Opinion of the Fiscal Council on the State of the Execution of the 2013 Central Budget of Hungary and the trend of the Government Debt

I. Antecedents, legal basis and publicity of the preparation of the Opinion

According to Point c), Indent (1) of § 23 of Act CXCIV of 2011 on the Economic Stability of Hungary (henceforth: the Stability Act) 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 government debt.

Summing up its evaluation of the budgetary processes of the past year, of the execution of Act CCIV of 2012 on the 2013 central budget of Hungary and – within this – of the connections, characteristic features of the second half of the year, together with the review of the government debt trend, are considered by the Council as part of the above outlined duties of the body.

The Council has dealt with the budget, its preparation, half-yearly evaluation and mid-year amendments. In the present Opinion the Council was building on the following antecedents

- in its resolution no. 13/2012.12.08. on the uniform recommendation of the 2013 central budget and related to the amendments made prior to the final vote, as regards the observance of the targeted deficit and the government debt rule, the Council considered it necessary to refrain from using the increased reserves, to remind the Government to make additional steps to promote the realisation of the targeted revenues as well as to initiate the launching of measures prompting growth. In its above resolution the Council took into consideration that on the basis of the earlier resolutions of the FC (resolutions 4/2012.06.08., 8/2012.07.16., and 9/2012.08.28.) in the course of formulating the bill – upon the recommendation of the Government - they have amended it (have doubled the Country Protection Fund, adjusted both the revenue and expenditures appropriations; the latter together with the changes of the tax system);
- in its Opinion No. 7/2013.07.16. the Council reviewed the trend, major processes and characteristics of the execution of the 2013 central budget and found that as regards

- the major part of the revenues, significant arrears arose. These were fundamentally related to the trend of the macroeconomic course (smaller than accounted with in the course of planning economic growth and inflation), uncertain external conditions, the difficulties related to the planning of the newly introduced taxes and – in case of certain appropriations – to the excessive governmental forecasts. Apart from the above the Council identified that the following factors introduced with the purpose of maintaining the targeted deficit of the government, have contributed to the amendment of the budgetary processes and certain acts: the balance improving measures ordered by a government resolution in May 2013 and the specific obligations of sharing public burdens that came into force as of August 2013 and concerned the revenue side of the central budget (mining fee, health fee contribution, telecommunication tax, fiscal transaction levy);
- additionally, in its above Opinion, the Council called the attention to the fact that the 2013 GDP proportionate deficit of the public finance system can be maintained at the planned level by following the measures introduced with the purpose of carrying out a disciplined budgetary management and by the partial or total non-using of the Country Protection Fund however, the balance also depends on the trend of the macroeconomic processes (economic growth, inflation, government securities' market). Apart from the above the Council also formulated its opinion that counting with constant exchange rate the GDP proportionate government debt could reduce by the end of 2013 – compared to the data of the previous year – thus the debt rule outlined by the Basic Law of Hungary could be met. However, the improvement of the government debt indicator shall be mitigated by the lower than expected growth level of the nominal GDP that is mostly the result of the historically low rate of inflation. The utilisation of the Pension Reform Fund and the Debt Reduction Fund could also contribute to the reduction of government debt;
- in its Opinion (1/2013.03.05., 9/2013.09.07., and resolution 13/2013.11.07.) concerning the proposed mid-year amendments related to the 2013 central budget act and in its Preliminary approval the Council called the attention to the necessity of maintaining strict and disciplined budgetary management as well as to the fact that frequent changes would destroy transparency and technical accountability.

When formulating its Opinion the Council was relying also on the findings of the State Audit Office of Hungary, the analyses prepared by the Central Bank of Hungary, the working documents prepared by the Secretariat of the Council, as well as the evaluations of research institutions and independent experts. The Council could not take into consideration the contents of the final account bill that was built on the final budget data as – according to the stipulations of the final account act – the Government shall present it to the National Assembly only later.

The Council shall inform the National Assembly and the competent officials of the Government about the contents of its Opinion respectively, it shall publish the said Opinion at the website of the National Assembly.

