Municipal loans and bankruptcies in Hungary

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Structure of the presentation

Description of Hungarian municipal finance, borrowing in Hungarian municipalities

Regulating local borrowing

Current legal challanges regarding municipal borrowing in Hungary


BUDAPEST, HUNGARY
North Atlantic Ocean
North Sea
Celtic Sea
Bay of Biscay
UNITED KINGDOM
IRELAND
DENMARK
GERMANY
POLAND
FRANCE
ITALY
RUSSIA
LATVIA
BELARUS
UKRAINE
ROMANIA
BULGARIA
PORTUGAL

Municipal Finance in Hungary

The role of loans in local finance

Levels of Public Administration

- Regions
  - Statistical reasons for creating, delegated tasks later
- Counties
  - County governments (19)
  - Relies only on state subsidies
  - Most expensive tasks
- Municipalities
  - Same rights and obligations
  - Administratively very decentralized system,
  - 3200 municipalities (10 million people)

Size of local governments

	Number of local govs.	Average population of local govs	Number of local govs before amalgamation	Reductions
Hungary	**3194**	**Average size of a municipality with Budapest: 3100 Without Budapest : 2600**		
Austria	2 301	3 400	3 500 (1970)	34 %
Belgium	589	17 200		
Denmark	275	19 100	1 391	80%
Finland	455	11,200		
France	36,559	1,600		
The Netherlands	636	27,000	1,050 (1950)	39%
Luxemburg	118	3,400		
Germany	16,121	5,000		
Baden-Württemberg	1111		3379 (1968)	67%
Italy	8,104	7,000		
Portugal	275	34,200		
Spain	8,082	4,800		
Sweeden	288	30,900	2,500 (1950)	88%

Local revenues

- Own sources (as percentage of the revenues)
  - Fees (12%)
  - Local taxes (16%)
  - Shared taxes
    - PIT (17 %)
    - Vehicle tax (2-4%)

Can be used as collateral

Cannot be used as collateral

- Central subsidies (70% in 1990 to 49% in 2009)

- Borrowing
  - Debt service must be covered by operating balance (net operating balance)
  - Total debt of Hungarian municipalities - 4 billion $ in 2009, 6 billion $ in 2010 (5% of the GDP)

Types of planned investments

	2001	2010
Sources of financing local investments	Centrally allocated grants Privatization revenues International grants PPP Loans	Grants Loans(!!!)
Collateral for loans	Mostly immobile assets	Mostly income generated by the investments

Control over municipal borrowing

Sources of municipal loan risks

- Size and tasks of local governments, asymmetries in local finance
- Property rendition to the local level
- Unnecessary investments (consequence of state subsidy policy)
- Future debt service is not calculated in advance
- Foreign currency bond issues also used for operational purposes
- Market is not transparent, information is not always accessible
- Role of off-budget institutions in covering operational deficit
- Competitive market (10-15 lenders) – risk taking banks
- Long term capital planning is “just” a legal requirement without practical use
- Availability of emergency grants - soft budget constraint
- Lack of fiscal conservatism at the local level (municipalities expecting the state to bail out)
- Moral hazard
- Amount of loans multiplied by 12,6 between 2001 and 2007

