

## **Opinion of the Fiscal Council**

### **on the state of the execution of the 2013 central budget of Hungary and the expected trend of public debt (characteristics of the first half of the year)**

#### **I**

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

According to Point c), Indent (1) of § 23 of Act CXCV of 2011 on the Economic Stability of Hungary the Fiscal Council (henceforth: the Council) shall give an opinion every six months on the status of the execution of the central budget and the expected trend of public debt.

With the present Opinion the Council is fulfilling the obligation stipulated by the Stability Act when summarises its evaluation of the characteristics of the major processes related to the execution of Act CCIV of 2012 in the first half of the year and the public debt trend.

By maintaining its awareness-raising notes regarding the risks, its earlier opinion and consent, the Council hereby presents its Opinion, being aware of the followings:

- On the basis of the uniform proposal to amend the 2013 central budget bill (T/7655) and the uniform evaluation of the amendment motions the Council formulated its standpoint related to the motion in its resolution 13/2012.12.08., in harmony with Indent (3) Paragraph 25 of the Stability Act. As regards the grounding of the revenue side the Council detected uncertainty concerning the revenue appropriations of small business taxes, the specific tax of small taxpayers and of the simplified business tax (EVA); pointed out risks as regards the fulfilment of the financial transaction tax, the appropriation of measures targeted to improve the efficiency of tax collection; in case of contributions because of the targeted preferences and regarding the feasibility of the gambling tax. The

Council underlined that the basis of tax assessments might be lower than the calculated level thus, in case of the major taxes (corporation tax, VAT, excise duty) and the incoming revenues they might be lower than the amount appropriated by the central budget act. Keeping in mind the revenue reducing risks the Council called the attention to the necessity of the consistent and implemented with due care realisation of the budget and the risks of growing expenditures throughout the year. The Council also called the attention to the risks of short term macroeconomic forecasts, as a consequence of what the growth rate might turn out to be lower than planned. The awareness-raising notes of the Council described in this resolution have been supported by the economic processes of 2013, first of all the realisation of the budget so far, the foregone revenues of specific incomes in the first half of the year, the vulnerability of the economy and the lagging behind output of the economy compared to the expected.

- In its resolution 1/2013.03.05. the Council formulated its Opinion of the motion (T/10332) on the amendment of Act CCIV of 2012 on the Central Budget of 2013 and the submitted to the above motion amendment (T/10332/4.) The Council also gave its prior consent (2/2013.03.25.) to the final voting on the bill. In the above Opinion the Council did not raise fundamental objections with regards to the authenticity and feasibility of the draft aiming at the amendment of the Act that would have justified the indication of non-concurrence concerning the submitted document. At the same time the Council emphasised that frequent law amendments spoil the predictability of budgetary financial management. The Council also called the attention to the necessity of maintaining strict budgetary discipline also in the future.

When formulating its Opinion the Council took into consideration the evaluations and analyses prepared by the State Audit Office of Hungary (ÁSZ) and the Central Bank of Hungary (MNB) – these have been available also on the website of the Fiscal Council – independent from the contents of the Government evaluation that will be completed later. Additionally, the Council was relying on the analyses and opinion of independent experts, just like the work documents prepared in the sphere of competence of the Secretariat of the Council.

The work document prepared by ÁSZ, titled “Analysis of the budgetary processes of the public finance in the first six month of 2013” evaluated the feasibility of the central budget by considering the effects of the cash-flow data of the public finance in the first six months of 2013, together with the governmental measures concerning the budgetary processes, and reviewed the macroeconomic risks. The document also gave an analysis of the implementation risks and the feasibility of observing the public debt rule.

The analysis prepared for the Fiscal Council by MNB titled “2012 evaluation of public finance processes in 2012 and the expected trend of 2013” offered a review on the budgetary processes of 2012 and the first half of 2013, the expected feasibility of the budget of the subject year and the rules concerning public debt, by relying on the macroeconomic changes, the available data on the central budget of the running year, the government’s measures introduced with the purpose of improving the balance and the expectations of the Central Bank.

The Council shall inform the competent officials of the National Assembly and of the Government and shall publish its Opinion.

