Opinion
of the Fiscal Council
on the draft bill of the 2016 budget of Hungary

I
Antecedents, legal basis and publicity of the Opinion

According to the stipulations of § 24 of Act CXCIV of 2011 on the economic stability of Hungary (henceforth: Stability Act), the Fiscal Council (the Council, FC) shall give its opinion on the draft bill of the central budget. In its opinion the Council can make comments regarding the draft and – in case it has fundamental objections as regards the authenticity or feasibility of the draft – it shall indicate its non-concurrence.

The approved document of the draft bill on Hungary's 2016 central budget, previously approved by the Government, was forwarded to the Chairman of the Fiscal Council as an attachment of the letter of state secretary Mr. Péter Benő Banai, responsible for the public finance, under file number NGM 12045/27/2015. on 30th April 2015.

The Council formulated its opinion (the FC's recommendations concerning the mitigation of the risk also included) with regard to the antecedents hereunder:

- in its Opinion no. 11/2013.09.23. elaborated for the draft of the 2014 central budget bill the Council called the attention to the possible negative consequences acting against economic growth of the stipulation (debt formula)[1] of Indent (2) § 4 of the Stability Act – valid from 2015 and mandatory to implement in the 2016 budget. Due to this the reviewing of the rule shall be necessary;

[1]Debt formula as per the Stability Act:

Indent (1) § 4 The central budget bill shall state in amount the value of the public finance deficit planned for the last day of the budget year – in harmony with Indents (4) and (5) Article 36 of the Fundamental law;

Indent (2) According to the central budget bill the value of Indent (1) shall be defined so that on its basis, the growth measure of government debt compared to its measure in the previous year (reference year) shall not be higher than half of the difference of the real growth measure of the inflation and gross domestic products expected for the budget year and stipulated by the central budget bill.

- in its Opinion no. 4/2014.07.14. on the state of the execution of the 2014 central budget of Hungary and the expected trend of government debt (the characteristics of the processes in the first six months of the year) the Council has repeatedly focused the attention to the examination of the expected consequences of the debt formula. In its Justification the Council pointed out that the debt formula concerning the growth of government debt would require significant budgetary corrections.

- in its Opinion no. 7/2014.12.10. formulated on the uniform budget bill T/1794/561. about the 2015 central budget the Council laid it down that „by the end of year 2015 the GDP-proportionate government debt shall very likely be in harmony with the decreasing stipulation of Indent (5) Article 36. of the Fundamental Law" and that the measure of the government debt stipulated by the Stability Act, planned for 31st December 2015 was in harmony with the processes foreseen for 2015. In the Justification part of its Opinion the FC called the attention to circumstances that might endanger the implementations – even by favourable macroeconomic conditions (like the moderate growth of the economic performance of the EU, the possible spill over of geopolitical tensions and the consequences of the EU sanctions against Russia, etc.) thus, in order to observe the targeted deficit and the application of the government debt rule, a strict budgetary management is required;

- according to the Opinion No. 7/2014.12.10. of the Council formulated for the submission of the 2015 central budget bill for final voting, from among the revenues the appropriation of „other revenues from selling and utilisation of assets" was risky thus the FC considers it necessary to launch new developments financed by the central budget in a rhythm that follows the influx of revenues under this title.

- apart from the written evaluations[2] of the State Audit Office of Hungary and the Central Bank of Hungary, when formulating its Opinion, the Council also considered the evaluations of domestic analysing institutions[3] – commissioned by the Secretariat of the FC (like, GKI Economic Research Institute, Századvég Economic Research Institute, Institute of Economics Centre For Economic and Regional Studies of MTA/Hungarian Academy of Sciences), the updated economic forecasts

2 Following the submission of the budget bill to the National Assembly, the FC shall publish the analyses on its website.
3 The analyses can be found at the FC's website.

of international organisations (EU, IMF, OECD) as well as the evaluations prepared by other benchmarking market analysts. Apart from the above the Council also took into consideration the contents of the 2015 – 2018 Convergence Programme of Hungary.

At the same time and contrary to the opinions given in previous years, the Council could not take into consideration the contents of the annual accounts bill as – in harmony with the rules of the public finance act - the Government shall present the annual accounts bill to the National Assembly later than the budget bill. Apart from this and due to the early presenting of the budget bill, this year the Council has had less opportunities to rely on the base year data of the revenues and expenditures of the budget than in previous years.