FDI in Hungary in 1993

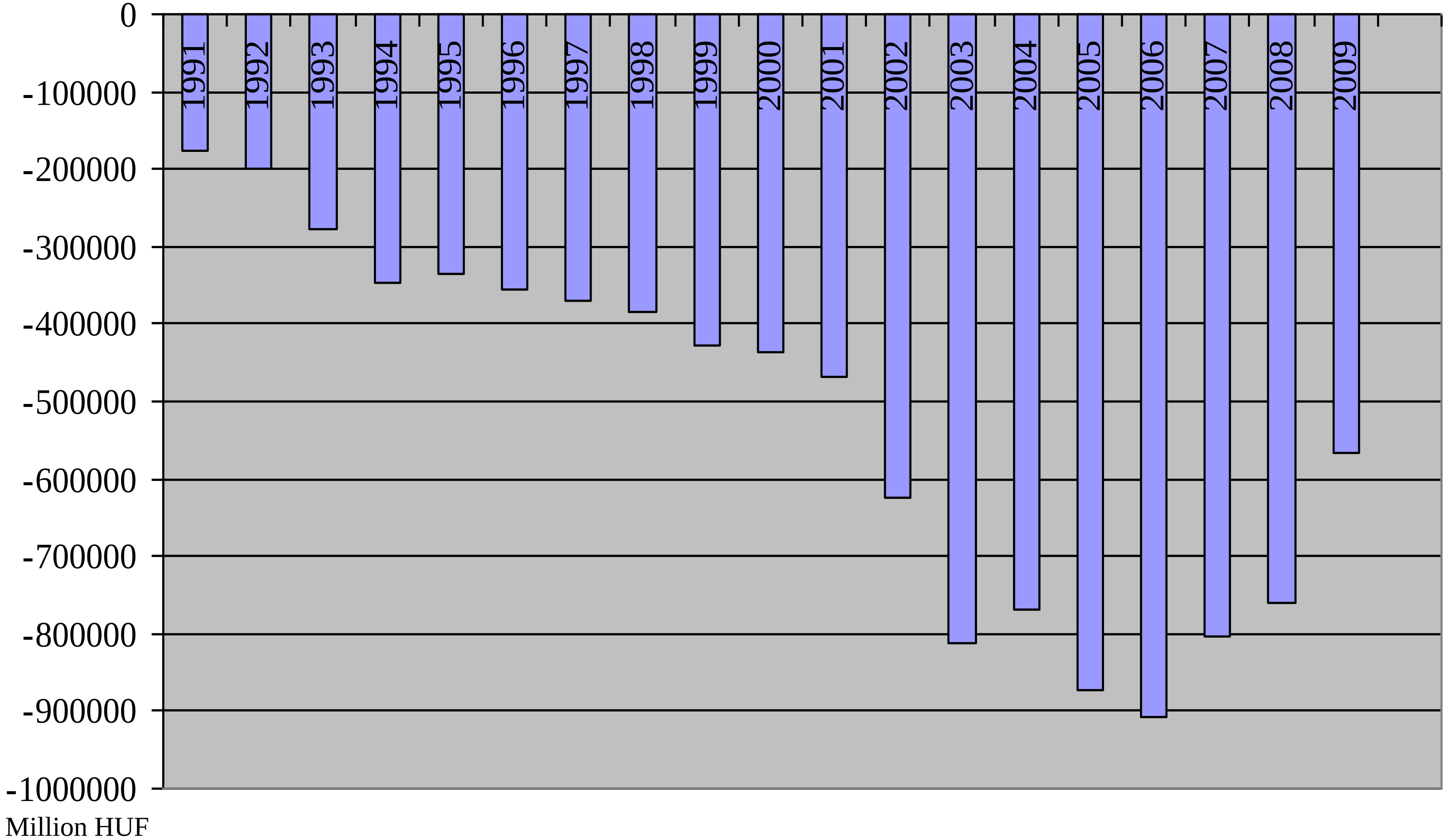
Table 3.6 Regional distribution of FDI in Hungary by number of foreign investors

	All sectors		Manufacturing	
	Absolute	%	Absolute	%
Budapest	546	60.3	187	40.7
Bp Agglomeration	590	65.2	213	46.3
Center	607	67.1	227	49.3
Northwest	121	13.4	87	18.9
Southwest	47	5.2	38	8.3
Northwest	37	4.1	30	6.5
Southeast	45	5.0	37	8.0
North	48	5.3	41	8.9
Total	905	100.0	460	100.0

Source: Hoppenstedt database

Source: J. J. W. van Hastenberg, Foreign direct investment in Hungary. Utrecht University. 1999.