## **II**

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

At its meeting held on 16<sup>th</sup> July 2013 the Council unanimously formulated its Opinion as follows:

1. The Council reviewed the major processes of the execution of the 2013 Budget Act in the first half of the year. It established that compared to the pro rata revenues, arrears have arisen in case of a significant portion of the revenues. These arrears are basically related to the trend of the macroeconomic course (lower economic growth rate and inflation compared to the measures calculated with when preparing the budget plans), uncertain external conditions, the fact that the newly introduced taxes have been difficult to plan with and, in case of specific appropriations, the excessive governmental forecasts.
2. In the Council’s opinion the balance improving measures stipulated in the government resolution in May 2013 and the amendments concerning

specific obligations deriving from the principle of equality before public burdens (mining fees, health contribution, telecom tax, financial transaction tax) have also contributed to the correction of the budgetary processes of the first half of the year. It is expected that the amendments shall promote the reaching of the targeted deficit of the government.

3. Being familiar with the available data, the Council is on the opinion that the GDP proportionate deficit of the public finance in 2013 can be kept on the planned level by executing the measures introduced with the purpose of promoting disciplined budgetary financial management and by not using – either partially or fully – the Country Protection Fund. Nevertheless, in the second half of the year the balance remains depending on the trend of the macroeconomic processes (economic growth, inflation, processes of the securities' markets).
4. According to the Council, calculating with an invariable rate of exchange, the GDP proportionate public debt could lessen throughout 2013 in comparison to the previous year. According to this scenario the debt rule stipulated in the Basic Law of Hungary shall be met by all probability. The low growth rate of the nominal GDP however shall mitigate the improving of the public debt indicator. This low growth rate originates mostly from the historically low rate of inflation. The utilisation of the tools of the Pension Reform and Debt Decreasing Fund might also contribute to the lessening of the public debt.

### **III**

#### **Justification**

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

The external macroeconomic environment remains uncertain. In the first quarter of the year the growth of global economy continued although the moderately improving GDP indicators were hiding significant regional differences. US economy was growing moderately while the economy of the developing world showed dynamic growth. As to the Euro zone, the recession experienced in the previous year continued. Hungarian economy has been performing in a fragile

growth environment; growth and quick recovery from the crisis have been moderated by the crisis of the Euro zone (debt crisis, high unemployment rate, general decrease of demand) as well as the pressures of budgetary amendments that are varying in size in the individual countries.

Compared to the same period of last year the output of the domestic economy in the first quarter of 2013 showed a decline however, when compared to the last quarter of 2012 it showed an increase of 0,7%. Together with other investment incentive measures and those encouraging the trust of investors might be an indicator of the expected turn in the growth rate, following the launching of the Growth Supporting Loan Programme and the fruition of the effect of demand-streamlining fiscal measures.

The forecasts of moderate international organisations (European Commission, IMF and OECD) concerning real economic indicators vary in a relatively narrow zone: they predict this year's domestic GDP growth between 0 to 1% (only IMF forecasted stagnation for the year); they expect the expansion of Hungarian exports between 1,2 and 1,7%; foresee the balance of the current balance of payment between 2,1 and 3,3% of the GDP and estimate the trend of the consumer price index between 1,2 and 4,2%.

Apart from the above additional positive signs can also be detected: moderately though, but the outlook of the German economic output – that represents pulling force from the aspect of Hungarian export – have been improving. The domestic unemployment rate decreased to 10,5% by the end of the first half of the year (this rate is 12,5% in the EU). The growth of household consumption was observed in the second quarter (the volume of retail sales grew by 2,5% in May). At the same time investment rate has improved somewhat yet, it remains low (16,8%) and as a result conditions of growth remain vulnerable. The lower than expected and lower than calculated in the budget inflation rate increased the real value of incomes and cash social entitlements on the one hand, but decreased the nominal taxes and thus increased the risks of the revenue side of the budget.

## **2. Feasibility of the targeted deficit**

Originally the planned deficit of the central subsystem for the whole year was set at HUF 842 billion and the amended appropriation was HUF 880 billion. At the end of the first half of the year the deficit reached the amount of HUF 722 billion that exceeded 80 % of the annual deficit. The budgetary processes of the first quarter have already strengthened the risk threatening the observation of the targeted deficit that equalled 2, 7 % of the GDP (due mostly to the low taxes and the revenue arrears resulting from other reasons in comparison to the planned).

The Government partially handled the deficit growing effect of the unfavourable processes by blocking the expenditures of the budgetary organisations and professional chapter managed appropriation controlled by the Government, in its resolution 1259/2013.V.13. Apart from this, by the amendment of certain laws of equality before public burdens, effective as of 1<sup>st</sup> August [raising the financial transaction tax and the mining tax, the expanding healthcare contribution (EHO) to interest revenues], by prescribing new payments (one-off banking obligation related to the financial transaction tax) the Government has increased the revenues as well. All together the above measures have the potential of improving the balance by 0, 6 to 0, 7 % of the GDP that in this way might turn out around the targeted deficit of the Government, by taking into consideration the savings on the expenditure side too.

