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THE SHIFT IN FOCUS OF FISCAL AND MONETARY CONTROL (FINANCIAL ASPECTS OF REVITALIZATION PROJECTS)

Summary

The opening up of the national financial systems of new EU-countries contain both considerable economic advantages and significant risks. Their national systems did not adapt to the accelerating innovation in the field of financial instruments. The fiscal and monetary control systems are the toolkit of regulations, its effects on process of revitalization are evident.

Key words: monetary system, revitalization projects, control procedures

1. Introduction

Demand rose from the early 1930s to measure the performance of the national economies. The result of this procedure was the establishment of the national accounts system, worked out by Simon Kuznetz, on which GDP is also based. Even Kuznetz warned that well-being is not equal to the income produced by a nation or to the increasing rate of income. Up to this day basically two viewpoints have gained general acceptance. The first one places income growth to its centre, while the other rather lays emphasis on qualitative change. The difference between the two schools is inherent in the applied indicators.

Thus performance measurement at national level is not a new phenomenon. However, the question is whether it is enough to measure only the performance of the whole national economy? The answer is a definite Cno" at both schools because this kind of measurement does not give us enough and adequate information about what (desired or undesired) structure the performance was accomplished.

To measure performance at all fields of life it is very important to be able to answer the following questions: (1) **What?**; (2) **When** and **Why?**; and (3) **How?**

– in this order. In microeconomic circumstances it is more or less solvable because the goal or goals are clear and it is easier to make a good timing on measures which are well supported with adequate analysis. These kinds of analyses at the same time identify the implements which are needed to reach the goals.

While performance is generated continuous attention must be paid to the applied procedures and adequate feed-back must also be made so that the predetermined goals could be realised and that the situation in which the goals are changed according to the results could be avoided. This holds true at both micro, and higher level. The difference lies in the complexity of the systems. A company at microeconomic level has clear aims and it has simpler methods to specify the answers to the above questions. At higher level of economy (local, and macroeconomic) the goals are very complicated and may even be contradictory to each other, which makes the basic questions hardly answerable. These kinds of conflicts between the aims call our attention to the real problems of performance measurement.

This paper tries to throw light upon the limits of the fiscal and monetary control systems which, for this reason, require the shift of focus and gives insight into some problems related to financial aspects of sustainable city revitalisation.

2. Material and methods

This paper is based on the analysis of special literature about both fiscal and monetary supervisions and revitalization. The main source was the „Ellenőrzési figyelő" which is a Hungarian quarterly specialized in the topic of supervisions. To the fiscal part of this paper the homepage of European Court of Auditors, to the monetary part the „De Larosiere" Report gave important and valuable information. For revitalization part of the paper online scientific databases were used.

3. Results

3.1. The fiscal audit

In view of the direction of fiscal audit it can be divided into two parts. One of them is the financial regularity audit while the other one is the performance audit. The financial regularity audit concerns the reliability, the lawfulness and the regularity of the accounts, while performance audits focus on the economy, efficiency and effectiveness. These audits ensure the security of public financing, which is the main goal of the fiscal audits [Kovacs, 2004].

The question is given: **How** can we measure the performance and the efficiency of this audit system at national level?

The answer is also given by the European Court of Auditors (ECA). Since 1994 ECA has been obliged to make a report about the reliability of the EU financial report which is called DAS (déclaration d'assurance). It is based on statistical sampling and the essence of this is that ECA examines the whole institutional and control system connected with the different revenues and expenditures. If the errors are not higher than 5% of the amount of money which was spent on the examined measures the DAS can be issued (reliability is higher than 95%).

This audit system reliability method is also suitable to examine not only the whole system but also its structures and this way the causes of the mistakes can be revealed. There is an expressive example at the field of agriculture where the EU financing between 2007 and 2013 comes from basically two funds: European Agricultural Guarantee Fund (EAGF) and European Agricultural Fund for Rural Development (EAFRD). The ECA report about the year 2007 shows that the reliability of the money spent on agriculture and natural resources was at the level of reliability between 95% and 98%. It must be noted that the biggest part of the faults came from EAFRD but the largest amount of money goes through the institutional and control system of EAGF [European Court of Auditors, 2008]. The structural analysis of the faults and mistakes disclosed by the audits is useful for future audits, too because these audits identify the risky fields that should be better supervised in the future. Besides, if we get a clear picture of the problem, we can make suggestions to correct them.