Operating balance of the Hungarian municipal sector



The number of Hungarian municipalities receiving state subsidies

Year	Operational subsidy	Capital subsidy	Emergency grant
1991	36	1	165
1998	95	9	888
2002	98	10	1279
2007	170	15	1050

Characteristics of local borrowing in Hungary

- Borrowing not significant before 1995
- Hard budget constraint, decreasing state subsidies after 1996
- Local government spending is 14% of GDP – imbalances have large impact on the national economy
- Municipal Bankruptcy Act - First regulation in 1996

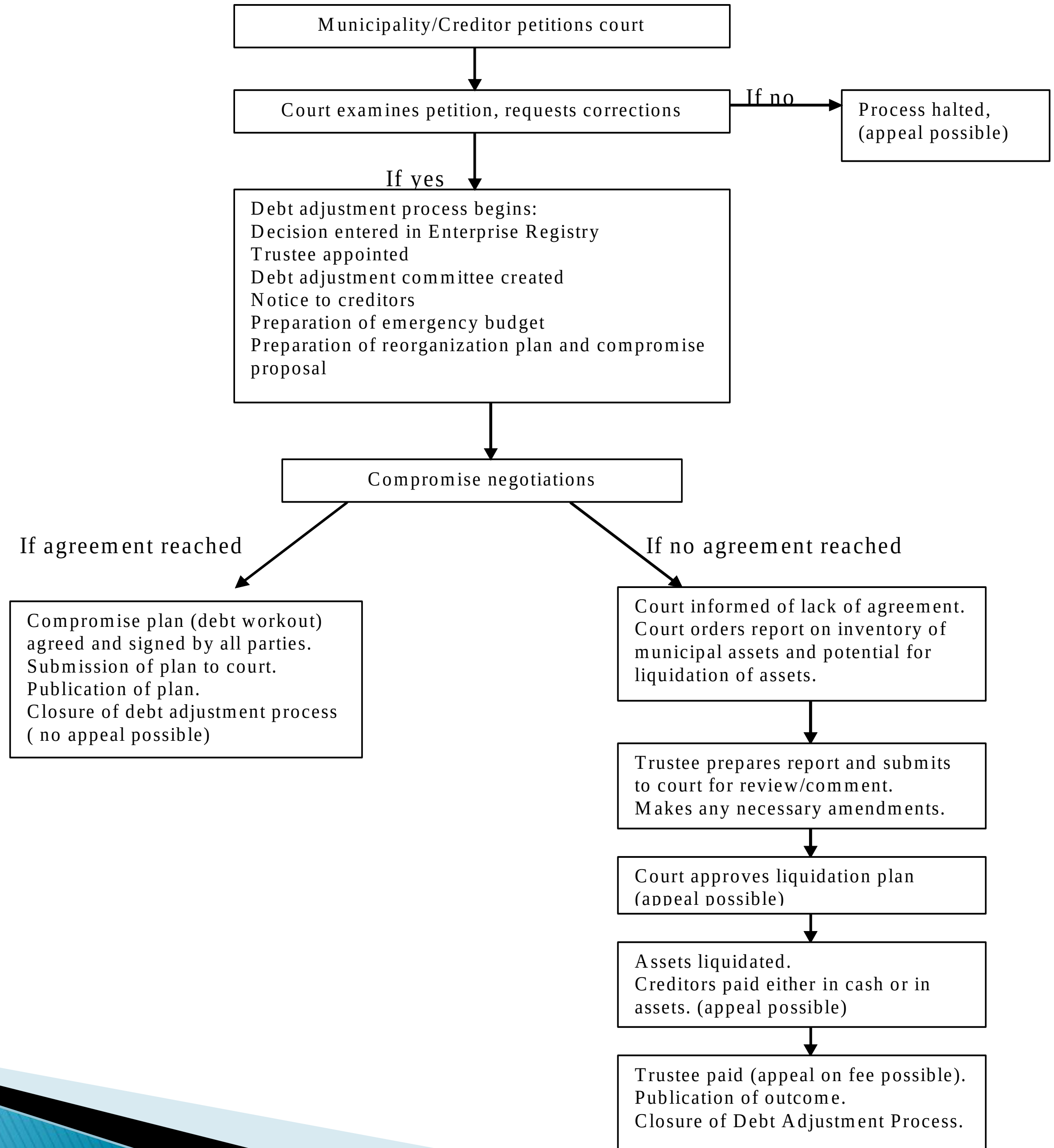
  Ex ante rules and *ex post* procedures

