

## **Opinion**

### **on the state of the execution of the 2012 central budget of Hungary and the trend of public debt (on the basis of the processes in the second half of the year)**

#### **I**

##### **Antecedents, legal basis and publicity of preparing the Opinion**

According to Point 'c', Indent (1) of Paragraph 23 of the amended Act CXCV of 2011 on the Economic Stability of Hungary, the Fiscal Council (henceforward: the Council) shall give an Opinion on the state of the execution of the central budget act and the trend of the public debt every six months.

Within the framework of its legal mandate the Council considers itself affected in evaluating the 2012 macroeconomic processes solely from the aspect of the feasibility of the executing of the central budget. Beyond this, it shall give its opinion on the public finance processes of the second half of 2012 being aware of the followings:

- In its Opinion of 7/2012/07/16 the Council reviewed the trend of the 2012 central budget in the first six months of the year on the basis of primary data and established the followings: in case of specific expenditure items there were overruns, while in case of revenues there were shortfalls, as a

consequence of the unfavourable trends of the macroeconomic course. In its Opinion the Council called the attention to the ensuing consequences;

- In its Opinion of 11/2012.10.29. about the evaluation of the processes of the 2012 central budget in the first nine months of the year the Council ascertained that despite the corrections concerning both the revenues and expenditures the tensions still remained. These were, primarily the consequence of the unfavourable trend of the economic growth. Apart from this the Council found that even by the execution of the measures stipulated by Government Resolution 1428/2012. (X.8.) on the observance of the balance of the 2012 budget, in case the Country Protection Fund were not used, the GDP proportionate deficit could be maintained below 3 % and that the basic budgetary processes ensured the decline of the GDP proportionate public debt compared to the previous year;
- In its Opinion on the processes of the first nine months of 2012 the Council also specified that the financial situation of the country remained vulnerable as public debt and - within this - the level of external indebtedness was high when compared to the development of the country.

In its present Opinion the Council is summarising the major characteristics and tendencies of the budgetary processes related to the execution of Act CLXXXVIII of 2011 on the 2012 central budget of Hungary.

When developing its opinion the Council was relying on the participation of the experts of the State Audit Office of Hungary, the analysis of the Central Bank of Hungary, respectively the work documents prepared under the guidance of the Fiscal Council. The Council could not consider the contents of the final accounts' bill built on final data as the bill will be presented by the Government to the National Assembly only later. In the course of forming its Opinion the

Council has been relying also on the opinions and analyses of independent experts.

The Council shall inform about its Opinion the responsible officials of the National Assembly and of the Government, respectively considering the publicity of the fundamental document of the Central Bank of Hungary, shall publish the Opinion also on the website of the National Assembly.

## II

### **The Opinion of the Council**

At its meeting held on 16<sup>th</sup> July 2013 the Council unanimously decided on the following Opinion:

1. The Council reviewed the trend of the major budgetary processes in the second half of 2012. It found that due to decisively one-off effects and partly due to measures taken in the interest of maintaining stability, the economic output in 2012 lagged behind the planned and behind what had been expected during the year. Thanks to the budgetary corrections introduced with the purpose of observing the targeted deficit the cash-flow balance of the central subsystem of the budget turned out to be better than the amended deficit target. The debt consolidation of the municipalities, as well as the transformation of the structure of the task- and institutional systems have also contributed to the fact that the balance of the municipal sub-system turned out to be significantly more favourable than originally planned.

2. According to the judgement of the Council the taken governmental measures, the decline of the agricultural output, the recession of the EU economy, as well as the outsourcing of the production of certain industries have jointly contributed to the economic recession that was bigger in the second half of the year than originally expected. The level of national economic investments in 2012 suffered an additional set-back; within it the low level of investments financed by own resources of the central budget also contributed to the improvement of the budget balance. Thanks to the stabile position of the public finance in the second half of 2012 one of the fundamental pre-conditions of lasting economic growth was established.
3. In the Council's opinion the continuation of the GDP-proportionate public deficit decrease requires additional commitment and efforts from the government.
4. In the Council's opinion it would be necessary to have regular and adequately deep, topical governmental information on the trend of the budgetary situation of the municipal sub-system, of all the components of the public debt (gross and net debt of the central subsystem, the debt of the municipal subsystem, the debt of other organisations classified under the governmental sector). The trend of the deficit and debt of the whole of the public finance throughout the given year can be followed only when these data are available.