For this structural analysis – because of the variability of the circumstances at the different fields – it is necessary to base the audits on the same principles and standards. INTOSAI (International Organization of Supreme Audit Institutions) has worked out these standards at the field of fiscal audit. The basic documents are (1) the Lima Declaration; (2) the Code of Ethics; and (3) the Standards of the Audits.

The standards have a significant role in the whole system of public administration, because the supreme audit institutes (SAIs) do not have enough resources to control all public spending. Here is the point where the local independent internal audit bodies which belong directly under the leader of the public body come into the control system because the mistakes, faults and the weak performances in the operation of the state is attributed to the lack of adequate internal control. The external control with wide range of authority and capacity is still unable to solve the problems at the different institutions, government offices, and local authorities coming from the weak internal controls which finally manifest itself in daily mistakes [Kovács, 2005a]. Thus it is relevant to the required operation of the public sector (to legally collect and effectively spend the public funds) that the external and internal controls are in harmony with each other and that they construct a gapless system [Ákos, 2006].

We have not yet answered the question: How? The financial regularity audit can be compared to a qualitative plan-fact analysis. The plans contain the rules, laws, regulations and procedures which should be realized and the facts contain the practice which was explored by the audits. If we know these plans and facts the audits can be made easily, the task is given.

The situation is not the same at the field of performance audits. If we would like to compare it to a qualitative plan-fact analysis too we would run into difficulties. As it was mentioned at the introduction at macroeconomics level the goals are heterogeneous and complex and the aims can easily contradict each other (for example let us consider the Philips-curve).

At macroeconomics level it is necessary to point out all the indicators which should be changed. If we know them we have to specify with adequate analysis and modelling how these indicators affect the economy and each other. Furthermore, as these indicators and their effects may change in time, it is a continuous task. These indicators represent the plan-variable.

The next question is: Why the selected indicators are the plan-variable and when should we use them?

The answer can be found in the economic and social situation. The economic development as a general goal can be reached by means of two basic models. The starting-point of the first one is that it tries to strengthen the basis of sustainable economic growth through the improvement of competitiveness. The other model places the saving and strengthening of the social cohesion in the centre.

The scenario which deliberately places the improvement of competitiveness into the centre of the social and economic disposing power is aimed at maximising individual social and financial responsibility. Besides, it tries to reduce the servicing role of the state and the bureaucracy which are combined with the idea of general tax reduction. As a result both the redistribution function of the state and the resource wastage decrease and more money can stay in the competitive sector thus improving their position and the flexibility of the whole economy. This scenario supposes an accelerating economic growth and the modernization of the society. This goes together with changes which increase social uncertainty, make strained relations and cause big chance-differences. These effects work against the necessary risk taking at the field of economic policy [Kovács, 2005c].

At the other scenario based on social cohesion the role of the public bodies are still high, which ensures the basic social services. In this model the private sector accepts more and more roles in state services. It requires a considerable demand on public spending thus the risk of the revenue creation is very high too [Kovács, 2005c].

Naturally, none of the two scenarios can be used on their own. It is necessary to find the adequate transition between the models. Referring back to the questions: Why and When? the question cannot be formulated without the answer of the question: What?

As for the answer to the question: What? we can find in the basic values of society and in the consensus based national program [Kovács, 2004]. If a national economy is able to decide which course of development is the most suitable and is also able to divide the plan into detailed measures, actions and programs – similarly to the planning method used in micro level – then we get the indicators which we would like to change.

If a nation has been able to verify what it would like to achieve then it will also be able to select the economic growth course and it can determine all the tasks and obligations that are referred to as task of the state. After this we can make priorities. The extenct of the role of the state thus can be cleared [Kovács, 2005b].

Previously – intentionally in a reversed order – we tried to demonstrate the national planning and conception making procedure. The goal of it was to prove that the first steps of any kind of planning is to decide where we would like to go or what we would like to achieve (what we would like to get and what we would not like) anything else may come after this phase.