In this context the Secretariat of the Council elaborated a work document for giving an opinion on the 2016 central budget bill that – in harmony with the rules of procedure of the FC – was followed by the harmonisation of experts' opinions. These documents served as the basis for the document presented to the Council.

When formulating the structure and the contents of its decision and the respective justification – apart from the opinion-giving mechanism and rules of procedure built on the respective regulations of the Stability Act – the Council followed the criterion that its decisions were comparable with the FC's earlier, similar documents. The FC's mandate stipulates that the draft bill and its macroeconomic background shall be examined as a whole and shall not go into its details, the issues of revenues (taxes) and distribution policy.

The Council shall inform the Government and the Speaker of the House about the contents of its Opinion. The FC's Opinion shall be published at the website of the National Assembly as well.

II

The Opinion of the Council

Having discussed the documents of the draft of the 2016 central budget bill submitted by the Government and in harmony with its rules of procedure, at its meeting held on 8th May 2015, the Council formulated the following Opinion:

1. Concerning the authenticity and feasibility of the 2016 central budget bill draft the Council has no such fundamental objections that would justify the indication of non-concurrence as regards the submitted document. However, the Council found that the draft was not in harmony with the stipulation of the debt formula as per Indent (2) § 4. of the Stability Act hence, the FC shall make a recommendation to establish the harmony in point 8. of the present resolution.

2. According to the judgement of the Council the draft bill has considered the expected compliance of the 2015 budget altogether in harmony with the governmental macroeconomic forecast, as the basis of the 2016 budgetary appropriations. Following the dynamism experienced in 2014, the economic growth can be expected around 3 percent and this would promote the implementation of the budgetary revenues as well as the maintaining of the 2, 4 percent targeted deficit, predicted for this year. The 2016 budget was built on a 2, 5 percent economic growth that – on the basis of our present knowledge and by a conservative evaluation – can be regarded as a well-grounded plan, together with the possible risks of the implementation.

3. According to the Council's opinion the economic and public finance processes counted with as the basis of the budget bill can be regarded fully viable if the trust of the investors, the international economic prospects and economic growth remain strong and the investment rate that has risen by 2015 shall not slow down significantly in 2016 despite the temporary decline of EU resources – among other things – thanks to the expansion of the SME sector supported by the loan scheme of the central bank. At the same time the possibility of the negative effects of the well-known geopolitical and other, external factors should be also considered.

4. The Council establishes that the 2 percent GDP-proportionate targeted deficit foreseen for 2016 and calculated by EU methodology is in harmony with the contents of the Convergence Programme of Hungary for 2015 – 2018 (henceforward: Convergence Programme) that was published simultaneously with the draft budget bill, as well as with the economic processes presented in the draft bill and the revenue and expenditure appropriations that served as the basis for the mentioned draft bill. The target is 1 percent lower than the 3 percent stipulated by point c), Indent (2) § 13/A of the Public Finance Law. This means that the requirement concerning the deficit shall prevail even if the GDP or the deficit turns out to be less favourable than planned. The Council considers it a positive thing that by continuing the processes according to the Convergence Programme, it seems viable to push down the deficit below 1, 6 percent of the GDP by 2018.

5. Risks can also be identified in the draft bill. From among them the most significant is that among revenues the appropriation of „other revenues from selling and utilisation" is not supported. Hence the Council is in agreement with the rule appearing in the draft bill, according to what when realising the revenues investments financed from the said revenues should be launched. As regards the planning of increased expenditures – the expansion of career models included – a certain amount of caution is perceptible.

6. The Council states that the trend of the 2015 deficit indicator (74, 3 percent of the GDP) calculated at constant exchange rate, and that of the 2016 debt indicator (73, 3 percent of the GDP), according to the stipulations of the Stability Act, are in harmony with the economic and budgetary processes, both as regards the expected trend for 2015 and those planned for year 2016 and meet the requirement stipulated by Point a), Indent (2) § 13/A of the Public Finance Law. The planned extent of the debt reduction according to the baseline scenario shall ensure that it would prevail even in case of the emergence of certain negative risks. According to the FC's opinion it is a positive sign that according to the Convergence Programme, the debt indicator calculated at a hypothetical exchange rate could also decrease by 1 percent in 2016, similarly to the value calculated at constant exchange rate. Additionally, it is also a positive sign that by 2018 the government debt could decrease below 70 percent of the GDP.