### **III**

#### **Justification**

On the basis of analysing the budgetary processes of 2012 altogether it can be established that the risks related to the execution of the budget act were primarily realised on the revenue side. In respect of the original expenditure

appropriations the excess was the result of having raised pensions – because of the higher than planned inflation rate and the transgression of the appropriations for the co-payment of medications. Apart from this, interest rate expenditures have significantly exceeded the planned however this was balanced by the bigger than planned interest rate revenues and the interest rate risk reserve. The balance improving effect of the measures of the Széll Kálmán Plan 2.0 expected in 2012, the resolutions of the Government made in the first half of the year and the balance improving measures introduced in October 2012 served the purpose of handling the risks arising in the course of the year. Upon the decision of the Government – and the recommendation of the Council – they did not use the Country Protection Fund.

## **1. The trend of the macroeconomic conditions**

Ever since the macroeconomic prognosis of the Government that served as the foundation of the 2012 central budget, the forecasts have continuously worsened. The submitted budget counted with a GDP growth of 1, 5 %.

In harmony with the changing forecasts the Government reviewed the growth course. As a result of this review the prognosis of the EDP Report completed in October 2012 was foreseeing a 1, 2 % decline in the annual volume of the GDP and was also counting with the unfavourable effect of the amendment concerning the year 2013 as well. Taking into consideration of its earlier opinion about the economic growth, the Council had considered it appropriate also in its evaluation of the processes in first nine months of the year.

Throughout the year growth perspectives of the world economy have worsened, the domestic agriculture output in 2012 has strongly weakened, the budgetary correction has decreased the aggregate demand, the decline of investments

(especially in the building industry) continued and all these factors resulted in having a 1,7 % decline of the gross domestic product.

The inflation rate reached 5,7 %, exceeding significantly the predictions of the prognoses.

## **2. Meeting the deficit goal of 2012**

As a consequence of the uncertainty of the macroeconomic processes and their becoming more unfavourable, the public finance deficit has been under continuous corrections by the analysing organisations, the international institutions and the Government as well. In October 2012 the Government raised the proportion of the ESA deficit target from 2,5 % - that had been used when calculating the 2012 central budget – to 2,7 %. In its Opinion of October 2012 the Fiscal Council considered the observance of the deficit target viable only in case the Country Protection Fund was not used.

Partially due to meeting the recommendations of the European Commission, maintaining its commitment to stability during the year, the Government adopted several measures with the purpose of keeping the budgetary deficit below 3 %. The Government Resolution 1036/2012. (02.21.) prescribed expenditure reducing and a ban on equipment procurement for budgetary organisations. Government Resolution 1122/2012. (04.25.) – related also to the Széll Kálmán Plan 2.0 – tried to ensure the targeted balance by ordering blockings, expenditure savings and introducing the telecom tax, while Government Resolution 1428/2012. (10.08.) wished to ensure this target mostly by blockings. As a result of the above measures the cash-flow balance of the central subsystem of the public finance turned out to be slightly better than the

mid-year amendment, while the balance in the municipal subsystem of the public finance became significantly more favourable.

### **3. The implementation of the public debt rule**

In the fiscal framework the public debt rule of the Basic Law of Hungary prescribed an annually decreasing debt rate. In 2012 the GDP proportionate public debt dropped from the previous year's 81, 4 % to 72, 9 %. The gross debt rate however is significantly higher than what would be the relevant threshold value for the country, i.e. both the 60 % level stipulated by the Maastricht Treaty and the GDP proportionate 50 % level stipulated by the Basic Law of Hungary.

The unfavourable trend of the external conditions (the crisis in the Euro area, the slow growth rate), as well as the budgetary corrections have also contributed to the declining of the real value GDP that, on the other hand, endangered the decreasing of the GDP proportionate debt indicator. In its Opinion of October, 2012 the Council called the attention of the concerned, indicating that the financial situation of the country continued to remain vulnerable because of the high level of indebtedness.

