

THE CASE OF REGULATION IN LOCAL GOVERNMENT FINANCES IN HUNGARY,
1990–2012

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Two decades of decentralization in Hungary present a good case of how the administrative and regulatory environment should (or should not) be adjusted to fiscal conditions. In the early transition years, fiscal decentralization was followed by political decentralization and transfer of public functions to municipal level, but this model did not meet all the requirements for an effective, efficient system of inter-governmental finances. Second-generation decentralization theories showed that intergovernmental fiscal relations needed to be matched with appropriate political and administrative mechanisms. The conflicts in Hungary centred round the optimal LGO size: institutional forms were not adjusted to the requirements of efficient local service provision. The paper uses a disaggregated database of local-government revenues and expenditures to present the inability of small municipalities to deliver the mandatory and merit-based service assigned to all; unmanageable inequalities evolved in local revenue-raising potential; disparities between assignment of services and own revenues led to targeted intervention through the transfer system; local finances were heavily influenced by political cycles. Since 2013, all these factors have prompted extreme re-centralization without consideration of alternative options for establishing larger, integrated municipal structures. The model will survive while this new system remains financially viable, but any fiscal difficulties at local or national level will again raise pressure to adjust to the fiscal and political components of a system that is properly decentralized.

WHEN CONFIDENCE EVAPORATES... DOES OPTIMAL MECHANISM DESIGN EXIST
UNDER DOUBLY ASYMMETRIC INFORMATION?

Iván Major

This paper evolved from a 2009 TÁRKI study *The Socio-cultural Preconditions of Economic Take-off* and from previous empirical research by the author on the relation between public trust in government institutions and economic development. TÁRKI's and the author's researches equally found that a strong, significant relation exists between a country's path of economic development and its citizens' confidence in governmental institutions. It is well known that governments must make their

economic policy decisions designed to influence development while possessing an imperfect knowledge of the type or effort level of the economic actors. These issues are discussed within a framework of classic adverse-selection or moral-hazard models. How does the government's and economic actors' behaviour change if relevant information is doubly asymmetric, i. e. it is not just that the government has limited information about the agents' type or effort level, but that the economic actors also lack perfect information about the government's trustworthiness. The paper proves, using the modelling tools of mechanism design, that the government – as principal – can only of presenting “perverse” incentives to the economic agents: it punishes the well behaved and rewards the badly behaved.

RECONSIDERING THE ROLE OF FINANCIAL INSTITUTIONS' BALANCE SHEETS IN THE CONDUCT OF MONETARY POLICY. THE EFFECT OF BROKER-DEALERS ON REAL ECONOMIC PROCESSES AND LIQUIDITY

Attila Ács

This paper defines liquidity as ease of money-function transformation, or specifically the ease with which the store of the value function of money is transformed into its medium-of-exchange function and vice versa. This transformation gives rise to debt (deposits, debt securities) and equity (shares), and hinges on two factors: confidence and financial innovation. Broker-dealers take part in money-function transformation in a dual way: they help to produce negotiable securities, and by market-making guarantee market liquidity. Furthermore, through mark-to-market accounting and repo refinancing, funding, market and macro liquidity conditions make their way into broker-dealers' balance sheets. So in a market-based financial system like that of the United States, liquidity conditions can be measured as broker-dealers' aggregated balance sheets and viewed as a liquidity barometer, in line with Adrian and Shin's proposal. This paper presents an empirical test of this using VAR models.

ILLEGAL ACTIVITIES AS PRESENTED IN SWEDISH, DUTCH AND HUNGARIAN STATISTICS

Péter Sárkány

The study presents statistical data on illegal activities in three separate countries. Sweden, the Netherlands and Hungary were chosen for a number of reasons. One is the long runs of statistical data available in them. Secondly, they vary greatly in their approach to regulating the criminal fields of drugs and prostitution. Interestingly, all three underwent considerable regulatory changes in these areas in 1999. It may be worthwhile to examine the results of the different approaches, as a contribution to international comparative observation of illegal activities, which also allows expansion and further study of these areas in Hungary, while aiding with official statistics the regulators in the field of prostitution and drugs.