Resolution No 13/2012.12.08. of
the Fiscal Council

RESOLUTION OF THE FISCAL COUNCIL

for submitting for final vote the uniform motion T/7655/453 on the 2013 Central Budget of Hungary and the recommendations T/7655/454-455 submitted by the Government prior to the final vote

I

Antecedents, legal basis and publicity of preparing the Opinion

According to the stipulations of Indent (3) Article 44 of the Basic Law of Hungary the prior consent of the Fiscal Council (hereinafter: the Council) shall be required for the adoption of the Central Budget Bill, to thus observe the rules of Indents (4) and (5) of Article 36. In harmony with the above and according to Indent (3), § 25 of Act CXCIV of 2011 on the Economic Stability of Hungary (hereinafter: the Stability Act), the uniform motion, respectively, on the basis of the amendments according to Indent (2), §25/A, the Council shall inform the Speaker of the National Assembly on its opinion in writing. Now, according to the stipulations of Indent (3), § 25/A of the Stability Act, the Council shall formulate its standpoint regarding the prior consent required for the adoption of the budget bill. According to the Stability Act, the Council shall examine if the uniform motion and the amendments submitted prior to the final vote are meeting the stipulated decreasing trend (hereinafter: public debt rule), specified in Indents (4) and (5) of Article 36 of the Basic Law of Hungary.

By its Resolution No. 4/2012.06.08. the Fiscal Council gave its opinion on the draft of the 2013 Central Budget Bill of Hungary that was sent to the Council by the Minister of National Economy on 31st May 2012. As regards the authenticity and feasibility of the draft the Council did not have any fundamental objections that would have justified non-concurrence concerning the document submitted for an opinion.

At the same time, regarding the macroeconomic forecast that was part of the draft, the Council has identified risks and, in order to handle them, it recommended that the Government should prepare an alternative macroeconomic forecast, considering the processes endangering the starting up of growth and based on the results of this alternative forecast – by unchanging deficit target – should ensure the increasing of the Country Protection Fund, in proportion to the incurred risks, as well as introducing corrections that would mitigate the risks of the budget bill.

As the Council diagnosed deficiencies regarding the viability of certain revenue and expenditure appropriations and, in case of certain uncapped appropriations, diagnosed the danger of exceeding the appropriation to a greater extent, it recommended that the

Government should take care of the timely adoption of regulations that should ensure the revenues appearing in the Széll Kálmán Plan 2.0, respectively the savings in expenditures, and review the uncapped expenditure appropriations judged as risky, as well as take measures to mitigate the danger of exceeding the appropriations.

In case of implementing the above measures the Council found the meeting of the planned deficit goal and the succeeding of the debt rule realistic. At the same time it indicated that prior to the final vote on the budget bill, in a separate procedure, it shall evaluate the succeeding of the public debt rule.

The motion submitted by the Government to the National Assembly took into consideration the recommendations of the Fiscal Council at several points – thus, for example, by doubling the amount of the Country Protection Fund.

Following the submission of the budget bill, the National Assembly adopted several amendments, some of them recommending significant changes in the revenue and expenditure sides of the budget and the tax system. As a consequence of the adopted amendment the 2013 budget bill – the corner numbers of what have been fixed by the National Assembly on 12th July 2012 – was significantly different from the budget bill that the Council had examined and had no basic objections against.

Taking this into consideration the Council found it justified to examine again the budget bill and form an opinion about it, prior to the final voting on the tax and technical rules that would serve as the fundament of the budget law. In order to lay the foundations of its opinion, by its Resolution No. 8/2012.07.16. the Council applied for information from the Minister of National Economy then, after having received those information, it asked for additional information and background calculations in its Resolution No. 9/2012.08.28.

In October 2012 the Government announced its downturn correction regarding former expectations related to the 2012 and 2013 macroeconomic course and envisioned a new course, respectively, in harmony with the above, it modified the deficit goals of the 2013 central budget. In harmony with the above the Government initiated corrections in several phases that shall be put across in the central budget by its uniform motion submitted by the bill No. T/7655/453 and its amendment submitted prior to the final vote by the bill T/7655/454-455.

The Council has dealt with the issue of the prevailing of the public debt rule in several resolutions. In those resolutions it indicated that being aware of the procedures in the first nine months of 2012 and after having introduced measures aiming at decreasing expenditures and increasing revenues, the tensions pointed out earlier by the Council, keep prevailing in the field of both the revenues and expenditures. Apart from this the Council also called the attention to the fact that regarding the implementation of the measures ensuring the maintaining of the balance and the non-utilisation of the Country Protection Fund, the deficit of the budget can be kept below the 3 percent of the GDP and that the fundamental processes of the budget could ensure the decrease of the public debt indicator compared to the indicator of the preceding year. The Council considered the resolution on the final lock of the Country

Protection Fund necessary. As to the local governments, the Council called the attention to the importance of such system-like measures that would strengthen the responsible financial management of local governments and – regarding the changing risks – would exclude the repetition of similar situations.