7. In harmony with counteracting the implementation risks, the Council considers it right that the budget bill increases the Country Protection Fund to more than the double of the

2015 amount to thus manage the risks. Apart from this and beyond the chapter managed general reserves employed so far, as of 2016 the central chapters (among them the separate funds) should set up a stability reserve amounting to 1 percent of their totals, without the EU appropriations, i.e. HUF 35 billion. According to the resolution of the Government, this reserve can be used only after 1st October, depending on meeting the goals of the public finance.

8. The Council finds that the Stability Act came into power in 2015 and by employing the debt formula to be applicable as of 2016, significant budgetary restrictions would be necessary. In order to avoid such restrictions – in harmony with the adoption of the budget bill – it would be justified to amend the debt formula so that the amended formula would regulate the aspects of public finance stability in accordance with the sustainability of growth.

9. The Council has authorised the Chairman to publish the FC Opinion concerning the budget bill as well as present the Opinion in the National Assembly (and its committees), with regard to its relation with the submitted bill.

III
Justification

The Council formulated its Opinion by evaluating the aspects hereunder as well as those of the tangible results.

The authenticity of the draft bill

According to Indent (2) § 24 of the Stability Act *„The Council […] may submit comments respectively, can indicate its non-concurrence, in case it has fundamental objections as regards the authenticity or feasibility of draft document”.* The draft bill does not contain such objectionable regulations or tendencies that would justify the indication of general non-concurrence by the Council concerning the document submitted for an opinion. However, the draft does not satisfy the stipulations of the debt formula set out by Indent (2) § 4 of the

Stability Act. In the last chapter of the Justification the Council shall deal with its respective proposal to establish the necessary harmony.

Beyond this, being familiar with the draft budget bill the Council draws the attention also to the non-compliance of § 38 of the Stability Act to take effect on 1st January 2016. According to this article *„The measure of the payment obligation of the business organisations after their achieved results shall be calculated independently from the amount of the basis of assessment, to an identical proportion of the basis of assessment and in a consolidated way."* The Council deems it necessary to establish the harmony between the two laws.

The expected meeting of the goals of year 2015 (base year)

According to the Council's judgement the growth rate that started to pick up in the economy in 2013 to be followed by a 3, 6 percent growth rate in 2014 - that was considered as an outstanding performance that's exceeded significantly the average of the EU – can continue also in 2015, even if to a more moderate degree. International organisations and domestic analysing institutions have continuously upgraded their growth expectations in the first quarter of 2015. The Government foresees the expected growth of the 2015 GDP around 3, 1 percent compared to the previous forecast of 2, 5 percent.

External conditions of sustainable growth are fundamentally favourable, like the low, although volatile oil prices, liquidity abundance on the financial markets, improving prosperity and confidentiality indexes, moderate but expanding economic performance of the EU (within this primarily in Germany), expected low rate of inflation, the asset purchasing programme of the European Central Bank, etc.

On the basis of analysing the macroeconomic processes in 2014 and the first quarter of 2015 the Council is on the opinion that, as regards their main tendencies, the positive expectations concerning the 2015 economic growth are well grounded and sustainable. While in 2014 it were the export and investments that have pulled the economy (the investment rate was 21, 3 percent), by the last quarter of the year consumption also became a pulling force. Thanks to the decreasing debt burden and one time transfer (the amount of what is close to HUF 1 000 thousand) on household consumption in 2015, the termination of the vulnerability due to fluctuating exchange rates by converting foreign currency loans to Hungarian Forints, together with the experienced growth of gross wages (gross national economy wages have grown by 3, 7 percent partially due to the increasing of the minimum wages and, the guaranteed minimum wages introduced in January) have all contributed to the increasing household consumption.

The labour market processes are favourable. Employment by now has continuously exceeded 4 million employees and the expansion can be observed dominantly in the private sector. Thanks to certain government measures activity rate has increased to 59 percent while unemployment rate fell back to 7, 8 percent.

