

Co-funded
by the European Union



Co-funded and implemented
by the Council of Europe

PEER REVIEW REPORT

Intergovernmental Fiscal Relations, Data Access and Use, and Local-Central Policy Dialogue

CEGGPAD(2023)11

This document was prepared by the Centre of Expertise for Good Governance, Council of Europe, in cooperation with Sorin Ioniță, Council of Europe expert, on the basis of the contributions made by the peers from Austria, Croatia, Czechia, Finland, Slovakia and the United Kingdom. The document was produced with the financial support of the European Union and the Council of Europe.

The views expressed by the members of the Peer Review team herein can in no way be taken to reflect the official opinion of either the European Union or the Council of Europe.

© CoE - Centre of Expertise for Good Governance 2023

The Peer Review formed part of the project 'Local Government Public Finance Development and Municipal Capacity Building In Hungary', co-funded by the European Commission (DG REFORM) under the Technical Support Instrument 2022 and the Council of Europe.

This version of the report has been updated on 25 January 2024 in line with the communication received from the Permanent Representation of the Czech Republic to the Council of Europe (No. 1009-1/2024-MZV/STRA) concerning the use of the short version 'Czechia'.

CONTENTS

LIST OF ABBREVIATIONS.....	2
EXECUTIVE SUMMARY	3
I. INTRODUCTION	7
I.1. Context.....	7
I.2. The EU-Council of Europe Project.....	9
I.3. The Peer Review	10
The rationale of the Peer Review	10
The Peer Review mission in Hungary.....	10
I.4. Purpose of this report	11
II. Peer Review findings	12
II.1. General remarks.....	12
II.2. Priority areas and recommendations	14
Priority area 1. The local tax base	14
Priority area 2. Inter-governmental transfers, the equalisation mechanism and the solidarity contribution.....	16
Priority area 3. The system of data collection and analysis.....	19
Priority area 4. Dialogue between central and local governments.....	22
Priority area 5. Assessment of the main causes of challenges and the general direction of inter-governmental relations	25
Priority area 6. Capacity building in municipal associations and local governments.....	26
ANNEXES.....	28
A.1. Peer Review Team mission to Budapest.....	28
A.2. Initial list of questions in the focus of the Peer Review	29
A.3. Detailed example for priority area 2 – the Slovak case.....	31
A.4. Detailed example for priority area 4 – the Czech case	35
A.5. Detailed example for priority area 4 – the Finnish case	37
A.6. The Peer Review Team: brief biographical notes	40

LIST OF ABBREVIATIONS

ASP	Application Service Provider, the platform on which key platforms and services of relevance to local governments are housed, such as the Municipal ASP
CEGG	Centre of Expertise for Good Governance of the Council of Europe
CoE	Council of Europe
Charter	The European Charter of Local Self-Government
EU	European Union
HST	Hungarian State Treasury
IKIR	Integrated Public Services Information System, hosted by Ministry of Interior
IMC	Inter-Municipal Cooperation
KGR-K11	Budgetary Management System, hosted by the Hungarian State Treasury
LGs	Local Governments
MoF	Ministry of Finance
Mol	Ministry of Interior
PIT	Personal Income Tax
PRT	Peer Review Team
Rec	Recommendation of the Committee of Ministers to member states
ÖNET	National Cooperation Council of Local Governments
TÖOSZ	Hungarian National Association of Local Authorities

EXECUTIVE SUMMARY

This report summarises the conclusions reached by the Peer Review Team (PRT) during their review mission in Hungary and presented in preliminary form to the Hungarian central and local authorities and partners. Six broad priority areas concerning inter-governmental financial relations, data access and use, capacity building and the structure of the local government system were identified. The report follows this thematic structure.

The mission was organised by the Centre of Expertise for Good Governance of the Council of Europe (CEGG) and included experts from Austria, Croatia, Czechia, Slovakia and the United Kingdom. They held consultations with the local partners and offered comparative examples and lessons learned from their own countries, summarised in the report, on how to better address the challenges that Hungarian municipalities are facing. The report also includes written inputs from a further Peer from Finland. The relevant standards of the Council of Europe, as well as the findings of the Monitoring Report on implementing the European Charter of Local Self-Government (Charter) in Hungary, published in 2021, were used as a benchmark throughout.

After extensive consultations and dialogue, the PRT understood that there is consensus on a number of points which function as working assumptions:

- No major structural changes to the local government system in Hungary are planned for the foreseeable future, and so the recommendations will be applicable under the existing territorial design and in incremental manner.
- It was agreed by stakeholders that the incentives for local fiscal effort and sound budget management at the local level are crucial for an effective deployment and use of local financial sources. Such incentives can only exist in conditions of predictability, stability and legitimacy of the inter-governmental financial system.
- A good data system to monitor performance in municipal services is essential for the overall policy design and for accountability to the wider public. Similarly, an effective consultation mechanism between central and local authorities should exist, that is inclusive and predictable, to improve the legitimacy of decision making on policies with an impact at the local and regional levels.

The six main domains of interest in which the PRT has identified potential and recommendations for improvement are the following.

Priority area 1. The local tax base

While local governments are able to introduce certain local taxes,¹ in practice, the opinion of the peers is that the local tax base is insufficiently diversified, relying predominantly on one source, and significant territorial imbalances in revenue-raising capacity exist. On the other hand, other sources appear to be under-exploited or were centralised recently.

¹ Correction 25 January 2024: removed double mention of 'local'. As per the Ministry of Finance, 'Pursuant to § 1 of Act C of 1990, local governments can introduce local taxes in their area of jurisdiction by means of a council decree. In exercising this right, in addition to the business tax, local governments introduce property-type taxes (building tax, land tax), communal taxes (municipal tax, tourism tax) and, from 2015, settlement taxes.'

Recommendation: The existing local business tax could be complemented with other significant local revenue sources (e.g. property taxation, the settlement tax). This would make the local budget more resilient to change and diminish the need for equalisation. Municipalities may also need more guidance and assistance with the assessment and exploitation of their tax base, and with the enforcement of existing rules, in order to achieve a higher yield.

Priority area 2. Inter-governmental transfers, the equalisation mechanism and improvements to the solidarity contribution

There is a high dependency of local authorities on grants and transfers from the central budget; no shared taxes exist. There is also a low level of institutionalisation of the mechanisms for determining, valorising and developing the financial resources of local governments. The current, task-based model of transfers from the centre creates rigidity, appears to be difficult to understand by local stakeholders and creates disincentives for autonomous decisions at the local level.

Recommendation: Alternative models of non-earmarked grants, tax sharing and equalisation may be considered in order to increase the transparency, predictability and trust in the system. One such consideration could be the restoring of the PIT sharing which existed before 2014, with a percentage to be determined after tax simulations. The sharing could be origin-based or distributed on the basis of a clear and simple set of criteria. Likewise, Hungarian stakeholders should consider reducing the size of the solidarity contribution and transforming it into an equalisation fund, in parallel eliminating the net negative effects of its operation for some of the local governments affected.²

Priority area 3. The system of data collection and analysis

Several important information systems exist at the central level that contain key data relevant to policy-making, planning, implementation and performance monitoring on local finances and service provision. The Hungarian authorities are keen to develop these systems further, increasing interoperability and expanding their use, for instance by incorporating a set of early warning indicators to be used by various state and local institutions. At the moment, the analytical capabilities of these systems still have limitations due to technological platform challenges, by the way their user access has been designed and the insufficient territorial coverage.

Recommendation: To meet the goals of better data coverage, reliability and accessibility, continuous improvements to the information quality and user-friendliness are recommended, plus some steps in the direction of database inter-operability and data exchange. Continued investments are also recommended into the IT infrastructure and database design. TÖOSZ is currently in close dialogue with central level authorities concerning the improvement of data access and use for local government stakeholders. This should intensify and ideally bring other local government associations around the table. In the near term, the recommended focus for the development of user-side tools is on

² In response to the final draft of this report, the Ministry of Finance noted that the 2013 local government task and financing reform moved the resources for care along with the tasks transferred to the state. For this reason, the return of the sources is not viewed as justified or possible. In the view of the Ministry of Finance, changing the municipal solidarity contribution system cannot be supported as it ensures the equalisation between municipalities with different financial situations and contributes to a large extent to the performance of mandatory tasks in those settlements where there is no possibility for a sufficient amount of business tax revenue.

a list of top priority analytical benchmarks and indicators that are immediately useful to local governments and associations; a list that can then be gradually expanded.

Priority area 4. The platform for dialogue between central and local governments

A National Cooperation Council of Local Governments (ÖNET) was set up to pursue the dialogue between central and local authorities on legislation and programmes with impact on the local government system. In parallel, specific forms of cooperation and a professional dialogue exist between the associations and the representatives of the Ministry of Finance and Ministry of Interior, especially at the technical level. In contrast, the consistency and impact of the interaction with the line ministries were described as suboptimal in discussions with the PRT.

Recommendation: The PRT recommends the strengthening of the framework for formal consultation between central and local authorities and the intensification of local-central government dialogue, in particular with reference to the priority areas 1 and 2: the local tax assignments, the system of central transfers and fiscal equalisation.³ The structure of such consultation could be enhanced, and formalised to include thematic meetings; technical-level consultations between ministry staff and municipal associations; mechanisms to identify in early stages pieces of legislation or decisions with impact on the local level; a local governance forum, and bringing together local government associations, the MoI, MoF, independent experts, representatives from authorities of varying sizes with the mission to publish regular reports with recommendations.

Priority area 5. Assessment of the main causes of challenges and the general direction of inter-governmental relations

During the discussions with the PRT, central and local authorities agreed that over the past decade, there has been a marked re-centralisation trend in Hungary. This has also been noted in the 2021 report on the Monitoring of the European Charter of Local Self-Government by the Congress of the Local and Regional Authorities.⁴ However, central and local authorities offered differing explanations for the causes of these developments.

Recommendation: The PRT suggests that a strategic evaluation could be carried out with the participation of an independent party, on lessons learned from the transformations which have taken place in the area of local governance in Hungary over the last decade and a half. This would contribute to a shared analysis of the effects of the measures aimed to strengthen central control, in particular if the quality, economy, effectiveness and efficiency of public services have improved as intended as a result. This evaluation could offer a shared understanding of facts, and enable a number of future scenarios to be considered, possibly in the consultation framework proposed under Priority area 4.

Priority area 6. Capacity building in municipal associations and local governments

Local government associations are partners of the central authorities in improving the system of inter-governmental finance, in the implementation of relevant national plans and as well as the

³ Cf. Art. 4.6 of the European Charter of Local Self-Government

⁴ Report CG-FORUM(2021)01-03final - Monitoring of the European Charter of Local Self-Government in Hungary, Congress of Local and Regional Authorities (12 February 2021), <https://rm.coe.int/monitoring-of-the-european-charter-of-local-self-government-in-hungary/1680a129f6>

follow-up and implementation of relevant European standards⁵. With regard to the operationalisation of the points suggested in this report under Priority areas 1 and 2 (local fiscal capacity and improving the system of transfers), 3 (improvement of the data system), 4 (consultation process) and 5 (strategic evaluation), they have essential roles to play. Associations also have an important role in contributing to the continuous development of the capacity of local authorities, in areas such as leadership and strategic management, service provision, community participation and public ethics.⁶

Recommendation: Building on the collaboration that already exists among Hungarian stakeholders, the PRT recommends that local government associations continue to be part of efforts to enhance data infrastructures and access. An enhanced and more formalised role for local government associations in policy negotiations is also recommended. In this context, local government associations will benefit from continuing opportunities to strengthen their capacity to access, use and operate data systems.

Municipalities would benefit from further guidance, analytical tools and direct training to increase access and use of existing and future data systems for financial and service planning (Priority area 3). Longer-term, strategic efforts for training and capacity building at local level covering key areas such as leadership, financial and performance management, public ethics and data use are also recommended. The PRT recommends considering a dedicated effort of capacity building covering the first years of newly elected officials' mandate following the 2024 local elections, building on existing efforts by TÖOSZ and others and drawing on the relevant European standards.⁷

⁵ such as the European Charter of Local Self-Government and relevant Recommendations of the Committee of Ministers of the Council of Europe including CM/Rec(2023)5 of the Committee of Ministers to member States on the principles of good democratic governance.