We can tell about the limits of the fiscal audit that the challenge appears not at the field of financial regularity audits but at the financial performance audits. If a nation (and its economy) cannot select a growth course which is based on consensus, backed up by adequate papers [Kovács, 2005a] and determine the role of the state than it leads to payments without any conception or well selected priorities (resource wasting). If it is combined with a high risk budget (for example: the over-planning of revenues, under-planning of payments[1], or basis-based budget[2] instead of program-based budget [Bathó, 2007] without any risk analysis [Csapodi, 2008] then the chance for realization will be very low – not to mention the measurability of the performances.

The „value for money" principle is enforced only in the case of measurable performances which needs (1) the creation of a national program, (2) the clarification of the basic values of the nation, (3) the accurate definition of the role of the state, (4) the management view at public sector, and (5) the quality-focussed public services. If these criteria are met then the audits can achieve their basic technical goals namely (1) prevention, (2) correction and (3) sanctions [Kovács, 2004].

3.2. The monetary audit

For the measurement of the performances – as it was mentioned in the introduction – the questions What, When and Why and How must be answered. At the field of monetary audit these questions are relatively easy. The first three questions can practically be answered with a complex sentence: The basic aim of the monetary audit is to provide prudential and undisturbed operation for the market of financial services [Farkas, 2004] or in other way: continuous control of the financial system.

The main question here is „How"? The first question is: what kind of model – organization – is used for monetary audits?

The monetary audit has many forms. They are developed through history (this kind of bodies at western countries have much longer history) and because of it there are no uniform rules to make or operate a monetary supervisory body. The countries which started establishing these bodies in the early 90's could choose from the existing (but different) models [Seregdi, 2008].

In the EU states we can meet with the following models:

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[1] In this case because of the too much priorities or the lack of priorities the „lawn mower principle" success can be expected which is stopping the realization of the whole.

[2] In this case the aim of the public bodies from year to year more and more resource to get independent of its tasks and obligations.

– The banking supervisory is inside the national banks and the other supervisory bodies like insurance, capital market, etc. are inside the Ministry of Finance.
– In the second model the banking supervisory is independent and the other supervisory bodies either operate independently or as a part of a ministry. If there are more independent supervisory bodies a supervisory committee is needed to harmonize their work and assure the flow of information.
– Uniform or integrated[3] supervisory body either inside the national bank or outside as an independent supervisory body.
– The fourth model is the so called „twin-peaks" model. The supervisory bodies are divided into parts not by the financial markets (sectors) but functions. The two peaks are: (1) prudential supervisory of the institutions, and (2) the authority responsible for the appropriate operation of the financial markets. In this model we can find the sector brake downs inside the institutional supervisory [Seregdi, 2008].

We can see in the pervious parts that there is no one uniform supervisory model for each country. The listed models developed roughly after each other in time. The cause of it is the „revolution of the financial products" in the 70's which made it possible to connect and accumulate unlimited risks throughout the world by the big financial institutes [Asztalos, 2005].

On the one hand there was an increasing demand for efficient supervisory bodies which could control the universal financial service providers within the states. On the other hand the financial markets can be disturbed easily by other – not supervised – sectors or institutions thus there was a need to control the whole financial market.

The importance of the national supervisory bodies increased parallel to the European integration – due to the regulations that concern the free movement of capital and service providing. This means that any financial institution can provide financial services into any member state inside the EU without any supervision by the supervisory body of the host country. This requires cooperation between the EU states and a kind of uniform regulation background, too. Inside the integrated EU market there must be uniformed conditions most importantly in two fields: (1) regulatory convergence and (2) supervisory convergence [Seregdi, 2008].

The reasons for the regulatory convergence:

1) Security requirements (because of the specific characteristics of the financial institutions it is necessary to make more detailed regulations as the normal companies which mean a guarantee for the security of the financial system).
2) Equal competition conditions (because of the duality and asymmetry of security and profitability).

[3] We can talk about integrated supervisory body if all participant of the supervised financial market are examined with (1) uniform methods, (2) uniform principles, (3) on prudential base and (4) from the viewpoint of correct market behaviour.

3) Consolidated supervision[4] (the whole financial conglomerate is supervised only one body – the body which supervises the leader of the conglomerate).

The regulatory convergence was thought to be solvable by the „level three committees" CEBS, CESR and CEIOPS[5] (Lamfalussy process). During the creation of the jointly accepted standards the aim was not only the regulatory but also the methodological convergence, too. To be more precise not only the rules but the procedures and methods are similar. (It is in the interest of the big financial conglomerates, too because in this way they can reduce costs connected to the internal supervisory controls.)

