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CHAPTER 1

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MANAGEMENT OF LOCAL COMMUNAL SERVICES

1.1 LOCAL GOVERNMENT FUNCTIONS

From among all local tasks the position of local communal services has changed to a great degree during the transformation of local governments. The direction this change has taken unquestionably indicates that a group of services with different operational regulations has developed within local governments prepared to fulfill traditional social public service (education, health care etc.) tasks. Unlike social services which can be effectively controlled through ownership, financing and employment authorizations, physical communal services require different methods of local government direction and influence.

Typically various *types of companies* were formed during the development of *municipal property* in the area of local communal services. This has changed the relationship between the founder, the municipality who owns the majority of shares, the enterprise providing the service, and the consumer, even in cases where the municipality owns the majority of shares. Today, when one third of the assets within the municipal balance sheet are financial assets, it is obvious that only methods of indirect influence will be effective concerning locally owned companies.

Regulations pertaining to the *financing* of communal services have also changed. User charges cover operational and a portion of capital investment costs to an increasing degree. Now the municipality is the authority which sets the charge of every single communal service, and the previous practice of central charge regulation and the connecting system of subsidies has been abandoned. As a result decisions pertaining to the development and municipal assistance of local communal services are made at local level.

A group of municipal services has therefore developed, which concerning the *provision of services for the public* is of fundamental importance, and which concerning the management can only be shaped using indirect methods. Local communal services, in the broad sense of the term, comprise one-seventh of all expenses of the municipal budget. Among these in the case of current expenditures the share is smaller (11.4% in 1994), while more than a third (36.9% in 1994) goes to areas of development. It is obvious that expenses appearing in the budget of service companies but not presented in the local budget would increase this group of local expenditures, making the importance of the communal service even greater. Expenditure data also attests to the fact that municipalities prefer to support primarily developmental tasks.

Financial data does not precisely reflect the local importance of communal services. Among all municipal services sewage and refuse collection and deposition are among those of primary importance¹. These, therefore, belong to that group of services which is locally preferred to be spent upon out of all areas of local economic development and social public services.

During the past six years of the municipal system changes made in communal services in areas of ownership, financing, and management were characterized by a turn towards *market type solutions*. There are three reasons for this. First, the general expectation, stemming from the meager source of finances, was the assurance of the effective and high quality provision of all types of communal services by organisations operating according to the principles of the market. Second, municipalities are less and less able to finance communal services directly from the budget, thus the service is financed through charges. In cases where the consumer pays for the service directly, control by the customer is greater. Third, intermediary semi-public and private organisational forms began to develop in the area of communal services. Even before the creation of the municipal system the establishment of incentive payments was on an experimental level, as was the utilization of the advantages of the entrepreneurial environment to the benefit of local services.

At the same time financial deficiencies in the area of communal and utility services, as well as problems caused by the new forms of operation, could cause the standstill of this specific type of privatization, in the broad sense of the term. After the first wave of changes made on forms of organisation and financing, criticism today pertains primarily to fundamental concepts, rather than methods of realization. This is exactly why we feel it is important that solutions devised to current problems of the communal service system developed during the course of state-municipal privatization should be in line with the changes of the past few years .

The goal, therefore, is to keep communal services based on municipal ownership, mixed (consumer and municipal) financing, a variety of organisations, and forms of public board type management. However, significant operational changes are needed within this framework in order to avoid problems of the present system. Of these, putting the relationship between the *municipality*, as owner and client, and the *service provider* in order is of primary importance, as is development of direct forms of *consumer influence*.

For these two goals to be attainable the practical forms of contractual relationships must first be developed. In the area of communal services, when municipalities and service organisations are independent to an equally large degree, the task can be carried out successfully only within a fairly well defined legal, financial and operational framework. This follows from the character of the service as well as from the various expectations of the communal service.

¹See also: Gábor Péteri: Változások az önkormányzati szolgáltatás-szervezésben. (Changes in Municipal Service Organisation.) PTI, October 1994.

In contrast to social public services and public administration, local communal services and public utilities can be listed in the category of *private goods*. In other words, the benefits of the service are characteristically linked to individuals, while others are excluded from their utilization. At the same time these fundamental requirements do not always prevail in several aspects of communal services. Since the provision of communal services is in the interest of the community, there are some externalities which are significant over and beyond individual interests (for example public health and economic considerations). The cost of exclusion from consumption can also interfere with the interpretation of public services as a service of a purely private nature. Therefore, the *communal character* also prevails.