⁶ Cf. Recommendation CM/Rec(2007)12 of the Committee of Ministers to member states on capacity building at local and regional level

⁷ In particular CM/Rec(2007)12 on capacity building (see footnote 4), and, depending on needs in specific areas, the relevant standards listed in the Explanatory Memorandum to Recommendation CM/Rec(2023)5 of the Committee of Ministers to member States on the principles of good democratic governance

https://search.coe.int/cm/Pages/result_details.aspx?ObjectId=0900001680ac77e4

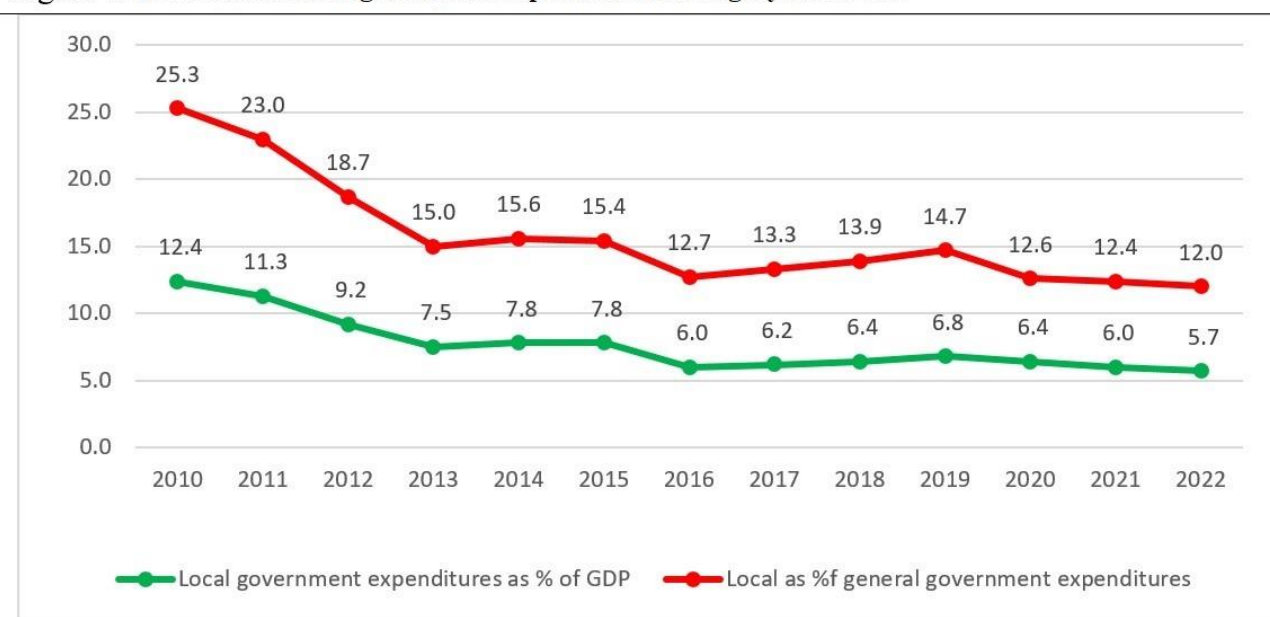
I. INTRODUCTION

I.1. Context

Hungary has a two-tier local government system, comprising 19 counties (*vármegye*) and more than 3175 municipalities.⁸ The vast majority of the latter are rural (2809) and 75% of them have less than 2000 inhabitants. On the other hand, the capital city Budapest, with a special status and organised on two levels itself, hosts almost 27% of the population of the country in its metropolitan area (and 18% in the city proper). What results is therefore a fragmented territorial structure, with large cities and small villages being treated more or less equally under the law, a reflection of the natural quest of communities for freedom of decision after the fall of Communism. The intermediary tier (counties) has always had relatively limited competences in European comparison.

The local funding model was initially organised to support this system incorporating a fair degree of local autonomy: in 2010 the local government expenditure represented more than a quarter of the total public expenditure (25.3%, see Fig 1 below⁹). It relied predominantly on transfers, in the form of general and block grants based on objective formulas. The use of these funds was largely unconditional. The remainder was made up of local own revenues and shared taxes. Capital investments were funded by matching grants and EU funds. The complex system of criteria for allocating the block grants had a pronounced equalisation effect, favouring small municipalities with low fiscal capacity. Inter-municipal cooperation was encouraged, and for municipal administration made mandatory for units with less than 2000 inhabitants after 2010.

Figure 1 The decline of local government expenditure in Hungary since 2010



Source: Eurostat

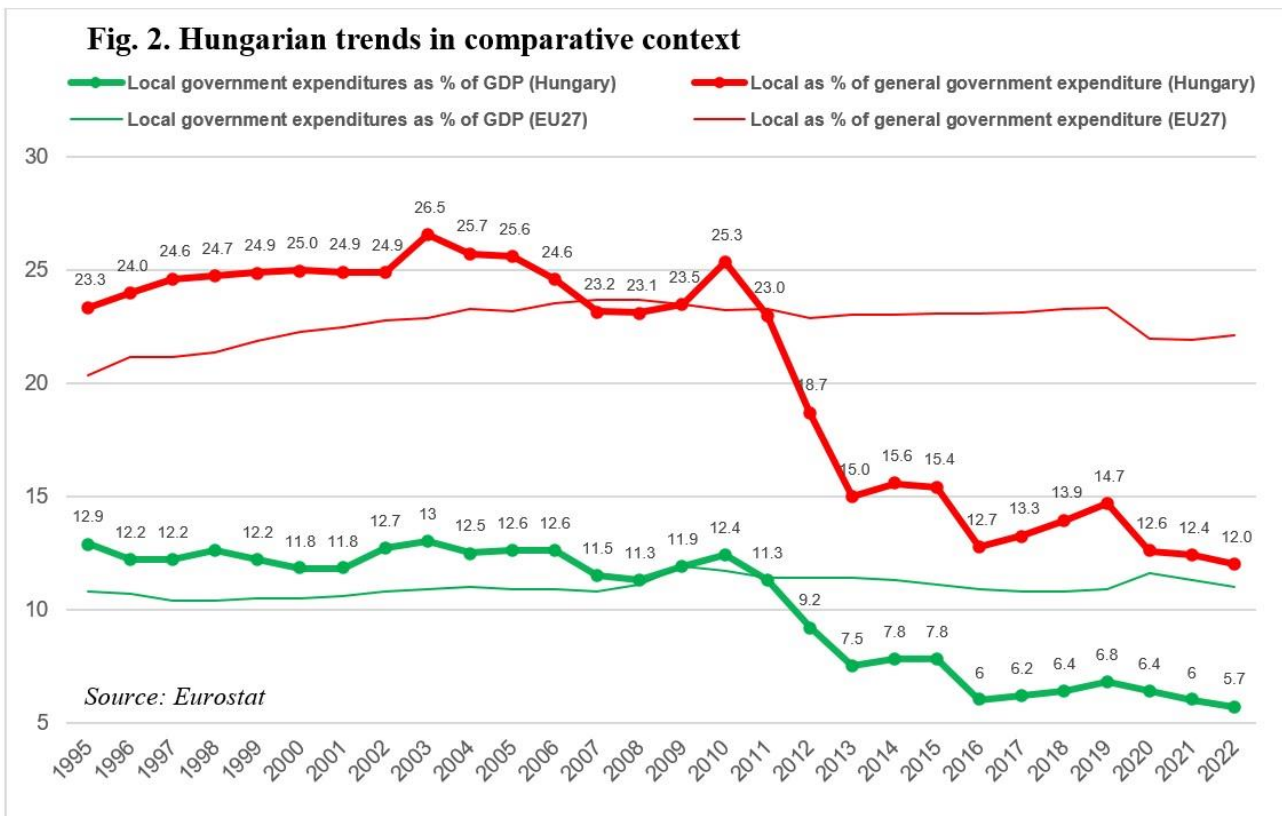
The global economic crisis of 2008-2009 came as a watershed moment: five successive quarters of severe GDP decline had a large impact on public budgets (central and local) – as happened in

⁸ Depending on the source, 3177 or 3178.

⁹ From the Technical Report (July, 2023) produced by the EU-Council of Europe co-funded project 'Local Government Public Finance Development and Municipal Capacity Building in Hungary'.

most European countries at the time – for which the fragmented Hungarian municipal system was ill-prepared. The new government taking office in 2010 felt the need to gradually re-centralise some costly functions (education, health care, social assistance) and a whole list of revenues over subsequent years, quoting the weak local administrative capacity, the danger of over-indebtedness and therefore the financial risk created by municipalities perceived as being too autonomous.

The crises that occurred in the following years (Covid, energy prices) reinforced the trend: by 2022 the local share of total public expenditure dropped by more than half, to 12% (Fig 1). This compares unfavourably with the developments in the rest of the EU (Fig. 2). The sharing of the PIT was abolished, while the rest of the transfers became largely conditional, task-based, a change which decreased the margin of local decision making. Municipal borrowing was made subject to central screening and approval. In general the legal, administrative and financial supervision of the municipalities through various deconcentrated bodies was strengthened.



Since 2017, the main own source of municipal revenue, the local business tax, has been partly centralised in the form of a mandatory solidarity contribution as a general purpose national budget revenue. Its share to Local Business Tax quadrupled from 5.9% of the receipts collected in 2020 to 23% in 2024. Budapest and its districts generate 45.1% of this solidarity contribution. The way the mechanism is designed makes some larger municipalities contribute more than they receive from different types of transfers, which is to say that they have become net contributors to the central budget.

In spite of the efforts to ensure a balanced distribution of resources across the territory and a task-based compensation of the costs of services, the steady erosion of the total pool of local finance creates challenges for the delivery of the remaining municipal services in many small and medium-sized local authorities, even after many services were transferred to the intermediate or central levels.

The central government has set up a National Cooperation Council (ÖNET) of Local Governments with an advisory role to pursue dialogue and to consult with the municipalities and their associations whenever national legislation has an impact on the local government system.

Hungary has also created various data systems and platforms of relevance to local government stakeholders, such as ASP and the Municipal ASP to manage key local government functions; the Hungarian State Treasury's budgetary management system KGR-K11; the ambitious IKIR system, a data platform operated by the Ministry of Interior which contains a range of statistical and financial data on and for local governments from multiple official sources; and other sector-based information systems. One of the objectives of the present EU-Council of Europe co-funded project, detailed below, is to design and test develop a platform that will draw on these source systems to enable local governments to access and use data and information on key performance indicators for financial and service planning and management.

I.2. The EU-Council of Europe Project

The European Commission (DG REFORM) under the Technical Support Instrument and Council of Europe co-funded project *Local Government Public Finance Development and Municipal Capacity Building In Hungary* aims to support the strengthening of administrative and financial capacity of the municipalities in Hungary, by assisting the Hungarian authorities to improve the institutional framework related to the good democratic governance of municipalities; and to improve awareness, knowledge and skills of relevant authorities on good democratic governance.

These aims are in line with the national authorities' commitments in the *acquis* of the Council of Europe and in the Recovery and Resilience Plan and the 2021 National Reform Programme to enhance cooperation and the quality of public administration at regional and local levels, and to advance the digitalisation of the public administration.

To meet these goals, the Centre of Expertise for Good Governance of the Council of Europe (CEGG) deploys tools such as the Peer Review, the delivery of a Policy Advice, and the implementation of instruments like the Local Finance Benchmark (LFB); the Public Ethics Benchmark (PEB) as well as a series of capacity development efforts in the context of the Leadership Academy Programme (LAP) and the European Label of Governance Excellence (ELoGE), among others. As highlighted above, the design and test development of a local government data platform and support for local-central dialogue are key components of the project.

This report following the Peer Review mission – with a mandate on *Intergovernmental Fiscal Relations, Data Access and Use, and Local-Central Policy Dialogue* is focused on a broad area of policy identified as a priority during the consultations with the Hungarian authorities: the fiscal decentralisation process and the institutional and fiscal framework at the local level. In addition, special attention is paid to the integration of the information system components related to financial and statistical data of local governments, in order to provide access to a comprehensive and structured set of data and allow their analysis, including benchmarks and performance indicators.

The project is implemented in coordination with the main project beneficiary, the Hungarian National Association of Local Authorities, TÖOSZ), the Ministry of Interior, Ministry of Finance and the European Commission (DG REFORM) as well as other Hungarian implementation partners and stakeholders at central and local levels.

I.3. The Peer Review

The rationale of the Peer Review

The Peer Review process has been developed by CEGG as a tool to provide assistance and advice to member states in preparing, adopting or implementing reforms aimed at strengthening good democratic governance at all levels of government.¹⁰ A Peer Review is essentially an intergovernmental exercise enabling colleagues from other European governments who have carried out similar reforms and legislative changes to offer information and good practice examples, and to provide friendly advice to the requesting authority. It encourages the sharing of alternative perspectives on the issues raised by the host institutions, as well as recommendations on possible solutions to them following a series of meetings and frank discussions in a confidential environment with the local officials.