The demand of unification at supervisory bodies is not a new phenomenon – there were earlier attempts for harmonization, too (BASEL I., SOLVENCY I., and CRIME I. → SUPERVISION I.). Their great disadvantage was that they were able to estimate and document the things only after they had already happened, that is why the new generation of these standards (BASEL II., SOLVENCY II. and CRIME II.) were created. The common elements of this second generation of the supervisory regulator mechanisms are as follows:

1) Every financial institute has to identify their risks based on the same principles.
2) More public information are conductive to institutional transparency – controls between each other.
3) The quality transformation of the connection between the financial institutions and the supervisory bodies [Asztalos, 2005].

Supervision II. means the new paradigm of the supervisory body controls. It is created parallel with the previously mentioned second generation standards but it is produced as a result of a several year process. This supervision is (1) risk based, (2) continuous, (3) preventive, (4) normative, and (5) able to self-regulate itself. The desired levels of the parameters are achieved step by step [Asztalos, 2005].

The question arises: will there be a Common European Supervisory body? because both regulatory and supervisory convergence has the aims of better co-operation and standardization [Seregdi, 2008]. The answer in the short run[6] is a definite „no" but later it can be developed.

How could the European supervisory system be not only effective but also powerful? [Farkas, 2004]

Task delegation – primarily in order to facilitate the close cooperation between home-host supervisory bodies (national regulations about the share of responsibilities).

Colleges of Supervisors – these colleges are organized around big financial conglomerates thus the experts can work together directly. They have no right to make decisions but through the colleges the national supervisory bodies can make the necessary steps.

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4 The co-operation between Consolidating Supervisors and Host Supervisors (GL09 CEBS).

5 CESR – Committee of European Securities Regulators; CEBS – Committee of European Banking Supervisors; CEIOPS – Committee of European Insurance and Occupational Pension Supervisors.

6 De Larosiere Report V. 218.

3) Implementation of the newest generation of supervisory standards into the Acquis Communautaire.
4) Cooperation with the supervisory bodies from the third countries.

The last point is particularly important because – as it was mentioned at the supervisory models – more supervisory models and more supervisory philosophies were developed in the world so we can be sure that there will not be one uniform global financial regulatory and supervisory model in the near-future.

The global financial – later economic – crisis originated from the United States and turned the world's attention to the importance of financial supervisory audits. On 11th November 2008 the European Commission charged the committee headed by Jacques de Larosiere with the task to examine (1) how to organise the best way for the supervision of the European financial institutes and financial markets in order to ensure the (a) prudential position of the financial institutions, (b) adequate operation of the financial markets and (c) the position of the depositors, the insured and the investors? (2) How to strengthen the cooperation between the European supervisory bodies connection with (a) the financial stability, (b) the forecast systems and (c) crisis management? (3) How could the European supervisory bodies and authorities cooperate with other important states at international level in order to keep up the financial stability? [De Larosier Report, 2009]

The „De Larosier" Report issued on 25th February 2009 touches upon the causes of the crisis and makes 31 recommendations starting from the national regulatory steps finishing with the international steps (for example: renewal of the capital requirements of BASEL II; accepting SOLVENCY II as soon as possible).

The report recommends setting up a new group called European Systemic Risk Council (ESRC). Its task will be to form judgements and make recommendations on macro-prudential policy, issue risk warnings, compare observations on macro-economic and prudential developments and give direction on these issues. Besides, it has to participate in international cooperation (IMF, FSF, G20). Another group is the European System of Financial Supervision (ESFS) which is also recommended to be established. It contains in fact the 3 level committees which operate as an authority in the future with a wide range of rights and tasks. It is important that because of many reasons the report does not recommend a cross-border supervisory institution at pan-EU level!

At international level the report recommends that the Financial Stability Forum (FSF) should be responsible for coordinating the work of the various international standard setters in achieving international regulatory consistency through international colleges.

The question „what" can after all arise connected with the „new" groups (ESRC, ESFS and FSF): Is it worth establishing another costly institution? Of course we have to see the other side of the coin too. If we can answer the question of what kind of other expenses could be avoided with the help of these new institutes, then we have already got the answer [Farkas, 2007].