This duality is apparent in the variety of service forms, and modes of financing. From forms of budgetary institutions with varying degrees of independence to various types of companies operating according to different restrictions, the organisational framework is developing on a wide scale. The same is true about service charges: the degrees of municipal grants are varied, and realized by way of direct and cross financing. The portion covered by charges as well as operational grants and investment subsidies also varies according to service type and municipality.

This regulatory environment demands municipal decision making, and also makes it possible. The relatively great freedom of movement assures that political decisions pertaining to the proportion of duality present in the private and communal character of local services, can be made. In other words, the extent of service costs covered by charges and the degree of influence of solely market methods which the municipality allows a service should be defined according to the *local system of values*. At the same time local autonomy makes it necessary for the municipality to make these decisions, since ultimately it is the one responsible for the provision of the service.

This is why we believe that it is useful if not one or two types of service provision and management exist exclusively in the field of communal services. This way local differences and unique situations can be observed by adjusting individual agreements and contractual forms to them. This variety helps services adjust to needs more precisely which ultimately results in the provision of a higher quality of service using the available sources.

1.2. CONSEQUENCES OF THE ACT ON PUBLIC PROCUREMENT

The development of an organisational, financial and management framework, conformity to autonomous local decision making as described above, requires various changes within the municipal system itself. The development of a well operating local communal system can be realized by the proper combination of two processes of transformation that basically complement each other. The separation of the spheres of the client and service provider is necessary in both areas.

One level of changes effects municipal *property management*, when the regulations of both the municipal body (council) and property

utilization organizations, those actually practicing property management, must be coordinated². The essence of this is that strategic and service (policy) decisions must be strictly separated from property utilization and management decisions. This provides better conditions of operation for both levels of decision making. In this way the municipality does not have to participate in day to day management and is able to concentrate on the general problems and long term questions of service provision in a more well established manner. At the same token the property management organisation is able to operate with a larger degree of autonomy allowing for a greater freedom of movement and an increase in responsibility.

Besides these necessary changes another requirement of successful communal service practice is the development of the *service client's* unambiguous role. In other words the professional officially responsible for the sector on the decision-making and executive level, must be defined. This "client" only keeps the success and financial efficiency of the service in view. Therefore, the organisational form which is to serve the task will be chosen according to property management and other financial aspects. This does not necessarily mean that the contract will be awarded to the municipality's own company, but if the municipality does choose to do so the relationship between client and contractor is unambiguously defined.

In order for this kind of client-contractor relationship to be established many methodological and conceptual changes must be made within the operational system of the municipality. In this book we strive to define the elements of a service system of this type and to provide methods which could help in the development of local practice. The most important area of change follows the elements of a contractual relationship : the establishment of the client's role, choosing the contractor (tendering), description of task to be accomplished, definition of the conditions of the contract, calculation of costs and charges.

The Act on Public Procurement can be of great help in the formation of the client-contractor relationship. Though the act can be interpreted in various possible ways from the municipal communal service viewpoint, it is still an important landmark, for if the regulations of tendering are given, then they determine a majority of the essential changes described so far. The prerequisite of good tendering is the precise description of the task, which in turn requires the clarification of the provisional and financial goals of the municipal client. The decision on tendering will be the result of taking the costs and other contractual requirements into consideration, which influences the financing of the service (revenue policy) as well.

Act XL. of 1995 on Public Procurement was born of a dual need. The goal was to make the system of submitting and awarding a tender ordered by the state, *transparent and controllable*. This is necessary because the efficiency of the utilization of public funds can only be assured if contracts are made within the framework of a public

²See: J. Kökényesi: Az önkormányzati vagyongazdálkodás helyi szabályozásának alapja (The Foundation of Municipal Property Management Regulations), MKI, 1995.

proceeding, at least that part which pertains to the choosing of the most suitable competitor, assuring the possibility and purity of competition. Corruption affairs as well as unfounded accusations prove that complying with the regulated procedure protects both the party calling the tender and the entrepreneur party bidding to the contract.

The other goal of the public procurement process is to meet the requirements within the *European Union*. The basis for integration is the assurance of the free circulation of prices, services, and manpower, and compulsory tendering serves all three. All over the world the modern state is one of the greatest clients. Concerning the area of services most of them are public, with the responsibility of organisation falling upon the state. Because of its size the state sector bears an influence upon the movement of the manpower market. Coordinating the practice of various countries, therefore, is important in many respects. It makes the broadening of international competition possible on the public procurement market.