The discussions during the Peer Review mission revolved around a comprehensive set of issues which were identified in advance in cooperation with the Hungarian authorities. These issues are grouped in six clusters and presented in Annex A2. The main area of interest for the national partners consists in the structural problems of municipalities and their relations with the central government and intermediary tier; the details of the intergovernmental financial relations and related challenges, the quality of the local financial management; the municipal data infrastructure used to inform policy; and the process of inter-governmental dialogue and consultation. During the debriefing session concluding the Peer Review visit, it was agreed that the impact of the recent global crises (Covid, energy prices), while important, would not be covered in detail in the report.

The Peer Review mission in Hungary

The Peer Review meetings took place from the 12th to the 14th of September 2023 in Budapest. The peers received in advance a set of background documents which included key Council of Europe documentation, a description of the Hungarian local government system, the budget practice and inter-governmental financial mechanisms, the current trends in revenue and expenditure, as well as various materials produced by the project such as on data availability.

The Peer Review Team (PRT) included the following national experts:

- Dr. Marek Jetmar, Head of the Unit for Territorial Public Administration, Ministry of Interior, Czechia
- Myles Binney, Head of Oflog Policy and Sponsorship, Department for Levelling Up, Housing and Communities, United Kingdom
- Thomas Prorok, Managing Director, Centre for Public Administration Research, Austria
- Martin Valentovič, Senior Fellow, MESA10, Slovakia
- Dario Runtić, Government Relations and Public Policy Advisor for public finance and ICT, Special Advisor to the Minister of Finance, Association of Cities, Croatia
- Markku Mölläri, Ministerial adviser, Department for Local Affairs and Regional Administration, Ministry of Finance, Finland (written input)

¹⁰ For a detailed description of the methodology see: Democratic Governance Division, Council of Europe (2022): PRP – The Peer Review Process – Member States Helping Each Other, <https://rm.coe.int/the-council-of-europe-peer-review-member-states-helping-each-other-/1680a6e819>

The CEGG Team was made up of:

- Dr. Sorin Ioniță, president of Expert Forum, Romania: Council of Europe expert, Peer Review facilitator & report author
- Conrad F. Zellmann, Senior Project Officer at CEGG, project manager
- Liubov Podtykan, Project Assistant, CEGG

The outline agenda of meetings is presented in Annex A1. At the beginning of the mission all peers made structured presentations of the situations and systems in their own countries, addressing the main issues of interest mentioned (Annex A2). The main government counterparts and the project beneficiary were consulted in a series of frank discussions and with the active participation of all the peers. Local government representatives were present in some of these meetings, as well as in dedicated sessions. All discussions were held under the Chatham House rule.¹¹

I.4. Purpose of this report

This post-mission report is the main deliverable of this component of the project, written for the main beneficiary (TÖOSZ) and the national partner authorities, the Ministry of Interior and Ministry of Finance. It integrates the main data, concerns and opinions shared during the meetings, plus additional desk research.

The report also summarises the conclusions reached by the peers during their visit and presented in preliminary form in the debriefing session to the national partners. A reordering of the initial topics was operated to better reflect the emphasis of the discussions and additional issues identified during the visit. There are now six broad priority areas across intergovernmental financial relations, data access and use and local-central dialogue. The remainder of this report follows this structure. The examples and advice drawn from the countries included in the exercise as a reference are organised accordingly.

The report offers recommendations for consideration in each of the six areas of interest. These are closely aligned with the provisions of the European Charter of Local Self-Government (ETS No. 122), in particular Article 9 concerning financial resources of local authorities as well as relevant other European standards and reports, in particular:

- CM/Rec(2004)1 - [Recommendation of the Committee of Ministers to member states on financial and budgetary management at local and regional levels](#) (8 January 2004)
- CM/Rec(2005)1 - [Recommendation of the Committee of Ministers to member states on the financial resources of local and regional authorities](#) (19 January 2005)
- CM/Rec(2007)12 - [Recommendation of the Committee of Ministers to member states on capacity building at local and regional level](#) (10 October 2007)
- CM/Rec(2023)5 - [Recommendation of the Committee of Ministers to member States on the principles of good democratic governance](#) and its [explanatory memorandum](#) (6 September 2023)

¹¹ The Chatham House rule stipulates that 'When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.' See: The Royal Institute of International Affairs (2023): Chatham House Rule, <https://www.chathamhouse.org/about-us/chatham-house-rule>

- Report CG-FORUM(2021)01-03final - [Monitoring of the European Charter of Local Self-Government in Hungary](#), Congress of Local and Regional Authorities (12 February 2021)

II. PEER REVIEW FINDINGS

II.1. General remarks

The PRT found a fair degree of consensus among stakeholders on most of the problems and obstacles faced in the local government system in Hungary, in particular in the area of local finance. There tends to be less agreement however when it comes to the deep causes of these problems, or the ways to address them. Several core points emerged from the discussions during the Peer Review visit and they will form the basis for the more detailed proposals in the following sections; these can be summarised as follows:

- No major structural changes are planned to the local system in Hungary in the foreseeable future, and so the PRT's recommendations on local finance will have to be applicable in the existing territorial design. The majority of small rural municipalities, and a significant proportion of the smaller towns, are likely to continue experiencing a shortage of fiscal capacity and expertise. The inclination of central authorities in such cases will likely be to rely on deconcentrated offices for service provision, and encourage inter-municipal cooperation.
- Since no systemic reforms are currently contemplated by the central government, gradual changes will predominate; it is therefore important to ensure their coordination and consistent implementation over time, to make sure they all pull in the same direction; whenever possible, new ideas should be piloted first and scaled up afterwards.
- Like many other Council of Europe member States, Hungary may continue to face inflation pressures and a certain budget squeeze in the next period. The need to keep the deficits under control prevent a significant expansion of public expenditure, including at the local level, and so the solutions proposed must be by and large fiscally neutral vis-à-vis the general consolidated budget.
- It was agreed by all stakeholders that the incentives for local fiscal effort and sound budget management at the local level are crucial for an effective deployment and use of financial resources. This principle, reflected also in Principle 10 'Sound financial and economic management' of the Principles of Good Democratic Governance, should be incorporated in all the corrections applied to the inter-governmental finance.¹²
- The predictability, stability and legitimacy of the inter-governmental transfers is of paramount importance, and all the more so since they are and will most likely remain the dominant source of the local budgets. However, it is difficult to quantify and measure the precise local need for every delegated competence at the municipal level, as the current task-based mechanism attempts to do; a simpler system of tax sharing and normative grants, based on a smaller number of indicators and more local flexibility in spending the funds, may go a long way towards meeting the goals of predictability, stability and transparency (and hence, legitimacy).

¹² Cf. Explanatory Memorandum to Recommendation CM/Rec(2023)5 of the Committee of Ministers to member States on the principles of good democratic governance, including the Annex referencing the most relevant Recommendations of the Committee of Ministers and the Congress of Local and Regional Authorities https://search.coe.int/cm/Pages/result_details.aspx?ObjectId=0900001680ac77e4

- There is agreement between national and local authorities that a good data system to monitor performance in municipal services is essential for the overall policy design, for benchmarking across territorial units and for the transfer of good practices between municipalities; it can also improve the accountability to the wider public. The data system would be best used not for the centralised micro-management of local budgets, but mainly for informing the policy design and decision-making.
- A mechanism for consultations which is highly visible, fairly representative and credible is necessary to facilitate decision-making on policies with an impact at the local and regional levels; measures which sometimes may be unpopular may thus be more easily understood and accepted, increasing the predictability of the whole system of multi-tier governance.
- In the view of a number of the stakeholders during the Peer Review meetings, it would be important to determine objectively if the centralisation of various tasks has improved the quality, reduced the unit costs of local services, and decreased the reliance on debt. Ideally, a minimal level of agreement between national and local authorities could be achieved concerning the root causes of the difficulties experienced by the local government system over the past decade and a half, in order to move towards agreed solutions.
- The areas of concern addressed in this report are resonant with the findings of the report adopted by the Congress of Local and Regional Authorities in 2021.¹³ The most important aspects are listed in Recommendation 451 (2021), Article 4 which highlights the limited scope of own and delegated competences of local authorities; insufficient local resources to match responsibilities; grants to local authorities are mostly earmarked for financing specific projects and the criteria of assignment are not objective; no real and appropriate consultation mechanism in place on all matters that concern local authorities, notably on redistribution and allocation of financial resources.

¹³ Report CG-FORUM(2021)01-03final - Monitoring of the European Charter of Local Self-Government in Hungary, Congress of Local and Regional Authorities (12 February 2021) <https://rm.coe.int/monitoring-of-the-european-charter-of-local-self-government-in-hungary/1680a129f6>

II.2. Priority areas and recommendations

Priority area 1. The local tax base

Own source revenues in Hungary make up about one third of local budgets, close to the OECD average. However, it emerged from the discussions with local government stakeholders that the local tax base is insufficiently diversified, relying predominantly on one source, the local business tax (LBT), which generates 80% of the local tax revenues and almost 32% of the total local revenues.

This type of source generates significant territorial imbalances, because it tends to accumulate in the main business growth poles, and fluctuates over time with the business cycle. In the post-Covid period, due to the pick-up of the economic activity, this can be buoyant and attractive revenue type, and even more so since the burden falls on businesses and not on individual citizens. However, in case of economic slowdown, it may lead to serious downturns in revenue in the local finance system. The uneven territorial distribution of the LBT collection also creates the need for substantial equalisation in the second step. On the other hand, other revenue sources appear to be under-exploited (the tax on land and buildings) or were centralised (the vehicle tax). The cases in textbox below offer alternative examples for the structure of local revenues from the peer countries, which could be considered in further discussions in Hungary.

*In **Croatia** own source revenues at the local level are a mix of communal fees (infrastructure maintenance fee), surtax on the personal income tax (PIT), tax on motor vehicle and boats, tax on gifts and inheritance, tax on the second home, tax on use of public space, asset lease and rent revenues, etc. None of these sources is dominant: communal fees provide 39,5% of own source revenues, asset rental 19,5% and surtax 14,7% of the same total. Some local taxes are highly regulated, such as those on vehicles, boats, inheritance; some are regulated but uncapped, like the communal fee; and some are less regulated and uncapped (public space).*

***Finland** has municipalities with strong self-government in terms of administration and finance, in spite of the fact that the local taxes are collected in a unified manner by the central government on behalf of local authorities and distributed accordingly. Under this system, the control of budgets under national law is strict and the indicators of local finance are easy to monitor. Financial mechanisms exist to balance municipal finance in some respects, but over time these have lost relevance as the problems and needs of the local communities have become more diverse. There is a permanent concern to balance, on the one hand, the liberty of municipalities to maneuver and innovate, and on the other hand the systemic incentives for municipal amalgamation or deepened co-operation in specific domains. Inter-municipal cooperation (IMC) has potential, which is only partially realised in practice, and the mergers of small municipalities have also not always been very efficient. This happened because the preparation of IMCs or mergers is hard work and involves a fair amount of local expertise and upper-level control.*

The differences between municipalities have increased in the last years, while the large cities are increasingly confronted with specific problems. In response to these challenges, the decision was to encourage the Nordic culture of experimentation, based on the local and regional freedom to implement gradual changes. Controlling the level of debt remains essential. The real estate owned by municipalities and the property tax base corresponding to private housing became today hot issues, especially in those areas where the value of houses is declining. City investments have also caused some excessive debt development in some parts of the country.

*In the **UK**, local authorities have three main primary sources of revenue: government grants, council tax levied on residential properties and business rates levied on business properties. In 2019/20, before emergency Covid funding, authorities received 22% of their funding from grants, 52% from council tax and 27% from retained business rates.*

Authorities are able to borrow and invest but are legally required to balance the budget each year. It is common practice to build reserves to increase their financial resilience and ensure budgets can be balanced. The Localism Act 2011 permits local authorities to set their own council tax rates. An authority can increase the tax rate. An increase of greater than 3% must be supported by a referendum.

Recommendations

The decision makers in Hungary may want to consider complementing the business tax with other local revenue sources such as revenues from local government owned assets, property taxation, leveraging the settlement tax or devolving the motor vehicle tax. This would be in line with Article 9.4 of the Charter, stating that ‘The financial systems on which resources available to local authorities are based shall be of sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.’ Further details about how these requirements are to be operationalised are offered in Rec(2005)1 on financial resources at local levels,¹⁴ in particular Section 3 (Local taxation guidelines).

The diversification of own source revenues would help local governments weather the economic contractions and assist with better predictability of revenues, due to the immovable nature of property subject to taxation. The motor vehicle tax may be of particular importance for vulnerable local governments or rural municipalities with limited business presence and insignificant business tax revenues, but still have some tax base due to presence of private vehicles.

