OPINION OF THE FISCAL COUNCIL

on the uniform proposal no. T/12415/1041 on the 2014 central budget of Hungary

I

Antecedent, legal basis and publicity of the Opinion

According to Indent (3) Article 44. of the Basic Law of Hungary, the prior consent of the Fiscal Council (henceforward: the Council) is necessary for the acceptance of the Central Budget Act and the promotion of the observance of the stipulations of Indent (5) Article 36. In harmony with this stipulation the Council's task is twofold. On the one hand, according to Indent (3) § 25. of Act CXCIV of 2011 on the Economic Stability of Hungary (henceforward: Stability Act) the Council shall inform in writing the Speaker of the National Assembly about its Opinion concerning the uniform proposal. On the other hand, the Council shall formulate its standpoint concerning the prior consent required for the adoption of the uniform budget bill, in harmony with the stipulations of Indent (3) § 25/A. of the Stability Act. In this connection the Council shall examine if the uniform proposal, respectively the amendments prior to the final vote, correspond with the regressive tendency of the size of the GDP proportionate public debt, as per the regulation of Indent (5), Article 36 of the Basic Law of Hungary (henceforth: public debt rule).

By its Resolution No.11/2013.09.23. the Council delivered its opinion on the Bill on the 2014 central budget of Hungary (henceforth: the Bill) that the Minister of State for National Economy forwarded on 13th September 2013. As to the authenticity and feasibility of the Bill the Council had no such fundamental objections that would have justified the indication of non-concurrence regarding the submitted document.

In its Opinion regarding the macroeconomic forecast of the Bill, the Council determined that the 2 % government forecast regarding the economic growth can be achieved, considering the international recovery and domestic demand – built on household consumption, investments financed by EU resources and the investments of the private sector gaining resources from the second phase of MNB's (Central Bank of Hungary) Funding for Growth scheme. At the same time the 2 % GDP growth falls in the upper zone of both the domestic and international institutional forecasts.

The Council also indicated that although the targeted deficit is below only by 0, 1 % the stipulated EU requirement of 3 % and the improvement of the public debt indicator is merely a few tenth, the 2, 9 percent GDP proportionate targeted deficit for 2014 and the decrease of the 2014 public debt indicator – calculated according to the Stability Act – measure up to the requirements. In this respect the Council noticed that the lower than expected economic growth, the lower than calculated inflation or the even the slightly higher than estimated measure of local governments' deficit and debt, respectively of the debt of other organisations classified in the governmental sector might hinder the fulfilment of the public debt rule and the observance of the targeted deficit.

When formulating its Opinion and taking into consideration the sustainability of the economic boom, the Council evaluated the risks of the 2014 central budget altogether as being low however, considered the effect of the growing consumption in respect of the sales tax and the whitening of the economy, over-optimistic. The Council identified negative risks regarding the foreseen revenues from selling frequencies. From among the expenditures it deemed that appropriations of higher education and human services were stretched. Additionally, the Council indicated risk concerning the use of EU resources (and own resources). Hence, the Council recommended that the Government should carry out further analyses regarding the aforementioned risks and the elaboration of measures fit for managing those risks.

According to the governmental response to the Opinion of the Council – on the basis of the newly completed risk analyses concerning the expected macroeconomic processes, the budgetary revenues and expenditures – the earmarked reserves shall be adequate and, in case of significant lack of revenues respectively, over-fulfilment of expenditures, the 2014 targeted deficit can be observed.

The Council also reviewed the budget bill submitted to the National Assembly. It has authorised the Chairman of the Council that in the general debate he should emphasise that, because the amendments were negligible when compared to the draft bill, the findings of the Council concerning the draft bill – thus the statement regarding the sustainability of the macroeconomic course, together with the awareness-raising remarks of the Council about the necessity of tight financial management and the risks threatening the fulfilment of individual appropriations, were justified and valid also in respect of the budget bill.

Parallel with the debate on the 2014 central budget bill, the National Assembly also accepted the tax related and other laws that serve as the base for next year’s budget.

On the 26th of November, 2013 the National Assembly voted the revenue and expenditure totals and the respective deficit of the central budget, as well as the chapter totals (the ‘Justification’ deals with some of the diversions that shall not result in fundamental changes).

On 12th December 2013 the Speaker of the National Assembly forwarded the uniform proposal T/12415/1041 concerning Bill T/12415 on the 2014 central budget to the Chairman of the Council, asking for the Opinion of the Council, in harmony with Indent (3) § 25 of the Stability Act.