On the basis of the good economic performance in the first quarter and assuming that in the remaining of this year no substantial fall-back occurs as regards the output, the expected tax and contribution revenues might exceed the planned amount this year as well. Beyond this, when considering the realisation of the budgetary revenues tools serving the transparency of the economy – like connecting online cash machines to the tax office, launching of the national electronic register of road transport system, strengthening the targeted tax and contributions' controls, respectively their IT support, etc. we should be aware of the important role these factors are playing.

As a result of the endeavours of the Government to introduce structural transformation expenditures – first of all social benefits and social transfers, the ever widening public work supports also included – are expanding at a slower pace compared to the GDP growth and interest expenditures (parallel with the improving opinions as regards the risks the country is facing) are lessening.

Having analysed the above factors the FC considers that the 2, 4 percent targeted deficit in 2015 can be realised.

Evaluation of the 2016 goals and conditions

The fact that the presented estimates regarding the macroeconomic and public finance courses of the analysing institutions and market experts mentioned different numbers, made the job of the FC difficult.

The expected macroeconomic indicators

The Council examined the macroeconomic course that served as the basis of the 2016 draft budget bill, by taking into consideration the Convergence Programme for 2015 – 2018 as well as the available professional analyses and projections prepared in the FC’s competency. As a result the Council reached the conclusion that the macroeconomic goals – the 2, 5 percent economic growth based on the more moderate and conservative forecast predicted for 2015, together with the 3, 6 percent expansion of household consumption - were realistic.

Reasons for the slowing of the economic growth are primarily, the temporary downturn of the EU development supports that affect the growth rate of investments as well as the set back of community consumption. These can be compensated significantly by the growing SMEs – thanks to the expansion of the Funding for Growth Scheme - as well as to the infrastructural developments financed by domestic resources.

It should be noted however, that the favourable trend of external conditions are also important to realise the targeted economic growth. Such are, for example, that the EU economy should further strengthen, that geopolitical conflicts (primarily the Russian-Ukrainian conflict) should not escalate and that the effect of the Greek debt crisis should not spill over. The continuation of the abundance of the financial markets and the stabilisation of the relatively low oil prices would also exert a positive effect.

Revenues and expenditures of the central budget

On the basis of the completed analyses the Council considers that the major tax and contribution revenues of the 2016 budget are reflecting the relative stability of the tax system and were planned on a realistic basis. Economic growth and the expected expansion of household consumption served as a solid foundation for the latter. Apart from these, the processes launched in 2014 and enhanced in 2015 (employment, expanding consumption, government measures introduced to promote the transparency of the economy and the effectiveness of tax inspections, etc.) shall exert a positive influence also in 2016. These factors shall then offer an opportunity to reduce the tax burden (personal income tax, value added tax, contributions, special taxes for financial institutions). As regards revenues, the FC deems it necessary to call the attention to the risks surrounding the appropriation of „other selling and utilisation revenues”. Although the appropriation (HUF 93 billion) is significantly less than this year’s appropriation (by 45 percent) however, due to the uncertainty emerging in respect of the realisation, it should be justified also in the future to prepare thoroughly the utilisation and to be careful with the planning and execution of the related investment.

In case of certain revenues (for example in case of the personal income tax appropriation, the growth is exceeding the changes of gross wages and salaries while in case of corporate income tax appropriation, due to the uncertainty of data related to decisive return and accounting with foreign currency) the Council identified negative risks. However, tax and contribution revenue appropriations might be realised, depending on the effectiveness of the steps introduced to prevent tax evasion respectively and, if the Country Protection Fund is able to cover the related risks.

The FC considers that the planning of expenditures was in harmony with the stipulation of improving public finance balance. The expansion of social supports remains below the economic growth, even if we consider the expansion of governmental expenditures for public works. As regards the material expenditures, economic planning is tangible. Tax expenditures might continue to decline (by HUF 65 billion) – thanks to the gradual spill over of lower yields and that parallel with the downturn of involving EU resources less, co-financing is necessary (by HUF 135 billion). At the same time the finishing of programmes originally launched with EU resources will burden the 2016 budget with more than HUF 300 billion. The expansion of the civil servant career model is characterised by cautiousness as, apart from continuing the raise of the wages/salaries of teachers and armed law enforcement employees, from the second half of 2016, only government officials will enter newly the circle of beneficiaries.