II.
The Opinion of the Council

Reviewing the trends of the major macroeconomic and budgetary processes in 2013, and within that, especially the trends of the second half of 2013, the Council formulated the following opinion:

1. The Council assessed that, thanks to the favourable changes of the international conditions (the effect of the take-off of international prosperity also on domestic economy and the expansion of domestic demand) when comparing the base calculated in the accepted budget as regards the economic output (0, 9 percent) and the degree expected mid-year (0, 7 percent), it has grown more significantly, i.e. by 1, 1 percent. Even by the existing uncertainties of both the external and internal environment, the economy moved onto a growth course.
2. The GDP-proportionate government debt in year 2013 decreased from 79, 8 percent, at the end of the previous year, to 78, 5 percent – according to the regulations of the Stability Act calculated on standard exchange rate, i.e. the debt rule, as stipulated by the Basic Law of Hungary, was observed. Taking into consideration the effect of the changing rate of exchange of the Hungarian Forint, the debt rate reached 79, 3 percent. According to the judgement of the Council, additional reduction would require ongoing governmental commitment and efforts in order to maintain financial stability and the sustainable financing of the public finance system.
3. As a result of the governmental measures introduced with the purpose of stabilising the public finance system, as well as refraining from using the major part of the Country Protection Found – the purpose of what is handling the revenue and expenditure related risks – the cash flow balance of the central subsystem of the public finance system was lower by HUF 200 billion than the targeted deficit that had been increased following the original appropriation (HUF 1 125 billion). The so-called

4. ESA deficit of the public finance system – calculated according to the EU methodology, i.e. containing the surplus of the local governments subsystem and other corrections, was 2, 1 percent, i.e. lower than the planned by 0, 3 percent, following the 2, 4 percent in 2012, mostly thanks to the more favourable balance of the local governments subsystem than the planned balance.
5. It was an important intention of the Government to have Hungary released from the excess deficit procedure (EDP) the threat of what has been looming over the country for 9 years. Hence, with regard to the uncertain economic environment and forecasts, the Government introduced such balance improving measures that guaranteed with great assurance the feasibility of this goal.
6. The Council assessed that the planned revenues of the central budget altogether have been met. The risks that the Council has pinpointed earlier and that originate from the repeated over-planning of the appropriations were manifested in the revenues related to consumption, primarily in case of the VAT and resulted in revenues lacking behind the appropriations. In case of wages and salaries-related taxes and levies excesses developed – in harmony with the expectations of the Council. The restarting economic development and the savings on the expenditures side created a cover for excess expenditures in certain fields, particularly for raising the wages and salaries of teachers and health care professionals in the public sector, and for financing part of the outstanding debts of the health care system.

III.
Justification

On the basis of the 2013 budgetary processes we can say that the risks concerning the execution of the budget act – as indicated earlier in several Opinions of the Council were manifested primarily in the field of tax revenues. As a result of the prescribed locking ordered by the Government in the first half of the year in order to keep the targeted deficit of the public finance system, together with the decrees issued by the National Assembly and valid as of August 2013, concerning mining fees, health care contributions, telecommunication tax, financial transaction levies, the risks of the revenues and expenditures have lessened, thus helping the reaching of the targeted deficit level and the observance of the government debt rule.

The Country Protection Fund did fulfil its original function by the fact that only its 21 percent had been used thus, this also contributed to the reaching of the targeted deficit.

1. The trend of the macroeconomic conditions

The submitted 2013 budget bill presumed a 1, 6 percent GDP growth. Prior to the acceptance of the bill this was modified by the Government to 0, 9 percent, to be followed by another amendment to 0, 7 percent at the time of submitting the convergence program in April 2013.

Starting with the second quarter of the year the economic processes have turned out to be more favourable. As a result the macroeconomic forecasts of both the domestic and international institutions have continuously improved. International and domestic processes have also supported the favourable changes of the economic performance. International economic prosperity started picking up. The starting economic growth was helped by the improving performance of the world economy and from the aspect of the Hungarian performance the growing German economy represented a pulling force. Domestic demand was expanded by domestic consumption on the one hand and investments financed partially by EU resources, on the other hand. On the production side it was the performance of the motor vehicle industry, within the manufacturing industry, and the above the average results of the agriculture can be highlighted. Gross assets accumulation has grown by 5, 9 percent. The ongoing retrogression of the investment rata of the national economy since 2006 stopped and by the last quarter of 2013 it exceeded 18, 5 percent. The above altogether resulted in a 1, 1 percent growth of the GDP, surpassing the expectations.