On the basis of the data of the first six months the Government did not have to ascertain the danger of the decline of the debt indicator; the Government's introduced measures had helped the mitigation of the risks. Several factors did play a role in the decreasing of the 2012 public debt. The major part of the decrease resulted from the fact that the rate of exchange of the Hungarian currency (Forint) became stronger compared to the Forint/Euro rate of 311 in the previous year to Forint/Euro 291. The surplus of the primary payment service balance mitigated the public debt while the higher than planned interest payments contributed to the increasing of the public debt. The decreasing GDP

affected the growth of the debt rate. Apart from the above the selling of the assets of the Pension Reform and Indebtedness Reduction Fund contributed to the mitigation of the debt rate by 1, 1 % of the GDP. The stock of Government Securities that had been transferred from those private pension fund members who switched to the public pension system in 2012 to the Pension Reform and Indebtedness Reduction Fund and that was destroyed later, also contributed to the decreasing of public debt. The fact that in December, 2012 the central budget gave support to the municipalities with less than 5 000 inhabitants in the value of 0, 3 % of the GDP also contributed to the mitigation of the public debt.

#### **4. The trend of the revenues**

From the aspect of the trend of the cash-flow processes having negative effects have prevailed throughout the year on the revenue side of the central budget's subsystem. The tax revenue decreasing effect compared to the appropriations appeared primarily in case of the payments of economic enterprises (HUF 245 billion) however, significant arrear in revenues from personal income tax (HUF 76 billion) and VAT (HUF 70 billion) was also detected.

In regards of economic enterprises the biggest losses were manifested in the simplified entrepreneurial tax (HUF 78 billion), gambling tax, under the title of other payments (HUF 32 billion) and the special bank tax (more than HUF 100 billion). Payments from corporation tax has also lacked behind the annually foreseen HUF 365 billion by HUF 14 billion as well. The payments from social contribution tax were in harmony with the annual appropriation.

When evaluating the data of the first nine months of 2012, in its Opinion 11/2012.10.29., the Council pointed out the risks on the revenue side and the arrears that could be projected. The fact that due to the number of people opting



for state pension instead of private pension funds, a surplus worth of HUF 50 billion arose according to the EDP report, has diluted the mid-year tensions. The Government made up the lack of revenues by several measures (raising the excise tax upon tobacco products, introducing the reverse taxing in relation of grain sales, the telecom tax and blockings).

Thanks to the transforming of the taxing system, substantial shifting of proportions occurred in the debtors' structure. The emphasis shifted from the income-type taxes to taxes related to consumption.

## **5. The trend of expenditures**

The processes on the expenditure side have balanced out the shortfall of tax revenues in comparison to the appropriations as contrary to the appropriated amount in the central subsystem the expenditures did show a balance of HUF 257 billion less than originally planned. The balance improving measures that were made throughout the year have been playing a decisive role in this, together with the maintaining of the free reserves. Due to the blocking of appropriations, respectively their decreasing, more than HUF 200 billion expenditure restraints were realised, the not using of the balance securing reserves of the chapters included. Apart from the above, using less than the planned EU supports together with the saving of the related domestic contributions, have also mitigated the expenditures.

At the same time, the effect of the expenditure decreasing measures was mitigated by the retrospective raising of pensions and pension-like entitlements by 1,6 % - due to the higher than planned inflation rate - (HUF 88 billion) and the dynamic mid-year raise of medical-prevention entitlements and the medication co-payments (HUF 30 billion).

Additional expenditure surpluses appeared in other appropriations of the budget, like in case of individual and normative supports, supports given to the public media, supplements to consumer prices and housing supports. The amount of guarantee validations has also surpassed the appropriated sum.

Expenditure decreasing measures continuously have resulted smaller or greater tensions in the financial management of budgetary organisations. Seeing the safe realisation of the targeted balance at the end of the year it was possible to partially release the blockings and to raise healthcare expenditures.

16<sup>th</sup> July 2013

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