

Chapter I

THE ORIGINS AND IMPLICATIONS OF PERCENTAGE LAWS

Hungary's 1% Law – why?

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When the scheme introduced by Hungary's 1% Law began operating in 1997 it turned – almost overnight – into a popular movement. The 1% scheme's operation is, however, fairly costly and elaborate. In February and March every year, just before taxpayers submit their tax returns to the tax office, newspapers publish the advertisements of hundreds of organisations trying to convince people to allocate 1% of their previous year's income tax to help support their activities, be they for the care of cancer patients, sick children, homeless people or supporting a school or dog shelter. If a taxpayer is persuaded to use this opportunity, the rules of game are as follows: the taxpayer fills in a separate form and puts it into a sealed envelope alongside their tax return; a tax official checks whether the taxpayer is entitled to designate 1% of their tax and what the sum is; then the envelope is opened and the 1% sum is transferred by the tax office to the addressee, provided it is entitled to benefit from the designation.

In 2003, close to 1.5 million out of the 4.5 million taxpayers in Hungary (nearly one third of income tax payers) decided to use the 1% option and allocated over 6 billion forints (over 23 million euros) to organisations such as associations and foundations, and also to cultural institutions this way. More than 600,000 people did likewise to support the running costs of their church with just under 3 billion forints (over 12 million euros). A further 140,000 people who did not wish to support a church chose instead to designate over 800 million forints (over 3 million euros) to special purposes earmarked in the national budget (this year, anti-ragweed and health-care programmes). In sum, over 2 million designations were made to almost 22,000 beneficiaries totalling nearly 10 billion forints (about 39 million euros).

Much effort and bureaucracy for little money, compared to the hundreds of billions of forints paid by taxpayers every year. As one of those politicians who suggested this 1% scheme in the mid-1990s, let me give my personal account of why it was designed so.

The challenge

Like other former socialist countries in Central and Eastern Europe in the early 1990s, Hungary faced, among others, the problem of financing institutions supposed to be independent of government.

Following the introduction of state socialism in the late 1940s, the entire economy was nationalised, press and culture fell under state control, and, consequently, the government financed everything from the state budget. Genuine not-for-profit, non-governmental organisations could not exist at all. Trade unions, clubs, hobby organisations like those of motorists, stamp collectors, fishermen, associations of writers, journalists, musicians etc. were controlled by the governing Communist Party. Their leaders were appointed by the Party, and their budget was covered by allowances from the state budget. The same related to churches: their leaders could not be appointed or elected without government approval, their priests and running costs were paid by the government. All this suited the mono-centric character typical of communist regimes.

With the abolition of mono-centric communist structures in the late 1980s and early 1990s in Central and Eastern Europe, business enterprises regained their autonomy. The economy was

largely emancipated from government control and financing by the state turned from being the general rule to the exception. But it was clear that the public sector (education, defence, public security, the health service, the judiciary etc.) would continue to be financed by the government from tax revenues. There exists, however, a third sector in a modern society which should, like business, be free from government controls but, unlike business, cannot always be financially self-sufficient. Non-governmental organisations and churches are the most important institutions of this kind.

Once all the former restrictions were removed, civil society organisations emerged spontaneously in all the former socialist countries including Hungary. The monopolistic position of former party-controlled organisations was mostly broken and free competition developed in the third sector as well. Local organisations, which had been non-existent before, appeared everywhere. With the withdrawal of the state from organising and financing many activities – partly because of the intention of the new political elite to limit the scope of the state and partly because of the lack of financial resources – people built new, self-governing organisations to arrange such activities on a voluntary basis. These organisations required new sources and forms of financing.

Following the introduction of the new income tax system in Hungary in 1987-1988, incentives soon followed allowing donations to organisations such as foundations to be written off against taxable income. Though this practice did gain ground in Hungary, only a narrow upper stratum of the population made use of this possibility. There were some additional shortcomings: not all types of organisations in the third sector could benefit from state incentives encouraging donations, and abuses, for example businesses operating in the form of foundations, later led to a series of restrictions to this form of indirect state support (though it continues and still exists today). Nevertheless, in the early 1990s finding a way to widen the scope of organisations benefiting from donations and, in the longer term, to promote and increase giving by the public were important issues.