Municipalities are one of the participants on the client side of public procurement. In order to fulfill their tasks they themselves buy goods and services partly to ensure their own activities and partly directly in behalf of the public, to ensure the fulfillment of public needs. Since here the circulation of public money takes place just as in the case of ministries and other central agencies, the formation of a local and regional public procurement system is warranted.

Mandatory procedure regulations of the law pertain only to municipal contracts of greater value. The bodies and their organisations can decide whether or not to apply the regulations onto the preparation of smaller scale agreements or not.

The local government not only as a client but also as the company owner, as a *contractor*, is the other subject of public procurement regulations. On one hand this means the fulfillment of ownership and company management tasks, while on the other hand demands the definition of the content of the service. On the municipal side there are other legal regulations defining the responsibilities pertaining to the content of contracts and agreements on the provision of communal services, and the order of procedures. The most significant of these are *concession* regulations, which hand over the right of usage, handling and profit collecting of public purpose properties in return for the provision of a service. A new regulation which Law No. 1995. XLII. on the mandatory utilization of certain local public services introduced, states that the municipality must by all means submit a public tender on the *provision of these specific mandatory services*.

1.3. INTERNATIONAL MODELS

Three basic models of local and regional public administration of western European countries are those practiced in Great Britain, France and Germany. The following is a brief overview of these three different models.

1.3.1. GREAT BRITAIN

Contracting out is a comparatively recent development. This type of local public service provision gained ground in the 1980's. In 1988 the publicity of tendering as well as competitive tendering was made mandatory in certain service areas, for example communal waste collection, the maintenance of public areas, and catering for schools . Later other service areas were included in the *compulsory tendering procedure*.

The new system prompted local authorities to expose their own service organisations, operating as a monopoly, to the effects of competition. These companies also had to compete in order to receive a commission announced by their own authority. The goal was to induce this seemingly peculiar situation. According to believers of the system this procedure forces public companies that have grown lazy to *compare performance* and to improve the efficiency of their service.

At any rate, organisational consequences became apparent immediately. Service organisations existing as a part of public administration organs became independent. The contractual (*client*) and *entrepreneurial* spheres of municipalities characteristically *separated* from each other. In the majority of cases companies were able to continue providing their service under municipal authorization. Declared or undeclared, however, performance demands had changed. At the same time in 10-30% of cases, depending on the task, the former internal organisational unit, acting as entrepreneur, loses the competition and does not get the contract. In this case, like all other participants on the market, it is naturally free to look for another commission. If it does not receive one of adequate magnitude, however, the loss of the public contract can mean *cut backs* or selling out to another company.

The most important lesson to us of the developments that have taken place in Great Britain is fitting local political considerations into the system of services. Competition in appropriate areas provides opportunities for public decision making. The acceptance or refusal of tenders announced by one's own company is not disguised solely by market decisions. In all actuality there are job, dismissal, and restructuring issues involved, as well as the municipality's long term strategy concerning the organisation of services. At the same time decisions concerning the policy questions of a service do not obscure requirements which must be met by everyone, such as performance measurement, the efficient organisation of work, and control practiced by the client and citizens (as consumers).

Therefore, competition also resulted in a new technique of social management and judgment of communal services, besides fulfilling the more conventional expectations of cost reduction.

1.3.2.

FRANCE

Contracting out and the provision of services by external organisations commissioned by the municipality is an old tradition. Private companies have provided local communal services and utilities ever since the beginning of the 19-th century, while the responsibility of supplying these naturally belongs to the municipality.

Therefore, the acceptance of responsibility based on the authorization of the community is traditionally compatible with external commissions. In France, where there are more than thirty-thousand municipalities, large companies have formed to carry out communal service tasks. Rational dimensions stemming from considerations of service organisation can therefore develop independent of the division of municipalities. However, the existence of large scale organisations, or the domination of certain companies and their chains, has not ceased competition between large companies. The original responsibility of municipalities in providing for communal needs has not ceased either.

Several institutional mechanisms of French public administration were able to create a *balance between the characteristically "small" client and the large service company*. The municipality was traditionally able to take advantage of the freedom of choosing a partner, meaning it was able to choose the most favourable offer. At the same time there was no competition since a few large companies dominated the market. Municipalities would contract a company on a long term basis (for example 15 years) according to given conditions. The company received charges and other revenues directly, and there were usually no subsidies.

Earlier, state control of agreements was in force and the Prefect had to approve every contract. Contract types, however, were developed according to practice. In this practice the role of the contracting parties was just as important as that of the permit of approval. Therefore, when we speak of formal constraints we must remember that they were not formed by legal regulations, but by contractual practice developed together by the market and the state.