Inflation turned out to be significantly more favourable than foreseen, apart from the exogenous effects (global reduction of oil and food prices, low level of external inflation environment) mostly thanks to the reduction of overhead costs. Through these the rate of the consumer price growth has lessened on a yearly average to 1, 7 percent. This represented a significantly lower level than the 3 percent foreseen in the forecasts.

Employment rate turned out to be more favourable, partly as a result of the expansion of the public employment programme and thanks to the applying for of the tax and contributions allowances by the employers and offered by the Workplace Protection Action Plan. Apart from this the employing of active tools (training, retraining, etc.) and the appearance of those concerned on the labour market also represented a chance.

2. The enforcement of the government debt rule

The government debt rule of the Basic Law of Hungary prescribes the reduction of the GDP-proportionate government debt (debt rate) expected on the basis of the acceptance of the budget act *ex ante*, net of any effects originating from the changing rate of exchange. At the same time, it is also appropriate to examine the concrete trend of the government debt rate and check if the purpose of the rule, i.e. the reducing of the debt, has been realised *ex post.*

In 2013 – calculating with constant exchange rate – the GDP-proportionate government debt decreased from 79, 8 percent at the end of the previous year to 78, 5 percent. This means that the debt rule stipulated by the Basic Law of Hungary was met. At the end of 2013 the rate of exchange of the Hungarian Forint at 296, 9 EUR/HUF was weaker in comparison to that of a year earlier, i.e. 290, 3 HUF/EUR. This fact in itself caused a 0, 8 percent increase of the debt rate. Thus, the preliminary actual data, containing the changing rate of exchange calculated by the Maastricht methodology was 79, 3 percent.

In case of dividing the change to several factors we can reach the conclusion that the surplus of the primary balance has contributed significantly to the reduction of the debt rate and the picking up of the economic growth has been also a factor. The lower than expected inflation (respectively the GDP deflator) made it more difficult to decrease the debt rate compared to the original plans however, even in this form it still promoted the reduction. On the other hand, the weakening exchange rate of the Hungarian Forint together with the interest rate paid upon the existing debts increased the size of the debt. Apart from the above, the debt management operations were also factors resulting in the reduction of the debt rate, especially the utilisation of the assets of the Pension Reform and Debt Reduction Fund, worth of HUF 268 billion. National Forint and foreign currency deposits presented the resources for additional repurchasing of government bonds and prepayments (for example, IMF loan and local government debt).

In harmony with the Stability Act the Government not even once has had the obligation to say that there was a danger of increase regarding the debt indicator; the introduced measures have contributed to the mitigation of risks.

However, the debt rate remains higher than in other countries of the region with similar level of development and the threshold limit prescribed by the European Union hence, the Fiscal Council supports and deems the debt reduction goals of the Government important.

3. Meeting the 2013 targeted deficit

The public finance deficit – calculated by the EU methodology – became lower than the foreseen 2, 7 percent and turned out to be 2, 4 percent.

The targeted cash-flow deficit of the central subsystem in 2013 has been modified four times during the year: the originally planned deficit was HUF 842 billion and was amended in November 2013 to HUF 1 125 billion. The actual cash flow deficit of the public finance central subsystem in 2013 was HUF 929 billion (in proportion to the GDP this meant 3, 1 percent).

In its Opinion 13/2012.12.08. published prior to the approval of the budget the Council issued warnings regarding the danger of not being able to maintain the targeted deficit of the Government equalling to 2, 7 percent of the GDP, by not meeting the targeted tax revenues, due to over-optimistic estimates and other reasons.

The Government partially handled the effect of the unfavourable processes when, by its resolution 1259/2013. (V.13.), it ordered the locking of the appropriations of budgetary organisations and professional chapter managed appropriations under its control (the amount equalled 0, 3 percent of the GDP). Apart from this – by amending the law – the Government raised the transaction fees, the items of telecommunication tax and mining tax, expanded the health care contribution also to interest rates and prescribed a onetime payment to the banks related to the transaction fee (these measures represented a revenue increase worth of 0, 4 percent of the GDP).