But the need for direct state-financed resources for these new, autonomous non-profit making organisations was also clear. In addition to central and local government grants and contracts which started to be made available to non-governmental organisations from 1990 onwards, the Hungarian Parliament awarded grants to several hundred organisations on an annual basis. Organisations had to submit applications and the grant-making decision was made by an ad hoc parliamentary committee established for this purpose. Only those organisations could apply which were active in several locations, not only in one city or county. Political parties and trade unions were excluded. Nevertheless, political clubs and semi-political organisations were widely involved and many of the applicant organisations, which had some degree of political commitment, found Members of Parliament (MPs) to lobby on their behalf every year. The committee assessed the applications and did its best to award the grants fairly, allocating money to organisations of all political persuasions. However, to a certain extent the organisations closer to the government of the day were always preferred to those closer to the opposition. More than that, politically committed organisations (both those close to government and to the opposition) enjoyed priority treatment compared to the politically uncommitted. A need to make the distribution of funds less dependent on party politics was widely acknowledged. In addition, it was always felt that the amount of state funds available to organisations in general was insufficient and there was a widespread wish to increase the amount of money available.

Likewise in the early 1990s the financing of churches constituted a particular problem because, according to the Hungarian constitution, the state and churches should be separate. Historically, the Catholic Church played a dominant role in Hungary, and, prior to the Second World War, was considered to be the “established church”. Some older protestant churches were tolerated while other, new ones were not. The problem was aggravated by official discrimination against Jews in the inter-war period in Hungary, leading to the Holocaust during the War. Historical experience highlighted the need to separate the state from churches and make the state neutral in religious affairs. While the requirements of separation and neutrality were formally enacted after the war, what in fact followed was subordination of churches to the communist state, and believers suffered discrimination and repression.

It was only the abolition of the communist system that made religious freedom and neutrality of the state in church affairs a reality. However, separation of state and churches required the separation of their financing. All the political parties elected in 1990 accepted this in principle, but the churches were afraid of financial self-sufficiency. They were aware of the fact that their influence among the Hungarian populace had substantially diminished, and insisted on the continuation of state subsidies. It was liberal politicians who suggested that direct state financing of churches should be abandoned. In 1991, when Parliament discussed the government’s Bill on Returning Churches’ Former Estates, members of the Alliance of Free Democrats (Hungary’s liberal party then in opposition) proposed replacing direct state subsidies to churches by a portion of tax revenues designated by citizens in favour of churches – a scheme that resembles Italian and Spanish citizens’ voting on church subsidisation. At that time the proposal was neither accepted nor rejected. The need for a change in the financing of churches by the state was recognised but finding a solution to the problem was postponed.

The idea that the running costs of churches should be covered by this kind of tax revenue redirected to the churches by taxpayers themselves was included in the manifestos of both the Socialist Party and the Alliance of Free Democrats in the 1994 elections. Additionally, both sets of manifestos suggested this form of financing for other non-governmental organisations, activities such as culture, sport and various interest organisations. These parties went on to win the election and the ideas were incorporated into the programme of the socialist-liberal government formed in 1994, the Alliance of Free Democrats serving as junior coalition partner. However, nothing was really done to further these suggestions in the government’s first year in office.

From suggestions to legislation

Paradoxically, the idea of the 1% designation scheme, included in the socialist-liberal coalition’s programme but forgotten in its first year in office, was brought back onto the agenda by a sector that would not particularly benefit from the scheme, and, in my opinion, should not even benefit from it. How did this turn of events come about?