Most of the analysing organisations found the Government's targeted deficit for 2013 feasible – with the exception of the IMF that completed its last forecast prior to the announcement of the revenue growing measures. The fact that the European Commission terminated the excess deficit procedure against Hungary due to the introduced measures is also a favourable sign.

However, the secure observance of the targeted deficit justifies the not using of the Country Protection Fund. Partial spending from the Fund could be feasible probably at the end of the year, in case of the favourable trend of the budgetary processes and by maintaining the strict control over the execution of the central budget. Another decisive circumstance would depend on whether the slight economic growth experienced in the first quarter could be strengthened in the second half of the year – also by launching the Growth Loan Programme.

### **3. The prevailing of the debt rule**

At the end of the first quarter of 2013 the gross, aggravated and nominally calculated (Maastricht) debt of the public finance was 82, 4 % of the GDP (at the end of 2012 the proportion was 79, 2 %). Basically the temporary weakening of the Forint's rate of exchange, the use of state resources exceeding the pro rate measure and the lower than planned nominal GDP contributed to the quarterly raising of the indicator. In the first half of 2013 the Government used state resources exceeding the financing needs (issuing foreign currency bonds and bonds in Forints). The reasons for the extra sales were partly the favourable market procedures in the first half of the year (decreasing profits, vigorous demand) and partly the higher than planned, pro rata deficit of the public finance in the first half of the year.

By the end of 2013 the GDP proportioned public debt might be reduced below the level of the end of 2012 by not using the free reserves and by calculating with unchanging foreign exchange rate. In case of the trend of the rate of public debt however, the change in the nominal GDP in 2013 represents fundamental importance that is influenced also by the volume effect and the growth of the price level (GDP-deflator). In the denominator of the public-debt indicator the current price GDP is recorded and thanks to the significantly more favourable than originally calculated inflation rate, the current price GDP growth is less. This alone has an unfavourable effect on the trend of the 2013 public debt indicator. Despite the above the GDP proportionate gross public debt might be reduced in 2013 to probably 78, 5 % from the 79, 2 % in 2012 – presuming a 2, 7 % ESA balance and the use of state resources not exceeding the necessary level. Consequently, the debt rule of the Basic Law of Hungary is observed. A bigger debt reducing could be made only in case of a quicker GDP growth. The Pension Reform, the Debt Decreasing Fund and the fact that the cash-flow deficit that is playing a decisive role from the aspect of indebtedness are contributing to the decreasing of the debt in 2013.

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

The cash-flow revenues of the central subsystem in the first half of the year amounted to the 46 % of the annual appropriation. The diversion of the macroeconomic course, primarily the lower than expected by the central budget act inflation rate, the moderate consumption and the gross payroll, together with

the size of investments in the cash-flow processes of the first half of the year have significantly made themselves felt.

The biggest arrears appeared in regards of the specific payments of economic entities (credit institution's allowance, gambling tax, specific tax of small taxpayers) and, from among taxes related to consumption/turnover: the financial transaction tax, the excise tax and the general value added tax. In the first six months of the year the revenues collected from the financial transaction tax reached HUF 69 billion, that was 23 % of the planned annual revenue of HUF 301 billion. The raising of the tax rate announced in July might promote the fulfilment of the appropriation, together with the cancelling of the limit on cash withdrawals and the prescription of the obligation of one-off payments. However, even with these amendments the fulfilment of the annual appropriation remains questionable, primarily as a consequence of its lower than planned net balance improving effect of the contributions burdening the budgetary institutions.

As regards the lower than planned bank tax revenues the lower than expected level of the utilisation of the so called fixed rate plan system was the cause. It has to be noted however that this does not represent a risk on the level of the central budget as a whole, as the accounting of the fixed rate plan system shall compensate the loss of revenues, i.e. under the title of housing programme subsidies less amount burdening the budget is (will be) paid. In case of the mining tax the decreasing oil prices and the decrease in the official gas prices – introduced at the beginning of the year – resulted in significant losses. These losses might partially be compensated by the raising of the mining tax rate, as adopted in June.