Similarly to the procedure followed when formulating its Opinion on the Bill, apart from the opinions of the State Audit Office of Hungary and of the Central Bank of Hungary, the Council was relying also on the economic forecasts of independent experts commissioned by the Chairman of the Council, analysing institutions (*GKI Economic Research Institute, Századvég Economic Research Institute*), reliable international organisations and other market researchers and formulated the Council’s Opinion considering these forecasts.

In the framework of its contribution to the Council’s evaluation, the State Audit Office of Hungary completed a repeated audit prior to the final vote. The audit was focusing on the public debt indicator. In the course of this audit the SAO checked the debt of the subsystems related to public debt, thus the debt of the central subsystem and of the local governments, as well as the debt of other organisations of the governmental sector.

According to the stipulations of Indent (3) §25/A. of the Stability Act the Council shall formulate its prior approval, in a separate resolution.

II

The Opinion of the Council

At its meeting held on 13th December 2013 the Council formulated the following, univocal Opinion:

1. The Council found that, on the basis of the uniform budget bill no. T/12415/1041. the GDP proportionate public debt to be expected by the end of 2014 meets the requirement of decrease stipulated by Indent (5) Article 36. of the Basic Law of Hungary.
2. By accepting the Bill the GDP proportionate public debt deficit, calculated according the 2014 EU methodology, shall remain below the 3 % required by the European Union. In case of certain appropriations though the Council identified risks thus, it deems it necessary that – in harmony with the contents of the Bill – the Country Protection Fund shall not be utilised until 30th September 2014.
3. On the basis of the review of the updated forecasts and calculations concerning the revenues and expenditures depending on the macroeconomic conditions the Council found that the risks identified earlier on the revenue side of the central budget remain existing however, their measure has decreased. The amount planned for the coverage of the risk damages in the Country Protection Fund appears to be adequate.
4. The Council called the attention to the consequences of the strict implementation of the stipulations of the budget bill. This shall lay the foundations for the balanced public finance together with the calculable budgetary environment that makes sustainable economic boom possible.

III

Justification

1. The reality of the macroeconomic forecast serving as the foundation of the budget bill

Following the annual 1, 7 % decrease of the GDP volume, in 2012 the trend took a favourable turn in 2013 and the economy started to grow from the recession: external economic environment was improving, international prosperity was picking up, public investments built on EU resources expanded, the building industry, vehicle industry, agricultural output and domestic consumption expanded. According to the Opinion No.11/2013.09.23. of the Council prepared by analysing the economic processes, employing the forecasts of domestic and reliable international institutions, in 2013 the GDP volume could develop according to the Government's macroeconomic forecast – as considered in the course of the preparation of the 2014 central budget – or even above that (around 1 percent).

As regards 2013 – as a result of the favourable changes in both the external and internal conditions – from time to time, the forecasts have improved. Thanks to the improving economic performance and the mid-year correction measures introduced by the Government with the purpose of observing the targeted deficit of the public finance (blocking appropriations, raising of transaction fees, pressing for the payment of additional contributions, etc.) the risks threatening expenditures and revenues have been mitigated and thus have helped the achieving the targeted deficit of the government – as the Council stated in its several Opinions.

Although some of the governmental measures have not invigorated the economic output yet, they promoted the maintaining of the economic and fiscal/budgetary stability and led finally to the termination of the Excess Deficit Procedure (EDP).

It is expected that, on the foundation of the 2013 performance, the economic growth will accelerate in 2014. According to the expectations the economic prosperity shall also gain momentum in the European Union that – especially the German economic output – shall offer further chances for domestic growth in Hungary. Upon having regularly reviewed their forecasts so far, reliable forecasting organisations foresee an economic growth close to the 2 % prediction of the Government, or even surpassing this percentage.

The fact that the amendment of the budget bill created the possibility of overtaking the remaining local governmental debt by the central budget has promoted the financial management of the local governments and potentially their respective investment activities. Namely, local governments can use their financial means thus liberated, for the development of local economy, saving jobs and expanding job opportunities.

2. The underpinning of the revenues and expenditures of the budget, the tenability of the targeted deficit

The realisation of specific revenues of the 2013 central budget - that is considered as the basis of the planning - together with certain taxes can be expected below the appropriated level. Apart from the inflation trend, the rhythm and level of income outflow and the effect of governmental amendments, the over-optimistic governmental calculations that overestimate the effects, can be named as factors.

As to the realisation of revenues, it is apparent primarily in case of VAT revenues that especially are in danger. The government expected more tangible results from the improving efficiency of tax collection. However, this was only partly realised because of the not full-range implementation of the online registration system of cash registers.

Despite the mid-year raising of one-time payment obligations and the termination of the upper limit, the realisation of the financial transaction tax appropriation – the planning of what has not been adequately underpinned – represents a risk.