Beginning in 1982 the traditional system of contracts has been modified. The approval of the prefect has been succeeded by less strict mandatory presentation. By the middle of the 1990's more attention has been paid to guarantee regulations. Now the consumer (the citizens of the state) may go to court in opposition of the contract. The usage of public money in this area is controlled by the audit office. The publicity of competitive tendering cannot be limited. This means that the form of submitting the tender, its conditions and procedure regulations, are legally defined.

Nevertheless, public service contract forms that have been developed on the basis of practice are still in use, though their constraints have loosened. The lifting of these formal constraints allowed for freedom in applying mixed and new types of solutions. While the municipality may provide a function with its own organisation, it can also delegate it in the following forms;

- a) *Concession*: The contractor invests and operates from its own resources. Instead of paying the service price the municipality cedes the rights of collecting public utility profits. At the same time the municipality has the right, as does the state, to define the conditions of the service.
- b) *Lease (Affermage)*: In this case public utilities remain under municipal management. The contractor operates only, capital

investment is not its task.

- c) *Mutual interest* (Regie interessee): The municipality participates in financing the local costs of the service, for example in the area of public transportation, by providing discounts for children and the disabled. The municipality covers the difference between returns and costs.
- d) *Management contract* (Gerance): No municipal property assets are handed over to the contractor in any form. A manager is employed whose interest lies directly in the organisation of the service, and who therefore is not merely an employee.

The highly developed French contractual and legal system is exemplary to us. Each various type of solution postulated support from "outside", from the state, to the same degree. Traditionally administrative control was the guarantee. This has been replaced by anti-monopoly solutions, audit office and judicial guarantees.

1.3.3.

GERMANY

Based on German management tradition the population is generally confident in the efficient and effective operation of state and communal service organisations. This, besides political opposition (Social Democrat) to privatization, is the main reason why contracting out is not typical in the area of communal services. What arises as a question of efficiency and consumer influence in other countries, is perceived in Germany primarily as an organisational or management problem, which in turn must be solved by using better management methods.

According to this approach the counterpole of the professional department in the earlier centralised organisational order, was finances, organisation and management. This meant external control of the "claimant", since the roles were divided: one party (the sector) had service goals, while the other (finances) made its decisions in knowledge of the sources. This organisational division, however, led to a control of expenditures and the exaggerated division of labour. The lack of a result-oriented approach caused individual interference and a heightened level of direct political participation, and has been characterized as "well organised irresponsibility".

In the *new management model* (Neue Stierung Model), which was developed in the interest of solving the problem, the main professional departments receive a budget which they must manage themselves, but they may decide upon the method in which they wish to spend it completely independently. Formally, this is a "contract" incorporating restrictions primarily from the budget side. Since communal service tasks have been passed on to the service sector it is enough for the financial offices to follow the basic figures. The branches have their own order of accounting. In the case of communal services a business plan is prepared for every task listed in the budget. Therefore the principle of performance, the contractual character, prevails within the municipality.

Generally in the case of services in which communal interests are present, in other words where externalities appear, the budgetary form of service prevails. This is why refuse collection is increasingly carried out by a unique budgetary organ. Management rationality is also functioning, according to which the goal is for organisations providing for a larger region should operate only on a higher level. At the same time intentions of practicing greater influence or forcing the number of tasks and burden down are not the primary arguments on the side of decentralisation. The main argument is the local need for the conditions of state responsibility, which the average citizen sees as somewhat mixed up, to be clear. Therefore, if the citizens of a community are not satisfied with the quality of a service, then the municipality should take responsibility and have influence, at least on a local level.

There are basically three legal forms of organising services. Their regulation framework is defined by public and civil (company) law, making public law and cash approach accounting characteristic of one extreme, and company law and cost approach accounting typical of the other. In the intermediate form accounting is cost oriented, but the service organisation remains under the authority of public law.

- * Budgetary organ (*Regiebetrieb*): A part of the municipal organisation, separate legal regulations apply.
- * Legally regulated unique intermediate organisational form (*Eigenbetrieb*): This service organisational unit belongs to the municipality and is legally not independent, but is related to the budget in a net way. Its manager is appointed by the council. It has been in operation since the 1930's, when this form was used for public utilities. Its advantage is that it ensures public control even in cases of monopoly services. It therefore comprises a part of the municipality, but the service can be sold outside as well. Services typical of this form: the operation of old age homes, community buildings, hospitals, and locations used for voting.
- * Company under public ownership (*Eigengesellschaft*): Here profit is not legally restricted, instead political and consumer control prevents excessive profit. Therefore, proceeding in this direction direct municipal influence gradually decreases and the independence of the service organisation increases. Communal services are characteristic of this form (for example water, gas, district heating, electricity, and social apartment maintenance), but airport, market and port management can also be carried out in this form.