In addition, municipalities need more guidance and assistance with the assessment and exploitation of their tax base, and with the enforcement of existing rules, in order to achieve a higher yield. The Hungarian authorities may consider carrying out an assessment on why local taxes are not used more in practice if local governments have in principle the right to levy them. An evaluation could be useful at the national level to see if the property tax is indeed under-exploited, as well as a local level evaluation to determine why the flexibility to expand the local tax base is not used more in practice if local governments have in principle the right to act in this respect. A more balanced mix of own sources would also reduce the need to equalise finances across municipalities with transfers from the centre.

¹⁴ CM/Rec(2005)1E - Recommendation of the Committee of Ministers to member states on the financial resources of local and regional authorities (19 January 2005), https://search.coe.int/cm/Pages/result_details.aspx?ObjectID=09000016805db09e

Priority area 2. Inter-governmental transfers, the equalisation mechanism and the solidarity contribution

Compared to other European countries, the Hungarian system of financing local governments is characterised by a high dependency on grants and transfers from the central budget and the absence of shared taxes. According to the stakeholder discussions during the Peer Review, there is also a low level of institutionalisation of the coordination mechanisms for determining, valorising and further developing the financial resources of local governments. The current task-based model of transfers from the centre creates some rigidity at the local level, disincentives for autonomous decisions, and based on the feedback received by the Peer Reviewers, appears to be difficult to understand by some stakeholders due to its complexity.

The task-based grants are in principle meant to compensate municipalities for the cost of a whole list of municipal services. However, according to the discussions during the Peer Review, this is only the case for some services (public lighting, road maintenance); for many others the transfers are reportedly not in line with the actual costs in many types of municipalities. What is more, the high inflation of the last years and the fact that the cost adjustments for some types of inputs were operated as far back as 2013 make the reforms urgent.

Although heavy reliance on government grants is not uncommon in centralised states, such fiscal arrangements may generate negative consequences, reducing local autonomy and discouraging innovation in service provision, the efficient use of available funding or efforts to raise own revenues. Setting minimum level standards and accompanying these with shared tax arrangements and minor service level equalisation grants could stimulate local governments to use available funding more efficiently and combine these with own source revenues. It would also encourage innovative approaches to service delivery and the effort to achieve higher standards of service with minimal budget costs overall.

Austria enacted a Fiscal Equalisation Act (FEA) which represents a well-established and accepted instrument for equalisation under which the fiscal relations between the three tiers of government are determined. It is negotiated every four years between the three tiers of government and it regulates the distribution of revenues, defining the amount allocated to each tier of government. The FEA covers a broad range of issues, dealing with the assignment of sources and the distribution of sums from (i) the own taxes; (ii) shared taxes; (iii) transfers. Most of the revenues, with the exception of local taxes, are levied by the federal level which in the second step allocates the proceeds from shared taxes to municipalities. The allocation is determined by one main rule – the tiered population scheme – according to which urban municipalities with a larger population receive a larger share of the revenues, in order to compensate larger local governments for their additional expenses as urban centres.

The result is that the most important source for the Austrian municipalities are the shared taxes, which have represented most of the time at least 40% of total local government revenue. Among the shared taxes, the most relevant are the value added tax (VAT), personal income tax (PIT) and the corporate income tax (CIT). The most relevant local taxes are the municipality tax and the property tax. The first is a type of business tax paid by companies based in Austria and is determined as 3% of the total amount of wages; the second is levied on individuals owning property. Fees represent the remainder and are mainly generated in the process of providing public services and utilities.

In **Croatia** the central government is setting minimum standards for municipal services which are funded with a PIT share going up to 6%, split as follows: 1.9% for primary education, 1.3% for secondary education, 0.8% for social care, 1% for health care and 1% for fire protection. This is complemented with a government grant based on specific service indicators: number of pupils or classes, service area, etc. There is also a non-earmarked fiscal equalisation system in place providing about 7% of total subnational revenues, aimed at addressing regional fiscal disparities. The broader target is to equalise a 5-year average tax revenue per capita in municipalities, by closing the gap between the real level achieved and the target. For individual municipalities, the equalisation grants range from zero to amounts in excess of 100% of total local government unit revenues. The formula is based on the total potential yield of several local taxes at maximum rates, irrespective of actual rates set by the local government, in order to discourage a “race to the bottom” among local governments who are primary beneficiaries of fiscal equalisation.

In **Czechia** most of the total tax revenue of municipalities and regions is generated under Act No. 243/2000 Coll., dealing with taxation planning (RUD). The main principle of the RUD system is mutual solidarity resulting from the definition of the tax shares belonging to municipalities and regions. The national taxes used for sharing are VAT, Business tax (entrepreneurs), Corporation income tax (CIT) and Personal income tax (PIT).

The RUD is thus a statutory mechanism for sharing tax revenue proceeds between the state and local governments in good times, but equally for sharing the burden in the event of a downturn (together in “good and bad times”). Thus, under a given scheme, both positive and negative effects from so-called shared taxes should be spread between the state, municipalities and regions.

Currently, the ratio of the distribution of revenue between the state budget, regions and municipalities is 64.38% / 9.78% / 25.84%. The fractions may change slightly over time. The real estate tax and CIT from companies 100% owned by municipalities are the exclusive tax of municipalities. The consumption taxes are not covered by the RUD mechanism, as their revenues are income of the central budget only.

The main benefit of this arrangement is to keep the budgets of all the tiers in lockstep. The mix of revenues and the different sensitivity of taxes to economic cycles or bouts of inflation makes individual budgets more stable and connected across tiers. However, in practice the enforcement of this principle is not as strict. Sub-national authorities have repeatedly refused to bear their share of the burden when revenues drop, for instance when the so-called super gross wage was abolished after 2021. In general, local governments have rejected those adjustments to RUD which were affecting negatively their budgets.

On the other hand, to meet the priority of consolidating public finances as part of the consolidation package, the government recently proposed a reduction of the shares going to municipalities and counties. Thus they will not benefit from the increase in collection due to the sub-measures proposed in relation to CIT and PIT, which will accrue to the central budget only. An increase of the property tax is proposed in compensation, with the idea of having a neutral impact on local budget revenues overall.

A detailed description of the experience in **Slovakia** with regard to tax sharing and equalisation is available in Annex 3.

Recommendations

Alternative models of non-conditional grants, tax sharing and equalisation may be considered in Hungary in order to increase transparency, predictability and trust in the system. This would be in line with Articles 9.1, 9.2 and 9.7 of the Charter which call for 'adequate financial resources for local authorities, commensurate with their responsibilities' and mention that 'as far as possible, grants to local authorities shall not be earmarked for the financing of specific projects'. Further, these recommendations align with Rec(2005)1,¹⁵ in particular Section 4 on Financial equalisation guidelines. Moving away from the task-based model of transfers would also be in line with Principles 7 (Efficient, effective and sound administration) and 10 (Sound financial and economic management) of the Principles of Good Democratic Governance.¹⁶

A review of the task-based funding model could be operated during a transition period of two-three years, following thorough analysis and tax simulations. Any changes should be based on: (i) a careful reconsideration of which services should be categorised as mandatory; (ii) an evaluation if the previous years' allocations were sufficient to cover the mandatory costs, and how much of these were paid from the local own revenues; (iii) consultations with authorities of different sizes, independent local budget experts, plus a wider online public debate.

As a result of these steps, the peers are of the opinion that:

- The solidarity contribution could be reduced in size and transformed into a proper equalisation fund, in parallel eliminating the net negative effects of its operation for some of the local governments. The functioning of the total system of transfers should in the worst case be neutral for those municipalities which are the main contributors to the equalisation mechanism.
- In the short term, the solidarity contribution could be made more transparent in terms of destination and purpose: the few dozen municipalities which generate it should at least be able to see where it goes. This can be implemented without much effort and would meet the requirement of Art. 41 in Rec(2005)1: 'local authorities should be provided with appropriate information about the way in which equalisation systems work, for they cannot accept a system with which they are unfamiliar or which they do not understand'.
- The Hungarian authorities should consider restoring PIT sharing which existed before 2014, with a percentage which remains to be determined from tax simulation scenarios, in accordance with Article 14 of Rec(2005)1, that 'shared resources of local authorities should primarily consist of non-earmarked additional resources and/or non-earmarked shared proportional resources decided by a permanent law.'
- Shared taxes could be distributed based on the fiscal capacity of municipalities or based on a set of objective and transparent criteria. There are various options to consider in designing such a system; for instance:
 - Based on the equal opportunity principle (e.g. number of elderly residents for financing social services), which also motivates local authorities to prioritise preventative care;

¹⁵ CM/Rec(2005)1 - Recommendation of the Committee of Ministers to member states on the financial resources of local and regional authorities (19 January 2005),

https://search.coe.int/cm/Pages/result_details.aspx?ObjectID=09000016805db09e

¹⁶ Cf. Explanatory Memorandum to CM/Rec(2023)5 - Recommendation of the Committee of Ministers to member States on the principles of good democratic governance,

https://search.coe.int/cm/Pages/result_details.aspx?ObjectID=0900001680ac77e4

- Based on simple cost indicators (number of pupils in schools, length of roads for local roads maintenance, etc) and a system of weighting to factor in various local situations (geographical isolation, depopulation etc)

Priority area 3. The system of data collection and analysis

The Hungarian national authorities operate several information systems with key data on local government statistics, budget execution and performance (IKIR, ASP, KGR/K11). They hold strong potential for better informing the policy decisions, to increase transparency and to facilitate a meaningful dialogue between local and central authorities.

Hungarian stakeholders are keen to further develop these systems further and to expand their use, for instance by incorporating a set of early warning indicators to be used by various state and local institutions. Access to the databases is granted to national associations of local governments and local authorities. However, the coverage and analytical capabilities of these systems are still limited in some respects due to technological platform challenges and, partly, by the way their user access has been designed. The current EU-Council of Europe project supports greater access to and use of official data sources, in particular through the design of user-side analytical tools that can assist local financial planning, decision-making and service delivery.

The conversations on the topic of data access and use during the Peer Review meetings were particularly interesting and productive. The PRT noted both significant efforts by the Hungarian authorities to invest in data systems like IKIR as well as a clear willingness for collaboration across different stakeholder groups to promote data use. The need for increased coverage, access to and use of data on local government finances and performance was recognised by all stakeholders during the peer review process. In the context of the recommendations in this report, these will be highly beneficial, e.g. for a review of the current system of inter-governmental transfers, and any improvements to the equalisation system.

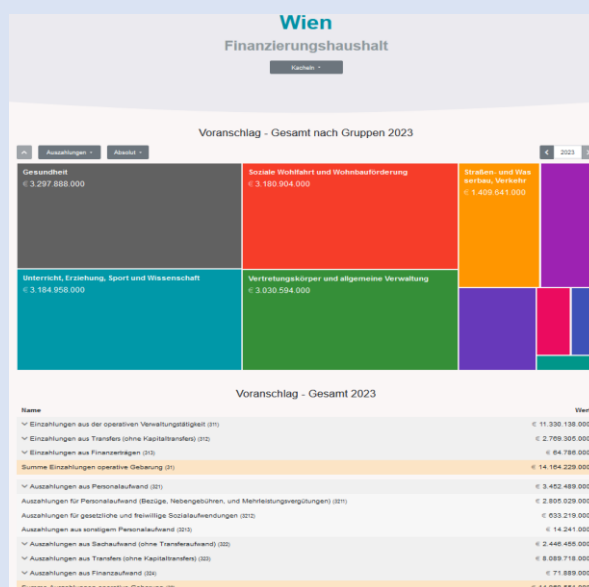
Further investments and improvements to the existing mechanisms of data collection, sharing and analysis will strengthen the positive impact they can have through increased data use. At the moment, access and user-friendliness of authoritative financial or performance data for the local governments is still considered insufficient by various interlocutors during the Peer Review meetings. The main challenges are (i) limited access rights for all stakeholders (ii) the usability is sub-optimal, and (iii) some local authorities are not within the scope of fiscal data. However, data systems such as IKIR and the KGR/K11 system of the State Treasury have strong potential for the central government, the local governments and the local government associations. They are key to developing user-friendly data and analytical tools for local governments.

In **Austria** municipalities report their budgets to the states (Länder), which in turn deliver these reports to the Ministry of Finance and the Federal Statistics Office, where they are aggregated and checked for quality of data. An electronic dataset of all the spending data can be purchased at Statistics Austria; more recently this data is made available to Open Spending Austria in case the individual municipality consents (www.offenerhaushalt.at).