At the above the FC identified uncertainties as regards external factors, like the economic prosperity relations of the European and world economy and the affected European fields possibly threatened by economic and political crises. Thus the Council considers it correct that in the draft of the 2016 budget bill the Country Protection Fund appropriation is significantly bigger (altogether HUF 70 billion) compared to the previous year. As a matter of fact the FC is on the opinion that further increasing this amount should be considered. To judge the appropriateness of the planned reserves it would be necessary to present what are the risks that the planned reserves are set aside for. Apart from this, the fact that the central chapters should set up additionally a so-called stability reserve amounting to HUF 35 billion enhances further the security of realising the targeted balance. This reserve can be open only after 1st October, depending on the state of the public finance respectively, the disciplined financial management of the given chapter.

Public finance deficit

The draft set the measure of public finance deficit for 2016 – calculated by the EU methodology (ESA 2010) – lower than the planned deficit for 2015 by 0, 4 percent, i.e. in 2 percent. This remains significantly below the 3 percent Maastricht criteria and as regards it measure it is in harmony with the stipulations of both the domestic and EU regulations. The low deficit also assists the realisation of the decreasing stipulation of the public finance set by the Fundamental Law of Hungary.

According to the judgement of the FC the targeted deficit is feasible, in harmony with the altogether realistic planning of the revenues and expenditures, as detailed earlier.

Government debt

In the draft of the 2016 budget bill – calculating with a foreign currency exchange rate in harmony with the Stability Act, i.e. with constant exchange rates compared to the exchange rate assumed by the end of 2015 (expected for the end of 2016) – by the end of 2016 the government debt indicator shall fall back from 74, 3 percent to 73, 3 percent.

Thus the rule of Indent (5)[4] Article 36 of the Fundamental Law shall be realised. Taking into consideration the supposed exchange rate of the Convergence Programme as well as the Maastricht debt indicator, one percent reduction is expected (from 74, 9 percent to 73, 9 percent).

The FC sees an unfaltering governmental commitment in the Convergence Programme as regards the lowering of the GDP proportionate government debt below 70 percent by 2018.

[4] Article 36 of the Fundamental Law
(5) As long as government debt exceeds half of the total gross domestic product, the National Assembly shall adopt solely such central budget act that contains the lessening of the proportion of government debt to the total gross domestic product.

***The debt formula of the Stability Act*[5]**

According to Indent (4) § 46 of the Stability Act, the debt formula came into force on 1st January 2015. It should be taken into consideration for the very first time when formulating the 2016 budget bill. Unlike the Fundamental Law and the starting point of the respective EU regulation „1/20”[6] the debt formula is not prescribing the cutting of the proportion of the government debt but regulates the nominal growth measure of the government debt.

According to the debt formula [calculating with the difference of the inflation planned for 2016 (1, 6 percent) and the half of the measure of the economic growth (2, 5 percent)] government debt would increase only by 0, 35 percent. Contrary to this, the measure of growth is 3, 3 percent. The difference in amount is more than HUF 700 billion, i.e. expenditures should be contained by such an amount, respectively revenues should be increased accordingly. This however would mean consequences hard to calculate, both on the public finance and – via it – the economic growth.

This was the context on the basis of what the FC has recommended earlier the thorough reconsideration of the debt formula and now – emphasising the contra-productivity of the possible use of this formula – the Council considers it necessary to delete or amend the formula.

Budapest, 8th of May 2015

Domokos László	Kovács Árpád
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[5] In its letter asking the FC to give an opinion on the draft of the budget bill the Ministry for National Economy expressed its will that it was necessary to amend the debt formula. At the same time it indicated that the Government shall initiate the amendment. As the FC has no information yet as regards the concrete contents and the submission of such an initiative, it could do only compare the draft with the presently valid regulations.

[6] According to the so-called „debt brake” rule of package six of the EU when the GDP-proportionate government debt calculated at market exchange rate exceeds sixty percent, the member state shall decrease the debt rate by 1/20th of the departure from the reference value in the average of three years. In case of Hungary a transitory period is valid as in 2011 the country still was under an EDP procedure. In the three years following the closing of this procedure (i.e. until 2016) the Commission shall examine if the member state in question makes effective progress in meeting the rule.