Naturally the companies can establish further enterprises, but indirectly these remain under the control of the municipality as well. (The *Regiebetrieb* cannot establish companies. It also enjoys tax allowances: there is no VAT on its activities and is exempt from company tax.) The administrative and financial leaders, as well as municipal councilors, are members of the committee in charge of looking after the companies. They are generally delegated by political factions or parties. If the service organisation is joint (in *Zweckforband*, which is a district with a special

goal), then the organisation they have established is directed by the board of directors taking the decisions of their own council into account.

A common form of communal service organisation is the "city management company" (*Stadtwerke*), which is a collective term for multi-functional communal service companies. Among service units the number of services working according to public law and those operating according civil (company) law are about equivalent. (1888 and 1870 in 1986.) The number of public companies operating according to civil law are decreasing since privatisation is leading to the development of larger companies. Their capital is four times the size as that of those operating on the basis of public law.

The practice of *privatisation* is quite low key, though the degree of private ownership in areas of large public utility services (for example electricity) is high. The interpretation of privatisation is threefold:

- * Assets have actually been *handed over* to the private sector since they made no profit for the municipality and did not fulfill public tasks. An example of this is slaughter houses. Employees were not employed by the municipality.
- * The *function has been handed over* formally to the company owned by the municipality in cases where the possibility of municipal control had remained. In water and electric services the application of the company form was, as a matter of fact, mandatory. This method of privatisation applied along with the NSM model meant that financing capital investments generally remained under municipal jurisdiction.
- * The third form of privatisation is *tendering*. Where services are financed by user charges the service is partially (narrowed down or for a shorter time span) or completely contracted out. The regulation framework is secured by law (VOL/VOB) which defines the tendering process. It is applied mainly in areas where there are no monopolies (for example waste management). It is typical for larger municipalities to keep their own organisations, smaller ones contract out the fulfillment of the task. Taking international experience into account the general opinion is that it is better to initiate privatisation contracted out on one's own before legal regulations make it mandatory, because in this way the method can be learned.

Cost calculation, setting charges

Cost calculation is also recommended in the case of obligatory cost activities carried out in the Regiebetrieb form, although the prepared budgets are primarily of the cash approach. Concerning tasks fulfilled in the company form, just as in the production sector, a different depreciation rate per activity is accounted for, which comprises the basis of development. A very important cost factor in the case of companies is the "calculated cost" which, characteristic of the private sector, is interest which could be attainable if the capital were utilized in a different manner. This, along with amortization costs, is a cost component.

The trend is to convert to cost accounting in all three organisational forms. Expenditures and revenues indicate the annual financial flow but do not provide information on the true cost of the task. This is why labour costs, indirect costs and depreciation allocated to specific cost centers (for example information unit, legal office, organisation costs) are already indicated within the municipal organisation.

When the service does not fall under the sphere of public goods but serves individuals or groups (solid waste, waste water, burial), user charges must be imposed based on budget calculations. This, however, can only cover costs since the consumer cannot be overburdened. These so-called "public user charges" are easier to collect and enjoy priority during bankruptcy proceedings. The method for setting user charges is regulated by the state (for example the user charge of public cleansing may not exceed 75% of its costs). Generally, the user charge only covers the cost of operation, but operation itself is meant in the broad sense of the term, as described above. Typical user charge related services are: refuse collection, water, waste water, burial (park maintenance does not comprise part of the cost), ambulance services.

The user charge is primarily defined by the supervising committee of the companies. (The supervising committee is made up mainly of councilors and follows the political composition of the municipality.) All possible deficiencies are financed by the municipality. A high profit is not acceptable in the *Eigenbetrieb* or the *Eigengesellschaft* model, but these do not belong in the "public user charge" group, making collecting more difficult. The collection of user charges is the contractor's task. The service charges are usually paid by the property owner, not by the users.

1.4. CHARACTERISTICS OF CONTRACTUAL RELATIONSHIPS

The three international models described above all indicate that in the area of communal services the types of contractual relationships are varied. Besides differences in service systems, legal regulations and municipal traditions also differ from each other. If we therefore try to propagate contractual relationships within the Hungarian communal service system there are two questions which must first be answered. First of all we must find out the *extent* to which the practice of contractual communal services have *spread* in Hungary, and to what degree municipalities and contractors have confronted the faults of the system. The second question follows from the first: the *advantages and disadvantages* of the new system must be clarified, as well as the main possibilities for avoiding the latter.