3.3. Financial aspects of sustainable revitalization

Parallel with the process of globalization the structures of the economies have been changing. New industries are born and the old ones use to be outsourced to another – developing – country or simply finishing the operation. As a result of it all cities have difficulties with its inheritance namely left warehouses, unused office buildings and because of the worsening economic conditions the number of the residents starts to decline.

In order to achieve that these parts of the cities become revitalized the local government should make plans and has to stimulate the investors and the economy with its means that are usually manifesting in different allowances and subsidies. The main aim of these means is to urge investors to make a flagship property development that could play influential and catalytic role in urban regeneration. If this investment attracts other investments the goal will be reached [Bianchini, Dawson, Evans, 1992].

This kind of investments requires a lot of resources. The sources of these moneys are typically the follows: (1) Private investors, (2) Public investors, and (3) Development funds. The first one is use to be profit oriented private companies while the others are connected to the public sector. From this point of view the first is connected directly to the financial markets while the others to the fiscal policy of the (local)government. The first risk factor then comes from the incorrect operation of the financial market namely if there is not enough good condition credit on the market the private investors may delay or cancel their intention to invest even they could get a lot of allowances. The second – and higher – risk factor is the balance of the budget of the (local)government. In those countries where the budget used to have a negative balance both in national and local level there is no such opportunities to make these kinds of investments nevertheless these investments could be the source of further growth. Inside the European Union the (local)governmental part of the investments could be partly of fully substituted by EU funds particularly in the new member states.

The sustainability is the third risk factor. It is not enough to make an investment it should be sustained. In this there is a big stress on maintaining the circumstances and of course not only maintain but improve as the needs of the local residents changing. For instance in the case of culture-led urban regeneration [J-K Seo, 2002] it is very important to be able to support the local cultural institutions to keep the character of the revitalized area. It requires resources form the (local) government's budget.

4. Conclusions

The aim of this paper was to throw light on the limits of the effectiveness of both fiscal and monetary (supervisory) audits and the effects made on revitalization programs.

The efficiency of fiscal audits – similar to the ECA practice – can be made by a kind of reliability declaration at national level, too. It helps to find the real causes of the faults and mistakes with the ability of structural analysis. We examined the fiscal audit by its parts: financial regularity audit and performance audit. It was shown that the problems appear not at the regularity part but at the performance part. The cause of it is that there is not specified and clear (1) what the roles and tasks of the state are, (2) desired developing course and (3) the priorities which is coupled with an inadequate budget planning method. This way the „value for money" principle cannot be successful. It is important to notice that in the public sector there is not enough capacity in the control system to supervise everything; that is why the external and internal audits have some important roles which are based on uniform standards. It is extremely true for the local level of the public sector. Besides, connected with EU supports, the connection of internal and external audits (connection points) is also very important.

The weak-points of the monetary (supervisory) audits come basically from the flexibility and responsiveness of the supervisory system. The accelerated financial product innovation and the big financial conglomerates require a similar size, quickly reacting uniformed and/or integrated supervisory body or a net of supervisory bodies. The different supervisory models make this uniform-process clumsy, but the recommendations of the international organizations and institutes show a tendency to become standardized.

The common point at the field of fiscal and monetary (supervisory) audits is that both of them have to cooperate with the local/company internal auditors in order to achieve the aims. It is also common that the lack of adequate operation lead to serious problems. The problems at fiscal audits make their effects felt slowly but surely and it locates mostly at local level; monetary (supervisory) audits make their effects felt fast and locates not only in local level. Partly due to the pervious facts both type of audits exceeds the mere determination of the facts and forecasting and prevention also belong to their priorities.

The sustainability of revitalization requires a lot of resources and the advantages from the viewpoint of the society appear only on long-term. The private investors could realize their profit relatively soon so the stress is again on the measuring the results (performance of the public money – „value for money"). It is worth to spend public moneys on maintaining and developing these revitalized areas until the advantages (sociological, economic, etc.) of sustaining these areas are higher.

Summarizing the previously mentioned facts we can say that the stress is no longer on the financial regularity audits but rather on the performance audits. The main goal is to achieve the "value for money" principle which will finally lead to the correct, economic and effective use of public money both at national and at EU level. Looking at the monetary (supervisory) audits we can say that the future is definitely in the hand of the international organizations and institutes which can lead to a uniform and integrated supervisory body. Finally without adequate financial background no any revitalization project can be successful at long term.

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