The portal not only makes spending data available online; it also provides several types of interactive data visualizations that make it easier for both local government officials and citizens to understand municipal budgets. The main features available for each municipality are:

- tree map of spending data according to political (functional) classifications (i.e., where does the money go?) including the corresponding economic classifications (i.e., what are the types of expenses?)
- chart with detailed view of the budgets over a 23-year timeline;
- chart of the debts and liabilities;
- donut chart simulating the use of EUR 1,000 of tax money;
- Key Financial Indicators: a systematic approach of the financial soundness of the municipality according to sub-indicators displayed in bar charts:
 - Quota free financial top (cash)
 - Self-financing ratio (cash)
 - Debt duration
 - Debt Service Ratio
 - Net result ratio (accrual)
 - Net Asset Ratio (accrual)
 - Substance retention rate (accrual)
- the possibility to download spending data for each year in CSV format for further reuse (CC-BY license)

The introduction of the accrual accounting system in Austria as of 2020 made it necessary to implement a major reshaping of the platform. Besides the cash flow statement, an income statement and a balance sheet statement have been included.



Croatia created an Open Data Portal (<https://data.gov.hr>) which is used by national and local governments to provide various data sets to the wider audience for processing. The Ministry of Finance publishes disaggregated local government financial reports (revenue and expenditure, balance sheets) on their web site (<https://mfin.gov.hr/istaknute-teme/lokalna-samouprava/financijski-izvjestaji-ijp-r-s/203>).

The Ministry of Finance (including State Treasury and Tax administration) also offers to the Association of Cities (AOC) a wide range of raw data and financial reports, on a regular annual basis or on request. The Association uses various tools and platforms for processing and analyzing such information. Local governments also have access to Tax Administration data on property transactions (per request) and instant access to various citizen records, vehicle records and individual personal income records.

In **the UK**, local authorities report spending to the Department for Levelling Up, Housing and Communities (DLUHC) and all public spending is consolidated in national financial statements called the Whole of Government Accounts (WGA)*. HM Treasury uses the Online System for Central Accounting and Reporting (OSCAR) to discharge its financial management functions and to report departmental budgets for approval by the UK Parliament. Departments submit data to OSCAR on a monthly basis and key financial data is published quarterly as part of the government's transparency agenda.

The Office for Local Government (Oflog) was established in July as a new local government performance body in England. Oflog will provide authoritative and accessible data and analysis about the performance of local government and supports its improvement, to support accountability to the public and to provide authorities with comparable data. Oflog's Local Authority Data Explorer (<https://oflog.data.gov.uk/>) publishes metrics on waste management, adult social care, adult skills and finance. Financial metrics include:

- Non-ringfenced reserves as percentage of net revenue expenditure
- Non-ringfenced reserves as percentage of service spend
- Total core spending power per dwelling
- Level of Band D council tax rates
- Council tax revenue per dwelling
- Social care spend as percentage of core spending power
- Debt servicing as percentage of core spending power
- Total debt as percentage of core spending power

The Data Explorer will continue to develop with new metrics.

*<https://www.gov.uk/government/collections/whole-of-government-accounts>

Recommendations

To meet the goals of better data coverage, reliability and accessibility, gradual improvements in the information quality and user-friendliness should be implemented, and steps in the direction of data interoperability could be taken. This could include:

- Expansion of ASP to cover all budget institutions, which would help decision-making at local and central levels. This implies further investments to be made into the IT infrastructure and database design.

- Further steps towards integration, interoperability and usability of financial and service performance data through:
 - i. Continuing improvements to data coverage and quality as well as data access within existing data systems such as IKIR, KRG/K11, APS and
 - ii. Support to the development of user side tools and platforms that build on data from existing databases (IKIR, KRG/K11, APS etc) with an initial focus on a list of top priority analytical benchmarks and indicators that are immediately useful to local governments and which can then be gradually expanded.
- The Hungarian authorities may further want to continue leveraging available EU funding or specific sectoral projects to establish interoperability of data systems, in order to obtain a better understanding of the local government operations and improve its own analytical capabilities.
- The authorities may also want to consider migrating to more powerful platforms to avoid some of the operational challenges and limitations which are encountered today.
- Alternatively, some data requests could be accommodated through open data platforms, data dump publishing or providing stakeholders such as TÖOSZ with comprehensive access to raw data for their analytical purposes, on dedicated platforms or using custom tools. This line of development is supported by the present TSI project.

Local government associations like TÖOSZ are currently part of the process of discussing improvements to the data infrastructure and its use. The current dialogue should intensify and ideally bring other local government associations around the table, too. This would be fully in line with the principles of good democratic governance outlined in Rec(2023)5, more precisely Principle 6 (Openness and transparency) and Principle 12 (Openness to change and innovation).

In addition, an accelerated intergovernmental dialogue (see Priority area 4) and the establishment of joint analytical priorities and capabilities would help develop value-added data services and indicators of interest to national and local authorities. This could include data-based regular reviews of the task-based funding system or overall performance and financial arrangements for local governments in the National Cooperation Council of Local Governments (ÖNET). Another potential example would be a collaboration with the State Audit Office to help identify strengths or weak spots of local governments, or indeed burdensome regulation. This in turn may help with the prioritisation and planning of audits based on early warning indicators and risk assessments. Similar functional modules may be created for the use of various sectoral ministries and other public institutions.

Priority area 4. Dialogue between central and local governments

The Hungarian central government created a National Cooperation Council of Local Governments (ÖNET), having a consultative status, in order to maintain a dialogue with the municipalities and their associations whenever national legislation has an impact on the local government system; other stakeholders may be involved in the process, too. This is normal practice in many European countries, but the quality and relevance of this dialogue varies a lot from one place to another, or in relation to different institutions of the central government. In Hungary, there is also, according to the discussions during the Peer Review visit, a good professional dialogue between the associations and the representatives of the Ministry of Finance and Ministry of Interior, especially at the technical level, as well as specific cooperation, e.g. based on Memoranda of Understanding.

On the other hand, the consistency and impact of the interaction with the line ministries were described in the Peer Review meetings as suboptimal.

ÖNET is an important forum for the exchange of ideas and the coordination of key multilevel governance issues such as the competences, finances and cooperation of the tiers of government. This Council could have an even stronger position in the regular exchange and negotiation concerning local government competences, legislative proposals, and especially the fiscal equalisation mechanisms. This involves on the one side the technical exchange on the level of civil servants and experts, but also exchanges at the political level between ministers and mayors. The country cases below offer illustrations of different approaches to improving the relevance of intergovernmental dialogue.

*In **Austria** local-central policy dialogue is accomplished with the help of the Public sector accounting committee, the Fiscal Advisory Council and the Fiscal Equalisation Working Group which negotiates every four years the Austrian Fiscal Equalisation Act (see also priority area 2 above). The legally binding Consultation Mechanism ensures that the legislative acts with financial impact for local governments undergo consultation with the Local Government Associations before approval.*

This example is an excerpt of a longer description of the Czech system in Annex 4.

*In **Czechia**, the Government Council for Public Administration, chaired by the Minister of the Interior, was established in 2014 and is governed by a statute. It brings together central, regional and local governments; the Department for Strategic Development and Coordination of Public Administration of the Ministry of the Interior serves as its secretariat. The minister and deputy-minister of Interior chair this Council, which also includes representatives from the Ministry of Regional Development, the Ministry of Justice, the Ministry of Finance, the Ministry of Labour and Social Affairs, the Ministry of Industry and Trade, at least at the level of deputy ministers, as well as representatives from the Office of Government; the Office for Personal Data Protection; a unit from the Ministry of the Interior, which is the guarantor of the state service; the Union of Towns and Municipalities of the Czech Republic; the Association of Local Governments of the Czech Republic; the Association for Rural Renewal of the Czech Republic; the Association of Secretaries of Municipal Authorities of the Czech Republic; and the Association of Regions of the Czech Republic.*

The Council offers the government information to support the decision making on matters of public administration, and helps with the integration of departmental and national projects and processes in this sector. It is also in charge with monitoring the PAR Strategy: an annual report on the strategy and its action plan is published, as well as bi-annual evaluations on the strategy's implementation. By law, the same Council is also responsible for crucial agendas like the joint model of public administration or the PAR Strategy 2030. It does this by steering, supporting and monitoring all public reform initiatives and actions across the board, making sure the reform plans and measures are aligned. By mandate, it can also draft proposals for government decisions.

A detailed description of the Finnish local-central dialogue system is available in Annex 5.

*In **Finland**, when reforming, it is important to try to get municipalities involved in the process and build in the right expectations in accordance with the timeframe. The most important changes to the system usually take years to implement and there is a danger that the local level becomes more or less passive as things drag on. Co-operation is important, and even more so in difficult times.*

- Iron wire models must be used everywhere. Statistics are important, but even more important is to be practical, to define a few key guiding indicators early on and introduce user-friendly apps to make sure the practice picks up locally.*
- Long reports and evaluations should be also made more user-friendly with attractive layout, good summaries and traffic-light type of infographics clearly highlighting priorities.*
- Inter-municipal cooperation should encourage local specialisation and contractual sharing of such rare capacities. The scarcity of qualified personnel is increasingly a problem in all parts of the country, so this goal is essential.*

The Finnish experience illustrates painfully that when big reforms are implemented, time and a reasonable speed are important. Action should not be postponed until broad consensus and unanimity are reached; it is better to phase out reforms in smaller modules and observe how the implementation is proceeding, to learn from experience and adjust. The bottom-up and incremental approach is best.

*In the **UK**, central government has established the Local Authority Accountability Framework Review Panel, which convenes stakeholders from the local government sector to assess governance and accountability to determine whether it is fit for purpose and to provide recommendations to the Department for Levelling Up, Housing and Communities (DLUHC). The governance forum is an opportunity to gain feedback from key representatives of local government in order to inform central policy.*

The panel is attended by senior representatives from central government (DLUHC), the Local Government Association (LGA), the National Audit Office, the Local Government and Social Care Ombudsman (LGSCO), SOLACE, the Centre for Governance and Scrutiny, the Chartered Institute of Public Finance and Accountancy (CIPFA), Lawyers in Local Government (LLG) and the Association of Local Authorities' Treasurer Societies.

Central government also consults on key policy proposals which impact local government. A recent example includes new statutory guidance for Best Value Duty, which included an online consultation (see <https://www.gov.uk/government/consultations/best-value-standards-and-intervention-a-statutory-guide-for-best-value-authorities-consultation>)

Recommendations

In the view of the PRT, the framework for formal consultation between central and local authorities could be strengthened as an arena where major policy measures with impact at the local level are negotiated before final decisions are taken. In line with Article 9.6 of the Charter this includes,

importantly, the issues covered in priority areas 1 and 2 above.¹⁷ In the context of this report, the PRT considers especially relevant the consultation concerning changes in the local tax assignments, the system of central transfers and equalisation. Guidance on consultation of local authorities is also available in Recommendations CM/Rec(2004)1¹⁸ and CM/Rec(2005)1¹⁹. Improvements to the framework for consultation would also address a priority outlined in the Congress Monitoring Report 2021.²⁰

This would not only increase transparency and trust in the system, but also stabilise expectations by making clear for all stakeholders the intended course of action over the medium and long term. At the same time, the PRT commends and encourages continuation of contact and dialogue between local government actors and central ministries and its extension into domains where it was not as intense so far, e.g. concerning education, social services, and infrastructure.

As far as ÖNET is concerned, its functioning could be better structured and formalised along several lines, such as thematic meetings; technical-level consultations between all relevant ministries' staff and municipal associations; as well as 'trip-wire' mechanisms during early stages pieces of legislation of decisions with impact of the local level, to identify need and launch timely consultations.

In addition, a local governance forum could meet quarterly under ÖNET's coordination to consider the main issues facing the sector. This forum – such as the Local Finance Working Group, initiated by this TSI program – could bring together representatives from all local government associations, the MoI, MoF, reputed independent local government experts, and representatives from local authorities of varying sizes. Its mission could include:

- A commitment from the parties to identify risks and recommend mitigations;
- A quarterly, public report with recommendations.

The examples in textboxes may serve as useful models of institution-building for local-central dialogue based on quality data and shared analyses.

Priority area 5. Assessment of the main causes of challenges and the general direction of inter-governmental relations

During the discussions with the PRT, central and local authorities agreed that over the past decade, there has been a marked centralisation trend in Hungary. This has also been noted in the 2021 report on the Monitoring of the European Charter of Local Self-Government by the Congress of the Local and Regional Authorities. However, central and local authorities offered differing explanations for the causes of these developments.

¹⁷ Cf. European Charter of Local Self-Government (ETS No. 122), Article 9.6 'local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them'.

¹⁸ Appendix to Recommendation Rec(2004)1, Part I, Section Limitations on the financial autonomy of local and regional authorities, paragraph 11: 'The local or regional authority should be consulted, following appropriate procedures, prior to any measure to restrict its financial and budgetary autonomy, and it should be notified of the application and consequences of any such measure. Institutional mechanisms of regular dialogue, consultation and co-operation between the different levels of government could be created.'