It were partly the above listed governmental measures that established the ground for the decision of the Council of the European Union that terminated the excess deficit procedure (EDP) that has been on the agenda against Hungary for the past 9 years, i.e. since the beginning of Hungary's accession.

Being aware of the unfavourable processes, in the second half of the year the Government decided to increase expenditures in several fields. These were covered by partially lifting the lock of the Country Protection Fund. In harmony with the earlier recommendation of the Fiscal Council, approximately 80 percent of the Country Protection Fund was not spent by the budget and this has significantly (by 1, 2 percent of the GDP) contributed to meeting the targeted deficit.

Apart from this, in meeting the 2, 4 percent ESA deficit, the statistical corrections handling the difference between the cash accounting and accrual based accounting methods (ESA-bridge + 0, 4 percent), among them the asset contribution for the Integration Organisation of Savings Cooperatives. (At the time of its mid-year emergence its accountability was uncertain yet.)

The balance of the local government subsystem was even more positive as regards its effect (+ 0, 6 percent). The mid-year trend of the latter does not appear in the Governmental communication despite the fact that the continuous monitoring of the cash-flow processes of local governments by the Treasury has been completed. In its Opinion 6/2013. 07. 16. (Point 4) the Fiscal Council considered it important that „regular and appropriately profound governmental information were available about the state of all the components of the local government subsystem and of the government debt (gross and net debt of the central subsystem, the debt of the local governments' system) as the mid-year trends of the public finance deficit and its debt can be traced only when having the above information."

4. The trend of the revenues

Altogether the cash-flow revenues of the central budget were realised, in harmony with the 2013 appropriation however, in a different structure. The risks listed in the Opinion of the Council evaluating the budgetary processes of the first half of the year and referred to in the introduction (the budget act's lower than expected rate of inflation, the more moderate growth of consumption and gross wage bill, the over-optimistic governmental plans, etc.) in case of specific revenues (VAT, excise duty, etc.) resulted an implementation below the set appropriation while, in case of taxes and levies related to wages, the implementation was higher than the planned amount.

Revenues from economic enterprises were lacking behind the appropriation by HUF 300 billion. The major part of this amount was made up from the HUF 46 billion worth of arrears from the specific taxes of small taxpayer businesses (KATA), the HUF 120 billion shortfall of small enterprises' tax (KIVA), the HUF 20 billion credit institution fee arrear, the HUF 32 billion mining fee, the HUF 26 billion related to missing revenues from the income tax paid by energy suppliers and the HUF 16 billion shortfall from the planned revenues from gambling fees. In case of the credit institutions' fees the low level of realisation was the result of the lower than expected level of utilising the option of the so-called fixed exchange rate for foreign currency mortgages. However, as regards the complete budget this did not represent a risk and the accounting of the fixed exchange rate compensated the arrears in the revenues, i.e. a lesser amount was paid from the budget under the title of house building support (65, 4 percent of the original appropriation).

The arrears of the mining fee and the income tax of energy suppliers are related to the measures introduced during the year: the losses were due to the so-called overhead reduction and the possibility to deduct mining fees not exceeding HUF 1, 5 billion; in case of the mining fees the reduced oil prices and the official raising of gas prices introduced at the beginning of the year. Even the effect of the mid-year raising of the tax rate of the mining fee could not counterbalance the shortfall.

The foregone revenues from the online gambling tax contributed to the falling short of the expected revenues.

In case of specific items thus, in case of corporation tax and simplified entrepreneurial tax the performance was in harmony with the appropriations. As regards the taxes related to consumption a difference arose between the budget appropriation and the cash-flow implementation (94, 6 percent) amounting to HUF 232 billion. A significant part of this amount appears at the net VAT revenues (HUF 144 billion); a smaller part in case of excise taxes (HUF 50 billion) and the financial transaction tax (HUF 42 billion). As to the underperformance of the VAT revenues it were the over-optimistic governmental planning, the lower than expected inflation, the continuous postponement of switching to online cash registers that contributed to the outcome while, in case of excise taxes the underperformance was related to tobacco products. At the same time, fuel trading was favourable. The revenues from financial transaction tax turned out to be 86, 2 percent of the original appropriation; part of this however did not improve the balance of the budget in a net sense as it originated from the payments of the Treasury, respectively the Government Debt Management Agency.

