the system, and there is still a search for a proper model of providing health care for the poor, which would

prevent serious humanitarian problems from occurring. By contrast, Slovenian service is well developed. The whole territory of Slovenia is covered, and special services are provided for school children, women, etc.

It is interesting to note that, although the delivery of the service in Romania is privatized, private insurance companies, which would collect payments for the service, are still not allowed by law. Bulgaria has a national health insurance system. In Slovenia, a private initiative is developing so there are private providers of health services or some on the base of concession. Concession means that a private doctor has signed a contract with the Bureau for health insurance for a certain number of patients and the costs are covered by the national health insurance. In the case of private providers, costs cannot be covered through the national insurance system, they must be covered in full by patients.

Social care

Except in Macedonia, where it is still under the authority of the state, and Slovenia, where family welfare services are transferred to the municipal level and social housing and security are shared functions between the state and local governments, in all other countries social care is a responsibility of local governments. Social care is developed and implemented in most countries with extensive help from international communities, NGO's and other partners (like churches), but it depends to a certain degree on the ability of the local community to attract such help. The private sector is active in this area by opening new services, but there is not much privatization of the pre-existing structures.

In BH, one of the biggest problems is the lack of care for elderly people, and the severe lack of funds for the maintenance of existing social care centres that are developing very slowly. In Romania and Slovenia the social care sector is very dynamic, especially in developing previously non-existing services such as transport for children to schools, shelters, social canteens and other such places. Slovenian private and non-profit organisations can apply for additional funds from the state when developing services for special groups (drug abusers, abused women and the like).

Social tariffs exist in many different forms. In Romania, local governments are opening shops for the underprivileged with no VAT, while Hungary has an allowance system for medication for the very poor and local governments can decide to introduce housing allowances for the underprivileged.

In general, the quality of social care mostly depends on the well being of the community, and there are visible differences between rural and urban areas. In Bulgaria, well developed municipal centres for social care can get more funds in the form of state subsidy. In Slovenia social care has been developing based on quite advanced models inherited from the era of socialism.

Conclusions

During the presentations and discussions, several main problems arose that were present in all the countries represented at the workshop (Bosnia and Herzegovina, Romania, Bulgaria, Hungary, Macedonia and Slovenia). One of the first issues is the

general decline in GDP of the abovementioned countries, which has caused a deterioration of the financing of public services. Also, during the transition years, there was a lack of investment in this area, so infrastructure has suffered, and in some cases, it has still not recovered. In recent years, investments have come from different sources - either from the international community as a donation, from foreign investment based on market principles, or state investment. In the case of privatization, there is still a danger of corruption, so many of the countries still haven't decided to privatize some of the main services. Evasion of payment is relatively high (except in Slovenia), and it is connected to two factors - the low level of income of the population and the low quality of service delivered. There was a suggestion during the workshop that one of the ways to secure payment was to include user charges, where acceptable, into obligatory taxes either on the local or on the national level. But, if they are collected on the national level, there will again be the problem of distribution of funds.

As for the progress of the decentralization process itself, it can be concluded that Slovenia has made the most advancement. One of the reasons for this situation is the pre-existing structures that functioned effectively during socialism. Additionally, the people are receptive to taking the responsibility for their communities in their own hands. Finally, the level of cooperation is high and the standard of living is very good, especially when compared to other countries in the region. On the other hand, Macedonia and Bosnia and Herzegovina seem to have the most problems with developing functional and efficient local structures of authority. In BH this problem can be attributed to war damages and the lack of trust between people of different nationalities. The Macedonian government seems to be reluctant to disperse the authority to lower levels of government because of the internal strife between the Macedonian majority and Albanian minority in the country.

Since the region is so diverse, an exchange of experiences helps generate ideas and initiatives, but it is not possible to copy the pre-existing and specific solutions of each country.

The process of decentralization has transferred many of the responsibilities for the delivery of public services to local levels, but it has not transferred funds for its development. This will remain one of the biggest problems in the region until local governments manage to find ways to finance their own public service delivery.

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