¹⁹ Appendix to Recommendation Rec(2005)1, Part I Section 3 Local Taxation Guidelines, paragraph 23: 'Minimum conditions regarding the openness of decisions concerning local taxation should be laid down by law, both for central authorities (publication of information on which decisions are based, national debates, consultation of local authorities or their associations) and for local authorities (public meetings, public votes or votes by roll call, publication of key documents before meetings at which decisions are taken, etc).'

²⁰ CG-FORUM(2021)01-03final - Monitoring of the European Charter of Local Self-Government in Hungary, Congress of Local and Regional Authorities (12 February 2021), <https://rm.coe.int/monitoring-of-the-european-charter-of-local-self-government-in-hungary/1680a129f6>

In the view of government representatives, the centralisation process is described as having been necessary to address the systemic financial risk created by local authorities before the global economic crisis of 2008-2009, mainly through over-indebtedness; and the need to rebalance the level of resources and the quality of municipal services across the territory.

On the other hand, representatives of local governments challenged this narrative and pointed out that a lack of clarity exists about the objective and rationale of the centralisation process. In their view, the limitation of local financial flexibility encouraged a continual state of crisis management, and therefore did not improve municipalities' resilience and responsibility (on the contrary); and that alternative views exist of the severity and causes of the debt position before centralisation, and the extent to which the process really solved the municipal indebtedness problem.²¹

Recommendations

In the view of the PRT, a strategic evaluation with the participation of an independent party may be helpful to identify lessons learned from the transformations that have taken place in the local government system over the last decade and a half.

Such an evaluation could offer a shared understanding of facts, and enable a number of future scenarios to be considered, possibly in the consultation framework proposed under Priority area 4. From the perspective of the PRT it is important to establish a consensus among stakeholders about an interpretation of facts before further measures are taken. In this context, an assessment and management of financial risk in relation to local authorities should consider the relevant guidance in Recommendation in Rec(2004)1.²²

Relevant questions to be addressed in such an evaluation could include:

- What problems and weaknesses existed at the start of the re-centralisation process?
- How were these challenges addressed, in terms of cause-effect logic?
- What were the results of the changes operated? Is the financial risk in municipalities lower today than in the past? Have the quality, economy, effectiveness and efficiency of public services improved as a result of centralisation?
- How have the national-level programmes like 'Hungarian Village' or 'Modern Town' impacted local governments and public services?
- What were the effects of the task-based funding model since implementation?
- Have previous years' task-based funding allocations been sufficiently accurate to provide municipalities with the resources required to discharge their responsibilities?

Priority area 6. Capacity building in municipal associations and local governments

Local government associations are partners of the central authorities in improving the system of inter-governmental finance, in the implementation of the relevant actions under the 2021 National Reform Programme, the Recovery and Resilience Plan as well as the follow-up and

²¹ Indeed the chart in Annex A3 (priority area 2) shows for instance that Hungarian local governments performed no worse than the Slovakian ones, which face less restrictions, before and after the financial crisis.

²² Cf. Appendix to Recommendation Rec(2004)1, Part I, Assessment and management of financial risk, paragraphs 20-24.

implementation of relevant standards such as the European Charter of Local Self-Government and relevant Recommendations of the Committee of Ministers of the Council of Europe.²³

With regard to the operationalisation of the points suggested in this report under Priority areas 1 and 2 (local fiscal capacity and improving the system of transfers), 3 (improvement of the data system), 4 (consultation process) and 5 (strategic evaluation), they have essential roles to play.

As recognised in Recommendation CM/Rec(2007)12,²⁴ associations also have an important role in contributing to the continuous development of the capacity of local authorities, so that these have the '[...] right and ability [...] within the limits of the law to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population'²⁵. Such capacities include but are not limited to leadership and strategic management, service provision, community participation and public ethics.

In Hungary, TÖOSZ has a long history of providing capacity building interventions for local governments, collaborating in this with other associations, central government actors and international partners including the Council of Europe. In the view of the PRT, this is an important basis of expertise and experience to build and further expand on. In the discussions, the PRT also noted that investment into further strengthening the capacity of government agencies such as the Treasury would benefit collaboration.

Recommendations

Building on existing collaboration among Hungarian stakeholders, the Peer Review team recommends that local government associations continue to be part of efforts to enhance data infrastructures and access. An enhanced and more formalised role for local government associations in policy negotiations is also recommended. In this context, local government associations will benefit from continuing opportunities to strengthen their capacity to access, use and operate data systems – in order to underpin data-based policy dialogue.

With regard to strengthening local government capacity, municipalities – in particular smaller ones – would benefit from further guidance, analytical tools and direct training to increase access and use of existing and future data systems for financial and service planning, budget and operational management (see Priority area 3). Likewise expanding on existing efforts, further longer-term, strategic efforts for training and capacity building at local level could be envisaged.²⁶

Innovative activities can be also considered: an interval of a few months exists in 2024 between the local elections and the start of office for a new cohort of elected mayors and councillors. This window could potentially be used by TÖOSZ and the other associations to evaluate what types of strategic interventions would be useful to strengthen officials' skills and competences. Based on this, a longer-term, dedicated effort of training and capacity building with the newly elected representatives could be then planned, phased in during the first years of their mandate, building on existing efforts by TÖOSZ, including those drawing on relevant European standards.

²³ including CM/Rec(2023)5 of the Committee of Ministers to member States on the principles of good democratic governance.

²⁴ Recommendation CM/Rec(2007)12 of the Committee of Ministers to member states on capacity building at local and regional level

²⁵ European Charter of Local Self-government (ETS No. 122).

²⁶ Relevant areas could include leadership, financial and performance management, public ethics and emerging areas such using digital data. Cf. CM/Rec(2007)12 - Recommendation of the Committee of Ministers to member states on capacity building at local and regional level, https://search.coe.int/cm/Pages/result_details.aspx?ObjectID=09000016805d5271

ANNEXES

A.1. Peer Review Team mission to Budapest

Institutions and organisations met by the Peer Review Team

Date	Participants
Sep 12 th	Ministry of Interior, Ministry of Finance, TÖOSZ – presentations by national and local authorities and Peers, discussions
	Local government data experts
	TÖOSZ leadership, mayors of Tab, Berhida, Pápa
	Ministry of Interior
Sep 13 th	Ministry of Finance, Hungarian State Treasury
	Local government associations: <ul style="list-style-type: none">- Hungarian National Association of Local Authorities (TÖOSZ)- Hungarian Association of Local Governments (MÖSZ)- Hungarian Association of Villages (MFSZ)
	State Audit Office
	State Treasury
	Independent local government experts
Sep 14 th	Ministry of Interior, Ministry of Finance, TÖOSZ – debriefing session

A.2. Initial list of questions in the focus of the Peer Review

Based on initial conversations with the project beneficiary and the project's Advisory Group, the topic of **intergovernmental financial transfers** had been identified as the most relevant broader subject area.

1. Structural issues: There are a number of structural issues affecting the Hungarian local government system. What options can be considered to address them?

- What options exist with regard to ensuring appropriate financing of local government within highly fragmented contexts with major regional differences?
- What could be the role of the intermediary tier government (the county level) and the large county right cities in managing the presently devolved services?
- What are the lessons from re-municipalisation and nationalization policies of local utility services, such as water management and sanitation?
- What lessons can be learnt in terms of cost savings and effectiveness from the centralisation of municipal tasks, such as public education, health care and administrative services?

2. Intergovernmental fiscal relations, fiscal autonomy: How can fiscal autonomy and appropriate financing of local governments be improved in the present system?

- How does Hungary's local government revenue system compare to other country revenue structures?
- How can the local government own-source revenues (taxes, fees, charges) be evaluated against a good local revenue system?
- What are the options to ensure appropriate financing levels in the present "task-based" grant allocation system?
- How to build incentives in the intergovernmental fiscal relations for improved local autonomy and for more efficient utilisation of locally available funds?
- What are the mechanisms of controlling local borrowing and debt beyond central approval of municipal loan requests?

3. Financial management: How can financial management at local government level be enhanced?

- How local governments' involvement in capital investment planning can be enhanced under the EU funding schemes?
- What options exist with regard to improving appropriate internal audit, external supervision and audit of local finances?
- What are the lessons from diverse management forms of municipal accounts (commercial banks, central bank, treasury)?

4. Effects of Covid-19 and energy costs: How can local governments be supported?

- What are ongoing experiences with regard to supporting municipalities to overcome the centralisation effects of Covid-19 regulations in local government finances?
- In the recent period of increased energy costs how did national governments support municipalities (conditions of purchase, regulated energy market, price subsidies, etc.)?

5. Data access and use: How can access and use of data by local governments be improved?

- What experiences exist with integrating and increasing access to statistical, service performance and financial data required by local government stakeholders and the wider public?

6. Local-central consultation: How can local-central government dialogue be enhanced?

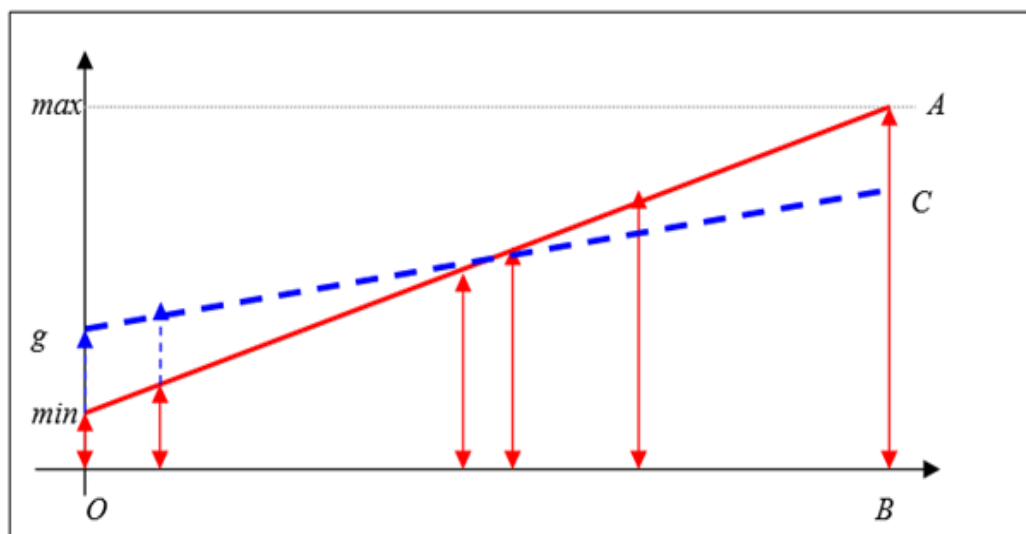
- What local-central government dialogue and cooperation mechanisms exist? What Peer experiences exist with these in areas such as annual budgeting, service regulations, capital investment planning?

A.3. Detailed example for priority area 2 – the Slovak case

How to change the equalisation mechanism

The main local tax in Hungary is the local business tax (LBT), linked to the place of origin through employment and local assets indicators. Dependence on this type of revenue is very pronounced: the Ministry of Finance expects that in 2024 LBT will represent 87% of local tax revenues. It is a revenue source notoriously sensitive to the business cycle and the differences between growth poles and laggard regions.

Therefore, the prevalence of LBT in local budgets results in high income inequalities among municipalities, which in turn requires substantial equalisation. Under the current scheme, municipalities above certain levels of per capita revenue must contribute to the central equalisation fund. This creates disincentives for the local fiscal effort in municipalities that are close or below the threshold. However alternatives do exist which do not create this effect.



Source: Nižňanský, V, Valentovič, M. „Funding of Local Self-governments From 2005“ (preparatory study, M.E.S.A.10, Bratislava,2004)

One such mechanism was developed in Slovakia during the preparatory phase of the decentralisation reform, when the idea was explored to transfer the personal income tax (PIT) to the municipalities based on their tax power²⁷. The PIT sharing produces imbalances similar to the ones generated by the LBT in Hungary. The chart above shows that a good equalisation scheme has no effect on the order of municipalities ranked from poorest to richest, but only reduces the differences between them: the red line represents the position of the local governments before equalization (ranked from poorest to the richest along the horizontal axis); the blue line represents the same local governments after equalisation. This mechanism guarantees the minimum per capita income (point “g” on the vertical axis). Each municipality is always motivated to increase its revenues, because each additionally earned sum before equalisation will remain in the local budget after the equalisation.