On 6th December 2012 the Speaker of the National Assembly forwarded to the Fiscal Council the uniform motion No. T/7655/453 and the amendments No. T/7655/454-455 concerning the amendment of the 2013 budget bill No. T/7655. It initiated that the Council should formulate its opinion according to the stipulations of Indent (3) § 25 of the Stability Act, on the joint evaluation of the submitted documents.

By using the analyses of the State Audit Office of Hungary and the Central Bank of Hungary and taking into consideration the opinion of experts invited by the Council, as well as consulting several times the staff responsible for the management of planning the central budget and exchanging working documents, the body formulated its opinion by taking into consideration the amendment No. T/7655/455, that is in harmony with Indent (3) § 25 of the Stability Act.

As regards to its opinion – in harmony with Indent (3) § 25 of the Stability Act - in a separate resolution, the Council shall formulate its opinion following the voting on the amendments, prior to the final voting.

II The Opinion of the Council

At its meeting held on 8th December 2012 the Council formulated the following unanimous opinion:

1. Concerning the fulfilment of the debt rule the Council established that on the basis of the uniform motion submitted by the bill No. T/7655/453 as well as of the amendment No. T/7655/454 – submitted prior to the final vote by the Government – the measure of the public debt expected by the end of 2013 is corresponding with the requirements stipulated by the Basic Law. With regard to the above the Council formulated its opinion concerning its prior approval, on the basis of the joint evaluation of the uniform motion, as per Indent (3) of § 25 respectively, and the effect of the amendments as per Indent (2) of § 25/A of Act CXCIV of 2011 on the Economic Stability of Hungary. The said opinion was displayed in writing prior to the final voting.

2. In the opinion of the Council the observance of the deficit target and the public debt rule requires that the significantly raised reserves should not be used as those are necessary for the handling of the already visible risks, in other words, the reserves do not make the mid-year increase of budgetary expenditures possible.

3. On the note of mitigating the revenue risks the Council calls the attention of the Government to consistently provide the efficient implementation of the existing measures and make further steps to promote the realisation of the targeted revenues.

4. The Council found that the effects of the individual measures and regulations introduced with the purpose of reaching the budgetary deficit target will, altogether, increase the existing and significant risks related to the starting up growth rate and to the sustainability thereof. Hence, the Council recommends that the Government should initiate steps serving the purpose of launching the growth rate in such a way that the debt rule should not be harmed in the meantime.

III Justification

The Council formulated its opinion on the basis of evaluating the following four issues:

1. The reality of the macroeconomic forecast that is part of the 2012 base year and the 2013 budget bill;

2. The viability of the revenue side of the budget;

3. The dangers of the over-fulfilment of the expenditure appropriations and,

4. The viability of the observance of the planned deficit target and the debt rule.

1. The reality of the macroeconomic forecast that is part of the 2012 base year and the 2013 budget bill

Following the 1, 6 percent growth of the GDP volume in 2011, it is very likely that in 2012 the growth rate will decrease in a proportion that might significantly exceed 1 percent, contrary to earlier expectations and the forecasted amount in the course of the planning of the 2012 budget.

Ever since the macroeconomic forecast of the Government that served as the basis of the 2012 budget the forecasts keep showing continuous worsening, due to the negative changes in the external and internal conditions. Due to the unfavourable shift of economic indicators, tax revenues (TAO=corporate income tax and dividend tax; EVA=simplified entrepreneurial tax; SZJA=personal income tax) have decreased while expenditures (interest rate) have increased. These tendencies have continued to be traceable also in the processes of the first nine months of the year. The Council continues to call the attention to the risks of the lagging revenues and within the revenues especially the lagging behind of payments of economic organisations.

In order to keep public finance debt below 3 percent of the GDP, the Government introduced several measures. The Council found that part of the measures undertaken in the interest of keeping the economic stability have weakened the 2012 output of the economy and might unfavourably influence the 2013 macroeconomic outlook. In its earlier resolutions the Council has already called the attention to this possibility regarding the current year 2012.

The various forecasting organisations have indicated different growth measures for 2013 in respect of the GDP. These forecasts usually have been different from that of the Government, i.e. they predicted a lower growth level. The 2013 growth forecasts are surrounded by downward indicating risks.

2. The viability of the revenue side of the budget

The revenues of the 2012 central budget have lagged behind, especially the realisation of the tax revenues, compared to the amended appropriation and the results of the same period of the previous year. The over-valuation of the effects of the changing regulations, together with the macroeconomic processes that have turned out to be more unfavourable than expected, have equally played a role in this result.

Because of a macroeconomic course that is more favourable than the consensus of the markets, in case of the major tax revenues - that are in direct relation to the macroeconomic indicators - risks of over projection might arise (for example in case of TAO/corporate income tax and dividend tax and ÁFA/value added tax, excise revenues).