Appropriations related of the taxes and levies related to wages and salaries over-performed. Within this category the tax and contribution revenues of the Social Security Fund and the National Employment Fund were nearly HUF 300 billion higher than the annual appropriation. In this respect the decisive factor was that only few had chosen the new, favourable tax forms (KATA-taxes of small taxpayers' businesses, and KIVA-small enterprises' tax). The survival of the early retirement insurance fee and the 6 % health care contribution imposed mid-year on interest rate revenues have also contributed to the increase of the revenues, even if to a lesser extent.

The appropriation of interest rate revenues related to the debt service (originally HUF 93 billion) was HUF 132, 6 billion. The reason was that the government debt was financed by a higher liquidity level. A significant part of the HUF 159 billion surplus of additional revenues originates from the selling of public assets. The realisation was the result of the payments of three mobile phone service providers in exchange for extending their rights of frequency use. As regards the posterior return of EU supports and other items of the social security and separated funds, the realisation exceeded the original appropriations.

On the basis of the effect of various taxes and tax-like revenues on the balance of the budget as well as the risks identified in the former opinions of the Council it can be concluded that certain revenues keep being over-planned every year. Hence, it would be necessary to improve the planning of the budget by making risk analyses and evaluations more well-grounded.

5. The trend of expenditures

The cash-flow expenditure items of the central subsystem surpassed the appropriated amount by HUF 48 billion. The diversion essentially originated from the raising interest rate expenditures that turned out to be higher than the estimations by HUF 41 billion, due to the increasing emission of forints. The continuously decreasing government security yields could counterbalance this only partially.

The amount of primary expenditures equals with the appropriation as the excess expenditures appearing under the individual lines were counterbalanced by the fact that 80 percent of the Country Protection Fund had not been used.

They spent less for the homebuilding supports by HUF 70 billion, compared the appropriated amount. The reason was the lower than expected interest for the fixed exchange rate for foreign currency mortgages.

The realisation of family supports and related social benefits is less than the appropriation by HUF 23 billion. The entitlements for those below the age limit were realised by HUF 60 billion less than the appropriation in 2013. A significant part of the departure originated from the entitlements for those below the age limit and was the result of the tightening of regulations valid from 2012 that contributed to the reduction of the number of those entitled.

The net expenditures of the central budgetary organisations and chapters were higher than the appropriation by HUF 342 billion. Apart from certain mid-year expenditure increases (for example the HUF 35 billion spent on introducing the career programme for teachers) it was in the background that the actual spending of the expenditures listed under the reserves (provisions, reserves for extraordinary governmental measures) at the time of planning, does happen exactly at this aggravated expenditure item. As a consequence of the higher than expected resorting to EU resources, the required own contribution turned out to be higher by HUF 135 billion.

Additional expenditures of the central budget exceeded the original appropriation by HUF 213 billion – as a consequence of the mid-year amendments of the law. From among them the capital increase given to MVM Zrt. was worth of HUF 71 billion. That covered the purchasing of the Hungarian gas branch of E.ON and there was an unplanned capital increase of the MFB (Hungarian Development Bank) by HUF 18 billion. The ruling of the European Court prescribed the obligation for the Hungarian state to pay back mining fees worth of HUF 35 billion to MOL Nyrt. (MOL Group) also contributed to the increase of the expenditures. The mid-year establishing of the Integration Fund of Cooperative Banks meant an additional expenditure amounting to HUF 136 billion.

The communal work programme introduced by the Government at the end of the year increased the originally planned expenditures of the Employment Fund by HUF 17 billion. The HUF 27 billion increase under the title of healing and prevention provision of the Health Insurance Fund was the result of the supports given to hospitals for consolidation. In both cases the Government created the cover by internal rearrangement.

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