Service

forms

As of yet there is no reliable full-scale information based on statistics available on the organisational and financial characteristics of municipal communal services. Therefore our only possibility is to provide a picture of Hungarian reality using a survey based on a large sample.³

³Data reproduced here is from a municipal questionnaire survey prepared by the Institute of Political Studies in 1994. The results of the survey were summarized in internal studies by M. T. Horváth,

With the results of the survey published here we will have a more precise knowledge of: 1. how municipalities organise the provision of communal services; 2. how wide-spread contractual relationships are; 3. the tendering system. (When interpreting the tendering system one must keep in mind that the answers given on the questionnaire reflect the situation before the birth of the law on "Specific local communal services" and the Act Public Procurement.)

The first group of municipal communal service functions are those which are characteristically *under municipal control*: management of rented property (carried out by the municipality in 79% of cases), public cleansing (78%), park maintenance (77%), public cemetery maintenance (61%), waste management (44%), public baths maintenance (42%). The municipality rarely enters into service contracts, although the degree of employing external contractors naturally differs from community to community. As a result of the scale of the task, services carried out by its own budgetary organisation, municipal administration, is more characteristic of villages than cities where the number of entrepreneurs which are able to carry out these services on a contractual basis, is larger.

In a majority of tasks the most frequent form of communal service management is that the municipality carries it out itself or assigns it to a locally owned company without a contract. When, according to the answers, the municipality carries out the task "itself" it does not necessarily mean that it is carried out within the municipal office or at the budgetary organ, that is that this service is within the municipality's own budget. Cases where the municipality holds its own economic company under tight control also belong to this group.

The direct service role of the municipality is smaller in the second group of services. Here half of all services are provided based upon *contracts*, for example solid waste collection (42%), and district heating (33%). In cities contracting out is frequent in several other areas of communal services (for example solid waste management, the maintenance of public areas, park maintenance). Contractual relationships, that is *service organisations that are not internal municipal organisations*, are typical in the areas of burial (61%), water network operation (49%), waste water treatment (36%), public transportation, chimney maintenance, and the operation of the gas network. Due to the various possible local interpretations of the survey no difference can be made between contractual services and those external organisational forms in which the service is not carried out by the municipality, based on the answers provided in the questionnaire. The answers reflect actual conditions and not the organisational and legal situation of services.

The third and final group of services are those which are either carried out by *companies* or *other municipalities*. This form is significant only in the area of water management (water network operation 26%, sewage and waste water treatment 18%), and occasionally occurs in the area of landfill operation. In the area of water management participation in joint service associations is slightly higher among villages, although

compared to cities the difference is not that great considering that these linear systems are connected in smaller regional areas.

In that group of municipalities in which a *contract regulates* the relationship between the municipality and the contractor, the characteristic form is contracts entered with *private companies or entrepreneurs*: in 44% of municipalities in the area of communal refuse collection, for example, and frequently in the areas of burial, solid waste management, the operation of baths, and park maintenance. In the three latter sectors economic companies with private interests carry out the service to a similar proportion. Service contracts entered with another municipality or *budgetary organ* occur mainly in the areas of management of rented property(33%), district heating (30%), and public area maintenance (29%). *Other forms*, which can be state companies, companies not owned by the municipality, or county companies are only found in the areas of water supply, gas services, public transportation, and chimney maintenance.

There is no qualitative difference between cities and villages in this respect. Therefore, if a contractual relationship is entered then the function is carried out by private companies or entrepreneurs not under municipal ownership in one-fourth to one-third of all city cases in the areas of solid waste management, park maintenance, and burial. In villages the ratio of external entrepreneurs is even higher in these areas, since there are no local municipal companies which would apply for the job. In all actuality, therefore, this ratio indicates how open municipalities are towards new service organisational forms.

Tendering is the condition for spreading the form of contractual relationships. According to our survey, however, this is not too frequent. *One-fifth* of the municipalities which filled out the questionnaire announced tenders for operational functions, primarily in the areas of baths operation (21%) and refuse collection (18%). In other areas of communal services only one-tenth of the municipalities applied the process of tendering (in the areas of park maintenance, land fills, burial, district heating, and cemetery maintenance). Tendering is 5-10% more frequent in cities since city municipalities are generally better able to manage the competitive tendering process, and since the supply of services is greater. In the cities participating in the survey there were even a few cases when the service institution, the company itself, submitted a tender, rather than the municipality.