  22 cases between 1996-2007, **??** cases from 2008

Different tools of control used in the European countries

No administrative restriction, market based borrowing	Administrative rule, permission from the higher level must be acquired	Budget ratios, based on budget lines, easy to calculate or golden rule	Mixture of the two
-	Germany, Belgium, Switzerland	**Hungary,** Spain, France, Estonia, Slovak Republic, Czech Republic, Poland	United Kingdom, Denmark, Austria

The Debt Adjustment Process



Municipal Bankruptcy cases before 2008

Settlement	Number of inhabitants	Debt (million HUF)	Starting date of precedure	Result
Atkár	**1685**	**98**	**2001**	**Agreement**
Bakonszeg (I.)	1278	152	1996	Debt restructuring
Bakonszeg (II.)	1278	60	2000	Debt restructuring
Bátorliget	**783**	**79**	**1996**	**Agreement**
Csány	**2298**	**46**	**1996**	**Agreement**
Csepreg	3333	89	1999	Debt restructuring
Domaháza	**1082**	**22**	**1997**	**Agreement**
Dunafalva	1185	69	2003	Debt restructuring
Egerszólát	**1107**	**24**	**1996**	**Agreement**
Felsőmocsolád	559		2005	n.a.
Forró	**2547**	**n.a.**	**2005**	**Agreement**
Gilvánfa	341	26	2000	n.a.
Kács	**654**	**32**	**1996**	**Agreement**
Nágocs (I.)	**856**	**123**	**1996**	**Agreement**
Nágocs (II.)	856	46	2000	Debt restructuring
Nemesgulács*	1 100	n.a.	2007	**Agreement**
Páty	4998	400	1996	Debt restructuring
Sáta	1391	55	1999	Debt restructuring
Somogyfajsz	553	86	1999	Debt restructuring
Somogyudvarhely	**1208**	**31**	**1998**	**Agreement**
Sorokpolány	**825**	**11**	**1999**	**Agreement**
Sóstófalva	**3509**	**6**	**1999**	**Agreement**
Felsőmocsolád	559		2005.08.11	n.a.

Municipal Bankruptcy cases since 2008

- …

In 2010

- About 70% of municipalities expected that investment acivity will slow down in the municipal sector in the next few years
- 80% of them invited banks for tenders (before borrowing)
- 83% said it is important to separate the operating and investment budgets
- 43 % thought that risks of public investments is less than that of private investments
- 25% expected the state to pay off their debt (75% did not)
- 30 % did not plan to raise loans for investments
- 80% thought that at least 5-10 years is needed for better market conditions
- 82% of municipaities would favour a tax reform

- Municipalities expected a reform aiming fiscal decentralization

Current changes in legislation

The new Constitution - 1 January, 2012

- Gives ground to forced amalgamations
- The new constitution does not regulate state administration at the local level and does not protect local government's rights

Other legal changes

- Structural changes (county and “jaras”)
- New division of tasks among levels of government, (education, healthcare, unemployment)
- Financial changes
  - business turnover tax
  - PIT
  - vehicle tax
  - tax on tourism

  will be central taxes (about 20-50% of local income is taken away)

  - Property tax (3% of property value)
  - Communal tax

  Local tax

- New central taxes: social tax, tax on car insurance
- From passive to acive control over borrowing
- Inconsistencies

Conclusions

- Administrative decentralization was not followed by fiscal decentralization
- Expectations of municipalities was not met by central decisions
- High degree of insecurity
- Intense critics of central steps