How to introduce tax sharing

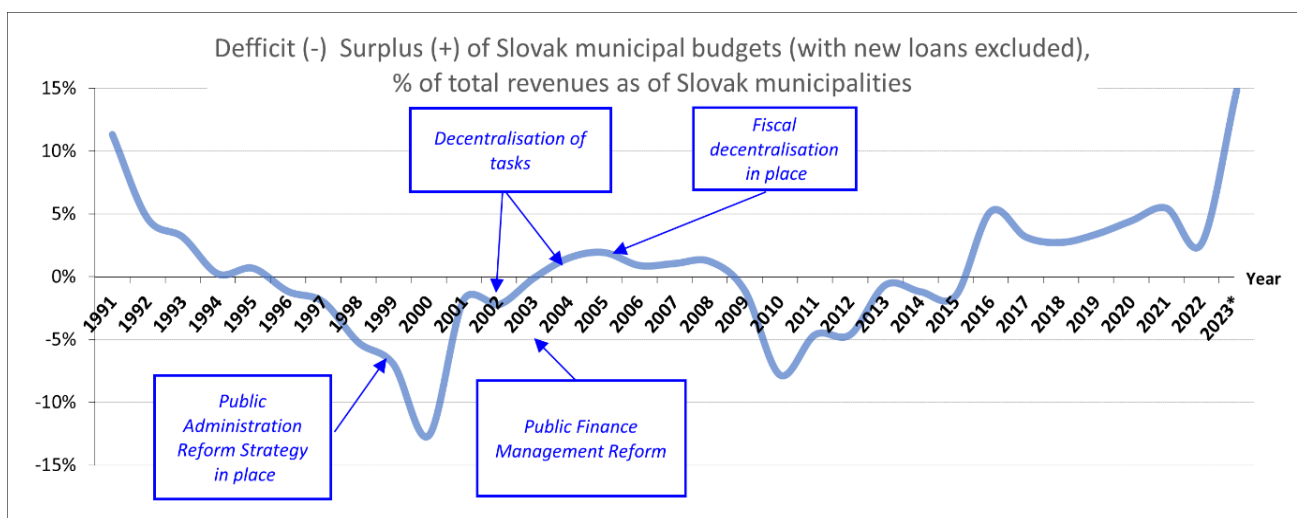
The dependence of Hungarian municipalities on the unequally distributed LBT can be reduced also by introducing tax shares, where the revenue of one or several centrally collected taxes is split

²⁷ The mechanism and its formula was published in: Nižňanský, V. – Valentovič, M. „Financing of the Local Self-governments From 2005“ (Bratislava, M.E.S.A.10 2004) - publication in Sk language only /Nižňanský, V. – Valentovič, M. „Financovanie samosprávy obcí od roku 2005“ (Bratislava, M.E.S.A.10 2004)/

between central and local governments. The assignment can be origin-based or redistributed based on a set of objective and transparent criteria. The former motivates municipalities to stimulate the local business environment, while the latter reduces inequalities and therefore substitutes – or complements – a proper equalisation mechanism. Since Hungarian municipalities already have incentives to stimulate economic development via the LBT, it would be appropriate to distribute shared taxes by cost-based objective criteria. This solution can also reduce current revenue imbalances from own sources.

The lessons learned in Slovakia from the decentralisation reform and the introduction of shared taxes may be useful, as in many respects the two countries have many things in common. The Slovak municipalities are as fragmented as their Hungarian counterparts. They were created in 1990 based on the notion that they should have a large degree of autonomy guaranteed by the Constitution. This obviously requires financial autonomy, which was one of the goals of a substantial public administration reform implemented in 1992, meant to inter alia change the local and state competences, depart from a system in which the central decision and the territorial deconcentrated offices were dominant, and reduce the overlapping of responsibilities.

Successive governments made attempts to re-centralise the system, but the local autonomy had already stricken roots, and so a decade followed which was characterised by a not very efficient *dual system*, where independent local self-governments coexisted with deconcentrated state administration. Municipalities were funded primarily through grants and subsidies, for which total limits and conditions were established each year through the State budget law, without little guarantees of stability, predictability, or transparency. The local budgets also functioned as a buffer where most expenditure cuts would be operated when the macro balance was in question.



Source: Annual public administration budget reports , authors chart and calculations

This in turn led to a rapidly deteriorating condition in municipal functions. Budget surpluses during the initial years could be achieved by selling public property, a practice in which the municipalities were encouraged as the process of privatisation was also a national priority. But when this one-off source was depleted and the funds available in State budget were gradually reduced, the initial surpluses turned into the growing deficits (chart above). The course changed again in 1999, when the decision was taken to complete the decentralisation and public administration reform. Most of the deconcentrated state administration offices were closed, with the state tasks transferred to

municipalities and the newly established regional self-governments. During the transitory period, new tasks were covered by a special “decentralisation subsidy”.

According to the new principles, *all original tasks of local governments were to be funded from own resources* with municipalities having extended liberty over their execution and funding. They could now decide whether to provide a particular service at all – for example to have or not a nursery, local school building, a social service house, municipal police, etc – and so were free to save money for other local tasks which may have been more in demand: school bus, nursing service, road repairs, et. It was expected that this approach would increase efficiency in a system with high fragmentation on the first tier.

The second category of municipal tasks, called “delegated” or “transferred”, for which the central authorities wanted to maintain control, remained to be funded through state transfers. It was the case, for example, with education, population registers or traffic signs for the local roads.

The calculation of resources necessary to cover additional costs of all the original competences after decentralisation was made using total historical costs of the services in individual sectors. Historical levels of current local tax revenues were used too, meaning that municipalities were not forced to raise their existing levels of taxation, although they were enabled to do so.

The Personal income tax (PIT) was considered the most appropriate own source for local authorities because it is stable over time and has a fair territorial distribution. It also helped that, by coincidence, the yield of PIT was historically higher than the extra sums the local and regional self-governments needed to cover their original competences. The original plan was to distribute PIT to local governments according to their real fiscal capacity, but the data system at the time was not good enough to make this a realistic option, and so, it was eventually decided to distribute the PIT via objective indicators.

For the purpose of defining the ‘optimal’ indicators and coefficients, correlation analyses were conducted with all possible data available in statistics at the municipal level, minimising gaps in relation to historical costs. But as time passed and discussions were expanded to include a high number of stakeholders, it became clear that the distribution formula must be also clear and simple, so everyone can understand its logic and accept the distribution as legitimate rather than politically motivated. Moreover, the aim of the new system was not to keep forever the existing service network, created under the previous regime and not always efficient, but to optimise it by providing equal opportunities to every municipality to offer or not a certain service to the local community.

The logic behind the first set of objective criteria goes as follows:

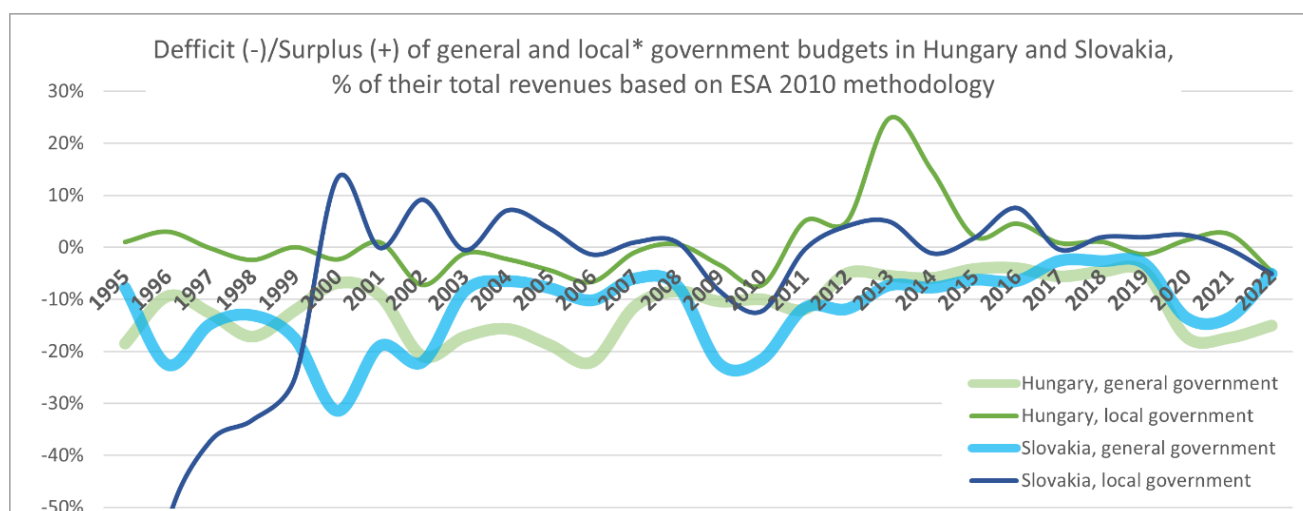
- Current costs of the original competences in education represents 40% of current PIT share revenue. This was to be distributed by the number of residents of school age, i.e. the number of enrolled pupils, since primary school is compulsory. The municipalities could then decide whether it is efficient to keep the school as it is, or buy a school bus and ship the pupils to another locality. Later the special coefficients were introduced to better capture different local situations: for instance a language school, which is least expensive, has a lower coefficient while a re-education centre has the highest coefficient since this institution is most expensive.
- The cost of social services amounts to 5% of the current PIT share. It is distributed based on the number of residents aged 62+, granting every citizen in that age bracket equal opportunities. The municipality can decide whether to build its own facilities, subcontract a service provider in other municipality, provide assistance in the residents own homes, fund other services instead, etc.

- 23% of PIT is distributed by the number of residents. The logic was to keep at least some stability or similarity with the previous system, where approximately same sum was distributed to municipalities based on the number of residents.
- The rest of the original competences (32%) is distributed according to number of residents weighted with the size coefficient. Bigger municipalities get more funds to compensate for the higher unit costs of infrastructure on their area. Moreover, these “employment centres” serve not only the local residents, but also commuters from the surrounding villages. In theory, the size coefficients should also be a stimulant for communal reform/amalgamation.

This fiscal decentralisation reform became effective in 2005. As time passed, the allocation mechanisms were refined. Coefficients for altitude have been introduced as a proxy for the increased heating costs of buildings in mountainous areas. The new mechanism of tax sharing brought about more stability and predictability than it was the case before. Each year a certain share of PIT goes to the sub-national governments, guaranteed by the law (today these are 70% for tier 1 and 30% for tier 2, the regions). In order to have more flexibility in the system, the set of criteria and coefficients are decided through the government decree.

The fiscal decentralisation brought remarkable financial stability to the Slovak municipalities. Overall they were able to run a budget surplus over the years after the global economic crisis of the last decade. They were also able to go through the current energy crisis with the exceptionally good results (see chart), mainly due to the PIT sharing and allocations, which function as automatic stabilizer, with buoyancy under inflationary pressure. In general, PIT-based shares give local governments a chance to keep up with the private sector in terms of wages, because when the salaries go up in the whole economy, this bolsters the PIT revenue.

In general, local governments tend to be more fiscally conservative than central governments both in Slovakia and Hungary, running less deficits as the result of stricter rules (chart below). What is more, both local and general government deficits in 2010 and subsequently were lower in Hungary than in Slovakia. If so, it should be reassessed to what extent the decline of local autonomy in Hungary and partial recentralisation of competences and revenues can be attributed to the systemic risks of fiscal deficit created by local governments.



Source: Eurostat, own chart and calculations. Note: *Local government includes both local and regional self-governments, general government includes the whole public sector

A.4. Detailed example for priority area 4 – the Czech case

Czechia has established a number of interministerial co-ordination instruments, particularly interministerial committees and public advisory bodies or line ministries to support policy co-ordination and consistency of action in different domains. About a dozen of these committees cover strategic issues, horizontal challenges or minorities' issues, as is the case with the National Security Council, the Government Legislative Council or the Committee for EU. Various interministerial working groups are formally established under a specific ministry, in which different ministries are represented. They help advance priorities over time that only concern specific line ministries.

Czechia created 16 councils under the Office of Government and a number of advisory and working bodies under line ministries. Most of these were originally placed in the Office of Government, but some were recently relocated under line ministries. The Legislative Council of the Government, the State Security Council and the Government Council for Human Rights and the Government Council for Gender Equality are some of the key councils that remain under the Office of Government, among others. These councils differ widely in nature as some are tasked with horizontal priorities (legislative, EU affairs, ethics, information society) while others are focused on specific social groups. They can help steer and co-ordinate cross-cutting issues from the centre and ensure strategic alignment, but also provide visibility and representation to minorities and help them address specific issues. Other advisory and working bodies have also been established under line ministries in charge of a specific policy area. An example is the Council of Public Administration. These bodies address horizontal themes, with the responsibility for the ministry in charge of the council to mobilize other ministries, or sectoral themes, such as the Government Council for Energy and Raw Materials Strategy.