This data indicates that the transformation of the content of service management in the area of municipal communal services, has begun. In the case of certain functions external service organisations and contractual relationships are functioning. However, the small number of tenders indicates that the regulation of the market as well as the relationship between public and private spheres is not adequate, which is why municipalities felt no pressure to organise services in the form of competitive tendering.

Advantages and disadvantages of the contractual relationship

Based on this information municipalities might question which

functions are worth fulfilling on the basis of a *contract*. As a general rule it can be stated that the possibility of contracting out should be considered in the case of functions which require a large amount of capital and manpower. Most communal services belong in this category. The exploitation of assets may be better in this case, since an external entrepreneur is more flexible to utilize leasing possibilities, and in comparison to budgetary organs it has no restrictions in determining wages being able to hire a larger number of part time and temporary employees.

The characteristics of the task also influence the possibilities of contracting out. A primary condition is for the task to be definable, and for the results to be measurable, as best as possible. This will be one of the most important elements of the contract. It is also important for the municipality to take into account the frequency of the task. It is more practical to employ external entrepreneurs in cases of rare, seasonal functions, rather than to tie down the municipality's own assets and capacity continuously in service areas that occur only during specific time intervals.

There are therefore several possibilities for the development of tendering and contractual relationships in the area of communal services. In order for municipal decision makers to be able to classify contractual relationships themselves they must consider the advantages of this type of practice as well as the known disadvantages.

In general within the present municipal system the most significant *advantage* contractual service organisation based on tendering is that the preparation process of *local policy formulation* can be improved. By local policy we mean decisions defined by interests, such as the definition of the circumstances of certain important communal commissions. On one hand, questions pertaining to the content and procedure of the neutrality of the competition must be clarified and set into practice. On the other hand, however, efforts must be made to consider and compare various different preferences of the municipality. Therefore, when each possible decision is individually argued the developed preparation system makes the objective consideration and comparison of each variation's costs and consequences possible.

In Hungary the regulation of the system of contracting out was initiated from the top. Legal intervention is not foreign to international practice, as we have seen. The first steps taken towards the local organisation of contracting out were motivated by specific values, which were primarily

- * the prevention of corruption, which during the course of the change of regime and the ensuing privatisation demanded immediate attention;
- * the economical handling of public money, which meant the provision of better quality services on one hand and a reduction of public expenditures on the other;
- * as a part of fulfilling the preliminary conditions for joining the European Union the prerequisite of transplanting the unified market of services into local conditions are the obligations

assumed by Hungary in international contracts.

During the course of the transformation of public services national goals can be applied to the conditions of local public services in various different ways:

- a) *Expense reduction*. This consideration appears on a long term basis in such a way that the tendering process helps enforce the demands of the municipality therefore relieving it of extra expenses, which of course are not always monetarily measurable. Until the system is developed, however, the expenses of certain functions might increase involving a one-time loss (in assets) on the side of the municipality.
- b) *Precise task description*. From among the variety of municipal tasks the characteristics of the function to be carried out must be defined exactly in the interest of the contractual relationship. This also helps the municipality examining policy considerations to confront their own system of values and the order of tasks it is to assume.
- c) *Measuring the contractor's performance*. Applying the concept of value for money (in other words "getting my moneys worth") to Hungarian conditions is especially important since this approach has not yet spread in the market of communal services. This pertains mainly to functions the performance of which are difficult to measure. It is not enough to turn assets over to the municipality, to terminate the monopoly administratively. A new system of conditions of operation must be developed. The market for public procurement can be of help in this.
- d) *More effective municipal decision-making*. Precise task descriptions and performance indicators modify the character of municipal decision-making. Mechanisms of the committee and the representative body become more transparent on this level, since tendering and contracting decisions are directed towards the "outside world". As a result municipal control receives greater emphasis during the course of implementation.
- e) *Better relationships between politicians and administration*. The council's modified expectations have created new circumstances for departments of the municipal sector and financial departments. The bodies are less at the mercy of the apparatus since the questions they must ask for the contract pertain to service conditions and are easy to answer and consider. At the same time the unanimity of decision-making qualification considerations helps the administration to professionalise its operation. Professional tasks must be performed, such as the detailed description of services, the calculation of total expenditures, and the development of a regulated order of procedures.
- f) *The position of locally owned public service companies*. One of the ever present endeavours of the bodies is to liquidate the transformed service organisations which are under the ownership of the municipality. The councilors are in a double bind: there is a necessity for the company since it provides jobs for local residents and is a work organisation that is controlled by the municipality, while at the same time they must strive to make it marketable in the interest of better quality service and economical operation. By defining performance criteria and enforcing them the tendering of public service functions can be of help in this process.