In case of the specific taxes of small taxpayers and of taxes paid by small businesses, the significant arrear is related to the lower than expected number of taxpayers opting for the above forms of tax payment. At the same time, thanks to the lower number of those stepping over, we were witnessing an improvement in case of the following revenues: corporation tax, simplified business tax and social contributions. This, altogether, has a balance improving effect when compared to the original plans. As regards the corporation tax the arrears are less (47 % of the appropriation was met). It has to be taken into consideration that as a result of the obligation of uploading advances, a significant part of the annual business tax shall be arriving in the budget in December and this

represents some uncertainty however, the extent of departure from the appropriation very likely shall be insignificant.

The revenue appropriations of taxes related to wages, contributions (personal income tax, social contribution tax, healthcare contribution) altogether were realised slightly above the pro rata level. The fact that significantly less than the expected number of taxpayers opted for newly introduced small business taxes (KIVA – small business tax, KATA- specific taxes of small businesses) has contributed to a large extent to this as this way the loss of the contributions and personal income tax turned out to be less than the planned amount. In case of the personal income tax – among others – it was the measures targeted at keeping the net wages (the raising of the minimal wages by 5, 4 %) and the lower than planned amount of tax returns, that compensated the decline of payments related to the removal of the half super-grossing.

Fifty-four per cent of the annual appropriation concerning the interest rate and contribution revenues related to debt service, amounting to HUF 101 billion, arrived in the budget by the first half of the year.

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

Forty-nine per cent of the cash-flow expenditure items of the central subsystem were met. The net expenditures of the central budgetary organisations exceeded the expected pro rata proportion of the appropriation, as 57 % of the planned expenditures were fulfilled in the first six months that represented close to HUF 200 billion overrun in the first half of the year. The specific, normative supports and those given to the public media, the socio-political transportation fare contributions and other expenditures were slightly higher when compared to the pro rata. From the aspect of the balance the 30 % fulfilment of housing supports were favourable thanks to its relation to the moderate resorting to the fixed rate plan. Expenditure savings were realised also in case of the expenditure side of the National Family and Social Policy Fund appropriation where, due to the falling short of the expenditures from the planned family allowance and entitlements for those below the set age limit, the fulfilment in the first half of the year neared only 74 % of the annual appropriation.

Expenditures of the separated financial funds were also showing a moderate trend (37 % of the appropriation). In the first half of the year the expenditures of

the social security funds reached 49 % of the appropriated amount. The financial entitlements of the Health Insurance Fund, respectively the preventive and curative health care entitlements were slightly lower than the pro rata amount. On the other hand, other expenditures of the social security funds turned out to be slightly higher. The net expenditures of the co-payment of medicines, the pension expenditures and expenditures of disability and rehabilitation entitlements were in harmony with the pro rata calculations.

Interest expenditures have minimally exceeded the half of the annual appropriation however this is not relevant as the distribution of interest payments is not evenly distributed from month to month. The decline of the securities' performances this year was favourable from the aspect of the balance but the uncertainty regarding the future changes of the yields represent risk from the aspect of the expenditures.

The losses of revenues might be balanced partially by the expected savings on the expenditure side. The blockings announced in May are playing a decisive role in this. The introduced package of measures shall result in a restraint of expenditures worth of HUF 90 billion.

Apart from the above the package concerning the population policy that is being designed might mean additional risk on the expenditure side by the expenses it would involve this year, together with the potential expenditures arising from institutions taken over from municipalities and the 'response reactions' of those sharing the burdens of specific budgetary (revenue increasing) measures. Taking into consideration the above circumstances as well, it seems to be necessary to not use partially or fully the free reserves amounting to HUF 400 billion, to thus ensure the balance.

## **6. Reserves**

The appropriated reserves of the central budget in 2013 amount to HUF 500 billion. In the first half of the year the Government decided on the use of HUF 35 billion against the (general) reserve (HUF 100 billion) separated for the purpose of extraordinary governmental measures and tied up an additional HUF 22 billion for specific measures to be taken in the second half of the year.

The amount of the Country Protection Fund (open and freely useable reserve) is HUF 400 billion (1, 3% of the GDP). In harmony with Indent (6), Paragraph 24.

of Act CCIV of 2012 no payment shall be executed from this reserve before 30<sup>th</sup> September 2013. With regard to the budgetary processes the observation of the GDP proportionate 2, 7 % targeted deficit of the Government demands that neither a part nor all of the Country Protection Fund shall be used.

Budapest, 16<sup>th</sup> July 2013

Domokos László

Member of the Fiscal Council

Dr Kovács Árpád

Chairman of the Fiscal Council