The number of changeovers of regulating those balance improving measures that concern tax revenues, their respective under-documentation and the liberal background calculations might represent risks from the aspect of the viability of the appropriations.

The Government expects very significant surpluses from the measures aiming at improving the efficiency of tax collection. At the same time the documents submitted by the Government do not support such a revenue surplus.

In case the so-called small taxes meet the expectations, the appropriated revenues from EVA (simplified entrepreneurial tax) will significantly decrease. Additionally, excise revenues might fail thanks to the targeted benefits. These factors represent uncertainty.

As regards the fulfilment of the financial transaction duty, it means a risk that even though they had calculated with the additional revenues as a result of the GDP growth in the period of 2011-2013, however, they had not calculated with the decrease in turnover, that usually follow the introduction of new taxes. At the same time, the fact that the Government promised mid-year supervision and in case of failing revenues the changing of the measure of the duty might mitigate the negative risks. Here we should note that the part of the financial transaction duty originating from the treasury, in essence, shall decrease the resources of the public finance institutions. The fact that the planned revenue numbers in case of both the private sector and the treasury are inadequate, represents additional risk.

Changing the of local business tax regulations in a recession wrecked economic environment might decrease the excess tax revenues. The tax burden of fringe benefits (cafeteria) has been modified, in the course of the present parliamentary cycle, from 27 percent to 14 percent, thus – assuming unchanged turnover – the revenue surplus will significantly lessen. The calculations regarding the surplus expected from the increasing of the tax burdens of energy suppliers reflect a static state; they have not calculated with the decreasing turnover due to the raising of the taxes and this also represents a risk when it comes to the realisation of the appropriation. Raising the 2012 gambling taxes did not ensure the expected revenues, due to the significant set-back of the turnover. Hence, the surplus expected from the increased dividend tax of the Szerencsejáték Zrt. (Lottery Company) is also risky.

As a consequence of the above, the tax bases might turn out to be less than planned thus, in case of the major taxes, only a smaller revenue can be expected compared to what they had calculated with in the planning phase. On the revenue side of the 2013 budget significant structural tax restructuring occurred. The structural transformation of the tax system implies both positive and negative risks that might result in additional uncertainties when it comes to the planning of taxes.

3. The dangers of the over-fulfilment of the expenditure appropriations

Due to the variability of the macroeconomic environment and the occurrence of the crises, the changing saving structure employed by investors – compared to the presently planned trend – the unfavourable trend of Forint and currency purchasing by foreigners, the trend of the government securities' yield forecast that differs from the prognosis, together with the unfavourable change of the planned rate of exchange of both the Forint and the Euro carry risks concerning the realisation of the 2013 financing plan, as well as the appropriation of the tax expenses and debt management costs planned for the year 2013.

As regards the planning of the individual and normative supports, the fact that they had planned a significantly lower amount of allowances concerning inter-city passenger transport and the operational costs of maintaining the rail system, and additionally, they did it without background calculations, also represent risks.

In case of invalid pensions the measure of the savings planned for 2013 carries risks as it greatly depends on the result of the planned medical examination of the entitled/applicants.

The budget bill is counting with the decreasing of the EU development contributions from 15 percent to 5 percent. This decrease of expenditure however is not grounded.

Regarding the provisions, as a consequence of the over-fulfilment of the appropriation without modification, the possibility of over-fulfilment, similar to the occurrence experienced in the previous years, represents a risk that might unfavourably influence the observance of the planned deficit target.

They have significantly increased the appropriation of the pharmaceutical subsidies compared to the appropriation of the budget bill submitted in June 2012. By this measure the tension in the expenditures of the pharmaceutical fund has been significantly eased.

5. The viability of the observance of the planned deficit target and the debt rule

In the Council's opinion, as a result of the measures adopted by the Government, the budget deficit can be kept under 3 percent in 2013. To ensure this, it is imperative that the measures announced in the Convergence Program and the Széll Kálmán Plan 2.0 were implemented fully and that the Country Protection Fund should not be used.

At the same time the Council calls the attention to the conjuncture risks affecting the realisation of the macroeconomic forecast, as a consequence of what the degree of the economic growth could be lower than the prognosis. The significantly raised reserves are required for the balancing of the already visible risks thus, there are no sufficient reserves left for unforeseen events. Should such events occur additional measures would be called for. Although the deficit of the local governments will increase the public finance deficit to a modest degree, the Council calls the attention to the fact that the observation of the deficit appearing in the bill requires strict financial management discipline from both the Government and the local governments.

According to the reviewed documents the amendment motion submitted prior to the final voting has increased the deficit however; its effect has not been posted up in the 2013 debt indicator as fixed in the uniform bill. The public debt rule however can be met despite this, as long as the deficit remains under 3 percent, assuming the macroeconomic course described in the bill. The narrow difference between the debt indicator in 2012 and 2013 reminds us that the observation of the debt rule requires an extremely strict budgetary management also in 2013.

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