Obviously communal services based on contracting out through tendering have their own disadvantages. One must be aware of these, since a portion of the more unfavourable elements of the practice of contracting out cannot be eliminated. They must therefore be acknowledged at the time the decision is made. Taking the disadvantages into consideration can also be useful since some of the more well known negative effects can be neutralised using comparatively simple techniques.

a) *Extra expenses.* The contractual operation of services does not necessarily mean that the client (municipality) will not have further expenses related to the fulfillment of the task. The cost of the tendering itself and later keeping an eye on the provision of the service, the cost of monitoring, will all appear as extra expenses. These in turn must be compared with savings and changes in the quality of the service.

b) *Extra expenses of modifications.* Due to uncertainties concerning the content of municipal tasks their detailed definition will most likely demand individual changes. In a contractual relationship adapting to changing demands beyond a certain tolerance limit entails extra expenses. In the case of a local company this correction resulting from inaccurate task descriptions is usually by tacit agreement on the debit of other expenses, generally without the special decision of the municipality, while in a contractual relationship it is exposed.

c) *Decrease in possibilities for cross-financing.* Within a service organisation there are always possibilities to divide costs between various functions with different incomes. An advantage of this is that projected upon the whole company the amount of income subject to taxation is smaller, through internal accounting. (A disadvantage, however, is that if accounting within the company is not adequate then there is not enough exact financial information on the actual expenses of the service functions, their success rate, and their need of grants.) At any rate there is no possibility of this type of cross-allocation in the case of tendering and contractual operation.

d) *Danger of entrepreneurial bankruptcy.* The most common argument against a contractual relationship with an external service organisation or enterprise is that in case of bankruptcy the municipality will not be able to ensure the provision of the service on a continuous basis. This becomes especially important when the municipality terminates its previous organisation after the contract has been entered. However, there is a lot a reliable municipality can do in the interest of avoiding service bankruptcy. For example, it can make inquiries about the competitor during tendering; it can divide the service task between several contractors to ensure reserve capacities; it can ask for security to cover unexpected expenditures; it can require guarantor insurance (performance bond); it can follow the developments of the contractor by practicing continuous monitoring.

e) *Depreciation of municipality's tangible assets.* In the case of contracts entered with non-municipal contractors the condition of unexploited machinery and buildings earlier belonging to the municipality's stock deteriorates ensuing in expenditures while there is no income. This is an expenditure which burdens the municipality and must be added to the

expenditures listed in the contract. This expenditure can be reduced if the municipality keeps only its most important tangible assets and either rents out the rest or sells it to the contractor. This must be considered at the time of tendering making the way it utilizes the municipality's superfluous assets one of the aspects of judging the tender.

f) *Uncertainties of tendering.* The tendering procedure itself makes municipalities vulnerable to attack, the dangers of which can only be reduced by a well regulated and explicit process. Also, the possibility of no local competitors is always present. At the other extreme by exploiting its position of monopoly one or several competitors form an alliance and set the municipality before accomplished facts. This risk can be minimalized by a well constructed process of preparation and pre-qualification.

To sum things up we can state that in the area of communal services financial and organisational transformation has resulted in a variety of solutions. The demand for contractual relationships entered with the private sector is present. In order for the municipality to successfully function as client it must exploit the advantages of contractual relationships based on tendering and must reduce the disadvantages as best as possible. In subsequent chapters we will discuss what kind of procedures and methods it is practical for municipalities and service organisations to use.

| Professional | communal | service | organisations |
|-----------------------------------|-----------------|----------------------------|----------------------|
| 1. Real | Estate | Management | Association |
| 2. | Horticultural | | Association |
| 3. Public | | Cleansing | Association |
| 4. Hungarian | District | Heating | Association |
| 5. Hungarian National Association | | and Body of | Chimneysweeps |
| 6. Professional Alliance of the | | Hungarian District Heating | Service |
| Providers | | | |
| 7. National | | Burial | Association |
| 8. Communal | | Service | Association |
| 9. National Professional Alliance | | of Water, Sewage and | Bath |
| Companies | | | |

Szerkesztő: Címek, telefonszámok a könyv 35. oldalán! A magyar nevet is be kell írni!