The socialist-liberal government was forced to undertake a painful stabilisation operation from March 1995 onwards which involved substantial cuts in the budgets of each ministry. During the summer of 1995 the Minister of Education and Culture asked his circle of advisers and friends what could be done to compensate cultural institutions for the cuts to their budgets. During one such brainstorming meeting the idea emerged to invite taxpayers to contribute 1% of their income tax to finance cultural institutions, provided that the government was ready to renounce 1% of income tax revenue. It was clear from the very beginning that state-owned cultural institutions like theatres, museums and concert halls, as

beneficiaries of this scheme, should compete with non-governmental organisations and other institutions for the public's 1% designations. The idea of including churches as beneficiaries was also put forward.

Parliament reconvened in autumn 1995 and the new law on income tax for the following year was prepared. At this point a group of liberal and socialist MPs submitted a proposal to incorporate a 1% tax designation scheme into the law. The proposal did not specify how the system should work in practice but only granted the power to introduce the scheme for funding non-governmental organisations operating on a nation-wide basis, national cultural institutions and the churches. What the initiators emphasised as the proposed 1% scheme's central point was that the financing of these beneficiaries should become independent of political will and the bargaining so characteristic at that time. Proponents argued that citizens themselves should replace politicians in choosing between institutions that depend on financing from the state budget. The 1% scheme, it was argued, would also show whether different organisations really enjoyed public support. Similarly, as the churches declared themselves to be deeply rooted in the hearts and minds of Hungarians and demanded increased financing from the state budget, again the idea was: let people decide if the churches were really so important in their lives and vote with their pens when they fill their tax returns.

True, people already had the possibility to support institutions by means of donations. Church members could also support their communities this way. Moreover, this support took place within the church and out of the state's gaze (unlike some western states which collect church taxes). However, only a minority of Hungarians made use of such giving opportunities. Most Hungarians were fairly poor and had lost a considerable part of their incomes as a consequence of the transition crisis in the early 1990s. Financing third sector institutions by means of donations from a wider segment of the population was very unlikely. The new idea, therefore, was to let people make "donations" without sacrifice: to "donate" to a selected institution, not from their own income after taxation, but from the money which they had already transferred to the state as income tax payment. In reality, a designation not a donation, but a solution which would allow ordinary people to decide and to support an institution of their choice.

The proposed 1% scheme led to a fierce dispute within the government coalition since the Socialists were afraid of a negative reaction from the churches. The proposal was withdrawn before voting but the Personal Income Taxation Act for 1996 (passed by Parliament in December, 1995) included the government's promise to elaborate a scheme in a separate law.

In 1996 parallel work started in the coalition parties on the proposed 1% scheme and the financing of churches. Two interesting questions emerged. First was the position of national cultural institutions, a somewhat alien element in the proposal. Theatres, museums, libraries, concert halls are typically those institutions in a modern society which, although they raise income from entrance fees and tickets, are subsidised by local and central budgets by virtue of being basic institutions of national culture. Still, the idea that they be included among the beneficiaries of the 1% designation scheme was accepted as the "culture lobby" in both government coalition parties supported the scheme. It was, however, citizens themselves who later made the necessary adjustment: although a group of national cultural institutions was included among the beneficiaries, they received very little money in practice.

The other question was the scope of non-governmental organisations to be included. The original idea was to focus on organisations operating on a nation-wide basis and exclude locally operating organisations committed to one city or village. It was felt that foundations could also be excluded from the new scheme as they already benefited from tax deductible private donations. According to the original concept of the 1% scheme, a limited pool of non-governmental organisations, which served important social goals and not directly the interests of local groups of people, might be the main beneficiaries, competing with churches. This implied that there would be at maximum no more than a few hundred beneficiaries out of the many thousands of organisations registered throughout the country.

Many MPs in both government parties had, however, a different approach. They considered the scheme as an appropriate way to mobilise people to establish and develop organisations and associations of local interest. While the culture lobby in Parliament intended to subsidise national cultural institutions by means of the 1% designation scheme, the “education lobby” preferred schools in each city and village. Many schools had established foundations to help fund costs, and parents might get the possibility to use the 1% option in favour of the school attended by their children. The “local lobby” in Parliament considered it important that people could support local organisations in whose operation they have a direct interest. Thus, the scope of potential beneficiaries increased to several tens of thousands. (Just under twenty two thousand civil society organisations were chosen by taxpayers in 2003.) So in the course of the debate, the character of the scheme changed substantially. While the first idea was to provide financial support independent of party politics to nation-wide NGOs and churches, the focal point moved to mobilising citizens’ interest in local organisations and foundations.