Policy advisory bodies and systems can support a better evidence-based and coordinated approach into policymaking systems and help break down administrative silos. Arm's-length policy advisory bodies play a special role in the policy advisory system, underpinning the knowledge infrastructure around governments. Often close enough to government to be up to date on ongoing policy challenges, they have the potential to act as knowledge brokers entrusted with the capacity to provide neutral and independent findings and policy advice that can fit into the policy cycle and help maintain trust in public institutions.

The Government Council for Public Administration, chaired by the Minister of the Interior, was established by Government Resolution No. 680 of 27 August 2014 and is regulated by a statute. The Department for Strategic Development and Coordination of Public Administration of the Ministry of the Interior serves as its secretariat. The council brings together central, regional and local governments. It consists of the president of the council, who is always the minister of the interior, and the executive vice-president of the council, the deputy minister of the interior, whose section includes public administration issues. The council also includes representatives from the Ministry of Regional Development, the Ministry of Justice, the Ministry of Finance, the Ministry of Labour and Social Affairs, the Ministry of Industry and Trade, at least at the level of deputy ministers, as well as representatives from the Office of Government; the Office for Personal Data Protection; a unit from the Ministry of the Interior, which is the guarantor of the state service; the Union of Towns and Municipalities of the Czech Republic; the Association of Local Governments of the Czech Republic; the Association for Rural Renewal of the Czech Republic; the Association of Secretaries of Municipal Authorities of the Czech Republic; and the Association of Regions of the Czech Republic.

In its activities, the council provides the government with information and knowledge to support decision making on the development, organisation and competence of the public administration to

better integrate and co-ordinate departmental and national projects, processes and methods in the field of public administration. The council is notably in charge of monitoring the implementation of the PAR Strategy 2030 and supporting the joint model of public administration. It issues an annual report on the fulfilment of the strategy and its action plan.

Evaluation reports are prepared every two years on the PAR strategy's implementation. These documents are publicly available and precisely monitor the different objectives and tasks carried out. By law, the Government Council for Public Administration is responsible for crucial agendas like the joint model of public administration and the PAR Strategy 2030. It should steer, support and monitor public reform initiatives and actions across the government and help align public administration reform plans and measures. By mandate, it can also make proposals to the government for decision. The Council monitors the implementation of the PAR 2030 through a dedicated working group.

A.5. Detailed example for priority area 4 – the Finnish case

In Finland, quite a lot effort has been laid in recent decades on developing the negotiation process between local and central levels better. The Ministry of Finance has a key role to arrange meetings between municipal association and the different ministries. The two main bodies are the Advisory Committee and the Working Group for preparing the Programme for Local Government Finances.

The Advisory Committee has persons nominated by Ministry of Finance, Ministry of Social and Health Affairs, Ministry of Education and Culture and from the Municipal Association, which is the law-based representant of local sector. The committee has to deal with the following duties:

- In the preparation phase, development plans and legislative projects concerning the finances and administration of municipalities.
- The state budget proposal for the parts concerning municipal finances
- Government proposals regarding the finances and administration of municipalities before their consideration in the Government Council
- Cost sharing between the state and municipalities
- Other significant matters concerning the finances and administration of municipalities

The Working group for preparing the Programme for Local Finances consists of experts from the same organisations, plus some other ministries as well, who have responsibilities connected with municipalities. Twice a year, this working group prepares a report including lists of different measures concerning municipalities and their financial effect on municipalities. The report also contains a current financial status of municipalities and how this position has been changed from the previous report. On the measures and current economic situation, the last part of the report contains a prognosis on future developments, for the whole local economy and its effect to different size classes of municipalities (under 2000 inhabitants, 2000-6000, 6000-10000, 10-20.000, 20-40.000, 40-100.000, over 100.000). There is a pressure calculation how this is going to affect the municipalities – this calculation is made in two ways, in pressure to municipal tax income %, or the pressure to take new loans. The idea is to give to municipalities information guidance and time to take the measures needed.

The report itself is usually 70 pages long. It is published as a part of the State Budget. Municipalities typically use a lot of this report text about the macro and micro level economic development picture in their own budget processes and for Local Councils. The weak point with regard to the report has been its last section with evaluate the economic balance of revenues and expenditures and the sufficiency of finance for municipalities. This is felt to be quite general, and not necessarily taking note of huge differences of various municipalities. The evaluation of the municipal size classes is a crude effort to make it better, but the ideal way would be a calculatory prognosis for each municipal separately. Maybe some day we will see that.

A lot of effort has been done to make this report more reader-friendly, with clear pictures and tables. One very important part is to make comparison with the former version of the report and observe the changes and their reasons. The spring version is usually published in March and the autumn version in October.

At the link, more information is available, mostly in Finnish, but the report has a brief English summary. The Powerpoint set gives idea what type of graphs are used.

<https://vm.fi/kuntatalousohjelma>

Annex: Finnish Local Government Act: Chapter 3, Relationship between central and local government, legislation texts

Section 10 Monitoring municipalities and oversight of legality

- (1) The Ministry of Finance shall monitor the activities and finances of municipalities in general and ensure that their self-governing status is taken into account whenever legislation concerning local government is drafted.
- (2) If a complaint on the grounds of procedural error is made, the Regional State Administrative Agency may investigate whether the municipality has acted in accordance with legislation in force.

Section 11 Negotiation process between central and local government

- (1) The negotiation process between central and local government shall consider the legislation on local government, central government measures that are far-reaching and important in principle concerning the activities, finances and administration of local government, and the coordination of central and local government finances, as laid down in sections 12 and 13. In the negotiation process the municipalities shall be represented by the Association of Finnish Local and Regional Authorities.

Section 12 Programme for local government finances

- (1) A programme for local government finances shall be prepared as part of the negotiation process between central and local government. Preparation of the programme for local government finances shall form part of the preparatory work for the general government fiscal plan and the central government's budget proposal.
- (2) The programme for local government finances shall include the part of the general government fiscal plan that deals with local government finances. Provisions on the general government fiscal plan are laid down in and under the Act on the Implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and on Multi-annual Budgetary Frameworks.
- (3) The programme for local government finances shall include an assessment of the adequacy of funding for meeting the duties of municipalities (principle of adequate financial resources). The programme shall contain an assessment of changes in the municipalities' operating environment and demand for services, and in the functions of local government, and shall provide an estimate of the trend in local government finances. Local government finances shall be assessed as a whole, as part of general government finances and in terms of different groups of municipalities. The assessment shall distinguish between the statutory and other functions of municipalities and shall assess the cost-effectiveness of the activities of municipalities.
- (4) An assessment of the trend in local government finances and of the impact of the central government's budget on local government finances shall be made in connection with the central government's budget proposal.
- (5) The programme for local government finances shall be prepared by the Ministry of Finance together with the Ministry of Social Affairs and Health, the Ministry of Education and Culture, the Ministry of the Environment, the Ministry of Transport and Communications, the Ministry of Employment and the Economy and, if necessary, other ministries. The economic forecasts and the assessment of the trend in local government finances, which form the basis for the programme for local government finances, shall be prepared by the Ministry of Finance. The Association of Finnish Local and Regional Authorities shall participate in the preparation of the programme for local government finances.

Section 13 Advisory Committee on Local Government Finances and Administration

(1) The negotiation process between central and local government shall include consideration of matters concerning the activities, finances and administration of local government by the Advisory Committee on Local Government Finances and Administration, which operates in conjunction with the Ministry of Finance.

(2) The Advisory Committee's task shall be to monitor and assess the trend in local government finances, and ensure that the programme for local government finances is taken into account in the drafting of legislation and decisions concerning local government. Provisions on the more detailed tasks of the Advisory Committee and its composition and sub-committees shall be laid down by government decree.

A.6. The Peer Review Team: brief biographical notes

Thomas Prorok, *Managing Director, Centre for Public Administration Research (KDZ) Austria*

Thomas Prorok is the Managing Director of the Zentrum für Verwaltungsforschung KDZ (Centre for Administrative Research) based in Vienna, Austria. His work focuses on quality management – Common Assessment Framework (CAF), impact-oriented administrative management, current issues of public sector reform, questions of European integration & local public governance, as well as capacity building.

Dr. Marek Jetmar, *Head of the Unit for Territorial Public Administration, Ministry of the Interior, Czechia*

Marek Jetmar is an expert in regional and local development, public administration and public finance. In his professional career, he has served in various managerial and expert positions in central administrative offices (Ministry for Regional Development, Ministry of Industry and Trade, Czech Government Office, now Ministry of Interior), participated in the elaboration of a number of important documents such as the Regional Development Strategy, Operational Programmes for Cross-Border Cooperation, National Innovation Strategy for Smart Specialisation, etc. He was also involved in the elaboration of local development strategies, methodologies for the needs of central authorities i.e. Methodology for Intermunicipal Cooperation, a number of studies and analyses.

His academic activities are focused on the sphere of public administration and public finance, in addition to the themes already mentioned. He was engaged at the University of Economics, The College of Regional Development and today he is a lecturer at the AMBIS University. He is the author of books and university textbooks. He is the researcher of projects focused on municipalities, regions, central administration.

Dario Runtić, *Government Relations and Public Policy Advisor for public finance and ICT, Special Advisor to the Minister of Finance, Association of Cities Croatia*

Dario Runtić has over 20 years of experience in intergovernmental fiscal and functional relations. He is currently serving as Government Relations and Public Policy Advisor for public finance and ICT at the Association of Cities of Croatia. As of 2023 he has been appointed as Special Advisor to the Minister of Finance of Croatia. His previous experiences include USAID, the World Bank and EC funded projects. Co-author of local finance, data publication and public participations papers and publications.

Markku Mölläri, *Ministerial Adviser, Department for Local Government, Ministry of Finance Finland (written contribution)*

Markku Mölläri is currently Ministerial Adviser in the Ministry of Finance of Finland. Markku has been member of the European Committee on Democracy and Governance (CDDG) for several years, as chair of the Committee and the local economic crisis 2008 working group, and is currently the chair of its Green Public Administration working group. Mr. Mölläri is a member of the OECD Network on Fiscal Relations across Levels of Government. He has been preparing reports on the COVID-19 effects on local level and between governments in the CoE and OECD. In Finland, Markku has worked on questions of municipal structure, economy and democracy. He has over 10 years' experience in Finnish municipal economy crisis procedure for municipalities in severe difficulties, as well as hands-on experience reforming the Local Government Act, introducing the governmental policy on administration reforms, tax and state grant systems, as well as on updating the data systems for local economic and basic service indicators. Markku is also

member of national boards for young people's involvement, services for disabled people and the National languages network. He holds a master's degree on Economics and on Philosophy.

Martin Valentovič, *Senior Fellow, MESA10*
Slovak Republic

Martin is the economic and decentralisation expert of MESA10. Martin graduated from the Faculty of Management of the Comenius University in Bratislava (1997) and Institute for International Relations and Law Approximation in Bratislava (1999). He was a consultant for a number of cities and self-governing regions and respectable institutions, among them Slovakia's Plenipotentiary for decentralisation and public administration reform, Canadian International Development Agency, UNDP, Slovak Agency for International Development, Slovak Ministry of Justice. He is an author of innovative instruments for public decision-making (calculating poverty in local level for the World Bank, optimal localisation of regional offices used by the Slovak Tax Office and several ministries, localisation of emergency stations used by Slovakia's Ministry of Health, input-output model for calculating macroeconomic and fiscal impact). He is a prolific author and his more than 40 specialised publications include development strategies on local, regional and state level, regular contributions to "Slovakia, Report on the State of Society" as well as publications on economic reform, judicial reform, institutional reform, social reform, funding of regional self-governments, consequences of Slovakia's membership in EMU, current crisis.

Myles Binney, *Head of Oflog Policy and Sponsorship, Department for Levelling Up, Housing and Communities*
United Kingdom

Myles is the Head of Oflog Strategy and Sponsorship. Oflog is a newly created organisation designed to provide greater data on local authorities to better understand performance. Myles' previous roles have been addressing and intervening in significant failures at the local level, writing statutory guidance on how authorities achieve value for money, leading a programme to improve availability of authorities' financial data and he has previously worked in local authorities, specialising in finance and audit.

Dr. Sorin Ioniță, *President, Expert Forum*
Romania (lead expert)

Sorin Ionita is an expert in Public Administration Reform and Development; consultant with the European Commission, Council of Europe, World Bank, UNDP on Eastern Europe and the Balkans; former civil society representative in the European Economic and Social Committee (EESC, on Transport-Energy and Environment); associate lecturer at Maastricht School of Management (MSM) and Babeș-Bolyai University (Cluj). Frequent guest in current affairs news programmes on TV and radio; blogger. Graduate of the Bucharest Polytechnic School (IPB); Bucharest University (UB); Central European University (CEU); PhD in Political Science, Fulbright fellow at Georgetown University, Washington DC.