Following the submission of the 2014 budget bill the risks on the base side altogether have been mitigated, thanks to the quicker growth pace of the VAT and personal income tax revenues, the mid-year corrections and the 2013 excess revenues coming in from the selling of frequencies.

It was favourable that when preparing the budget bill, in case of the underachieving taxes, they were calculating with the expected realisation as the basis for 2014 instead of the appropriated amounts. Although this shall mitigate the 2014 risks to a considerable extent, the VAT revenue appropriation remains to be higher than underpinned expectations. The risk is increased by the fact that since the submitting of the Bill they have increased the appropriation by HUF 14 billion (thus establishing cover for the support of the communal transportation system of the capital). The risk is growing as the full range online connecting of the cash registers keeps being delayed. At the same time, the risk is somewhat decreased by the fact that the reassignment under the category of a more favourable VAT rate concerned only a narrower group of goods than originally planned, i.e. only live pigs and pig carcases.

Compared to the situation known at the time of the submission of the 2014 budget bill, in case of tax revenues and apart from the above mentioned amendments of the VAT regulations – the amendments concerning the registration tax, the bank tax, utility line tax, personal income tax (SZJA), corporation tax TAO) and small business tax (KATA), have had but a marginal effect. At the same time, the said amendments don't seem to support the expectations of the government concerning the increasing number of taxpayers opting for KATA and KIVA (small enterprise tax) in 2014. The 2014 appropriations for financial transaction tax and telecom tax remain to bear only low level risk.

Altogether, compared to year 2013 the revenue side structure of the budget shall not change significantly however, the expansion of the economy shall increase the revenues. From the aspect of predictability it is good that, following the fundamental transformation of the tax system in the previous years, there shall not be significant changes in 2014. The sole significant measure shall be only the expansion of the eligibility of family tax relief for social security contributions.

As regards the expenditure side of the 2014 budget bill, the Council did not detect significant uncertainties that would concern the predictability. It is a positive sign that when voting the amendment motions submitted for the Bill, the Council could not detect any intention of over-spending as regards the chapter revenue and expenditure totals.

With the purpose of making the perceptible revenue and expenditure risks of the Bill manageable, the Council recommended the Government to repeatedly review the reserves that are significantly decreasing in 2014 in comparison to the amounts of 2013. The Government did not deem it necessary to raise the amount of reserves. In the course of voting the chapter totals the appropriated reserve of extraordinary governmental measures (HUF 120 billion) was decreased by rearranging HUF 7 billion. As a consequence, the amount of the reserves is nearing the minimal amount stipulated by the law (0, 5 % of the expenditure side of the central budget).

The significantly smaller risks than in 2013, justify that the Country Protection Fund appropriation is considerably smaller than in 2013. The appropriated HUF 100 billion would still be enough to counterbalance the revenue risks estimated by the Council however – naturally – it does not offer a cover to offset the arrears in revenues and growth of expenditures in case of a significantly more unfavourable turn in the economy that predicted.

3. Feasibility of the public debt rule

The Council's Opinion given for the budget bill considered the stipulations of the public debt rule feasible - in harmony with the Basic Law of Hungary - even if it qualified the mitigation of the public debt indicator as modest. Since that time, no decisions have been made that would have endangered the decrease of the GDP proportionate public debt. The take-over of the local governments' debts for the central budget shall take place within the public finance hence it shall not concern neither the public finance deficit, not the amount of public debt.

In the course of checking the calculation of the public debt indicator the State Audit Office found that, first of all in case of organisations classified in the local governmental and the so-called, other governmental sectors, a deficiency in data provision and recording exist. However, as regards their size these are not significant and don't influence in effect the value of the public debt indicator.

It should be noted that a significantly lower than planned inflation (2, 4 %) would represent a threat from the aspect of the decrease of the GDP proportionate public debt.

The Council considers the targeted deficit feasible and the public debt rule observable, supposing, the conditions of the external macroeconomic course won't change, i.e. the opinion concerning Hungary shall improve, the trust of investors shall strengthen and, thanks to the lower margins, financing the central budget shall become cheaper and budgetary expenditures shall not increase due to indebtedness.

At the same time, on the basis of the above and with special regard to the slight improvement of the public debt indicator in 2014, while the planned deficit shall remain by merely 0, 1 % below the measure stipulated by the European Union – according to the Bill – the Council emphasises that meeting the requirements of the Basic Law of Hungary and the acquis communautaire of the EU demands strict financial management also in 2014 at all levels of public finance. This shall lay the foundations for the public finance balance and a budgetary environment that would promote lasting economic recovery.

Budapest, 13th December 2013

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