There is, however, a further problem regarding the inclusion of a wider range of beneficiaries. Tax designations to school and hospital foundations or to national cultural public institutions listed in the law are nothing less than a substitute for state funding in favour of such institutions. There is no reason why these institutions should not receive more direct subsidies from the state – either nationally or locally – instead of using the indirect 1% support.

This shift in the main focus of the 1% scheme raises mixed feelings. The scheme helped promote the development of local initiatives and popular activities throughout the country – a strongly desirable development. On the other hand, the role of the scheme in deciding about the financing of non-governmental organisations according to activities taxpayers consider important without any direct personal interest has been much weaker than hoped. As a result, the amount of money allocated to nation-wide organisations cannot be considered as a measure of popular support or lack of support. But in any event, without the backing of the culture, education and local lobbies in Parliament, the scheme’s proponents would not have overcome the different kinds of resistance within the government.

Proponents initiating the new scheme also had to face other resistance – that of finance ministry bureaucrats who were necessarily concerned about the loss of budget revenues and particularly the clumsy and costly designation procedure. Nevertheless, the Ministry of Finance did not really resist and was even helpful. The real difficulty was the resistance of the big churches, in particular the Catholic Church. While some new and small churches that preferred to be independent of politics strongly supported the scheme, the big ones rejected it since they were afraid that it might reveal the real degree of their support in society. Late in 1996, when Parliament was due to vote on the “1% Law” (the popular name by which the measure had come to be known), the socialist Prime Minister was ready to accept the concerns of big churches and postpone the introduction of the scheme to allow further

negotiations and amendments. However, the majority of the government coalition (liberals and many socialists) insisted on the scheme's introduction and voted for the law. During the spring of 1997, Hungarian income taxpayers could already designate 1% of their previous year's tax to non-governmental organisations and institutions, as well as the new, small churches and organisations founded by churches to provide community services. The two main churches rejected 1% transfers; their chief grievance was that they were expected to compete with thousands of non-governmental organisations.

During 1997, negotiations between the Catholic Church and the government started and, in a few months, an agreement was reached. The compromise entailed the Catholic Church accepting the 1% designation scheme as a financing mechanism, and the government agreeing to a second 1% designation for churches, thereby eliminating competition between churches and other beneficiaries of the scheme. In addition to that, the government promised to guarantee that churches would obtain at least half of 1% of total income tax revenue even if taxpayers designated less money in favour of churches. In other words the tax transfers to them were to be completed by the state budget.

Thus, from 1998 onwards the 1% designation scheme included the churches as a separate category of beneficiaries. For those taxpayers who did not wish to support a church, the opportunity was provided to allocate this other 1% to special purposes defined in the state budget. These have varied from year to year and have included health-care programmes, emergency treatment of patients and flood prevention.

The presence of churches among the beneficiaries of the scheme demanded that strict data protection rules be observed. According to Hungarian law, a person's religious affiliation or membership of a church is a private, confidential matter about which information may not be disclosed without the individual's consent. Therefore, sophisticated rules for handling the designation forms had to be introduced that substantially increased the costs of the scheme's operation.

Some reflections

In late 1996, when the resolution on the allocation of annual grants to non-governmental organisations was being discussed in the Hungarian Parliament, I expressed my hope that, following the introduction of the 1% designation scheme, Parliament would cease to engage itself in allocating money this way. This hope was, however, not fulfilled and Parliament continued to award grants to non-governmental organisations. True, the amount of money distributed was halved in 1997, but increased again after that. Thus, the 1% scheme did not replace funding of non-governmental organisations by this political body.

As a matter of fact, many non-governmental organisations that were permanent clients of the parliamentary committee received very little or no money by means of the 1% scheme. Some of them clearly enjoy very limited support among the population; others, however, cannot compete with local organisations which directly serve the local population. According to surveys, more than one third of the beneficiaries are organisations and foundations engaged in education, most of which are probably foundations of schools. Teachers can easily convince parents to designate 1% of their tax payment in favour of the school attended by their children. Organisations engaged in social and health services are in the second and third place. These are particularly school and hospital foundations whose fund-raising activities

help plug the gaps in state funding for education and the health service throughout the country, and even serve to substitute higher budget allocations to these sectors.

Thus, enlarging the scope of beneficiaries prevented the 1% scheme from fulfilling its role as the decisive source for financing nation-wide non-governmental organisations according to the preferences of citizens. Nor, it should be added, does the 1% scheme that emerged fulfil all the funding needs of the third sector; it forms only a fraction of the sector's overall income. As a consequence – and despite the initiators' intentions – the scheme could not really serve a basis for non-governmental organisations to be independent of government and party politics. Nevertheless, the 1% scheme has added substantial amounts of money to the financing of thousands of non-governmental organisations throughout the country. This development has contributed significantly to the third sector's growth in Hungary. Hundreds of thousands of Hungarian citizens are aware that the subsistence of these organisations depends on their decisions. This is the most important result of the 1% scheme.

The introduction of the second 1% scheme for churches was an interesting compromise. Citizens duly voted with their pens and it turned out that only a minority of Hungarians is committed to churches. (This experience coincides with opinion polls which indicate that although the majority of Hungarians are members of churches, only roughly 16-17% of Hungarians follow the teaching of churches and visit churches regularly). On the other hand, the guarantee system maintained the situation making the financing of churches practically independent of the will of citizens. When the 1% scheme for churches was introduced, it was assumed that the guarantee would exist only for a transitory period. Just the contrary happened and in 2002 (some five years later), the guarantee was increased from 0.5% to 0.8% of total income tax revenue, and in 2004 will rise to 0.9%.

Is the 1% scheme to become a permanent solution for financing the third sector? In the long run, people should donate their own money themselves. Those who consider an organisation, institution or church worthy of support should transfer their own money to the beneficiary of their choice. To put it in another way: if the state decides the amount equal to 2% of tax revenue is to be allocated by citizens themselves, it should reduce taxes by those two percentage points and let people decide whether they wish to donate this money to any institution, organisation or church. I consider tax reduction and voluntary donations to be the long-term solution. For me, the 1% scheme is a transitory solution for a period when people themselves – due to social and economic conditions – are less ready and less likely to make financial contributions to worthy causes.

What next?

It is still only a minority of Hungarian taxpayers who make use of the possibility offered by the 1% scheme. Adherents of non-governmental organisations have repeatedly suggested finding a way in which such organisations receive the remaining or "lost" part of the 1% of tax revenue citizens do not designate. Several people suggested that the government or some kind of an independent body should allocate that money. In June 2003, the Hungarian Parliament passed a law establishing a National Civil Fund to allocate further money to non-governmental organisations independently of the decisions of taxpayers. The Fund's annual budget is to match the total of taxpayers' 1% designations to non-governmental organisations the previous year, and a new decision-making mechanism for allocating funds is foreseen which will see a much reduced role for Parliament in this area. (Other sources of central and local government funding for non-governmental organisations will continue.)

While I welcome Parliament's reduced role in allocating support to non-governmental organisations, I disagree with the establishment of a national fund as such. In my view, the degree to which taxpayers choose to utilise the 1% option reflects their judgement about the beneficiaries (non-governmental organisations and churches). Designating 1% of their income tax to one or both types of beneficiaries costs them nothing more than a few minutes: simply completing a form and putting it in an envelope. If they do not do so, it means that they do not find any organisation or church worth that small act of support. Organisations which do not get that kind of support from citizens do not deserve to be supported by any programme financed by the state budget. Let taxpayers decide not only which organisations merit their support but also how much state budget money they want transferred to the third sector as a whole.