Speech of the Chairman

as it was presented to the National Assembly Honourable National Assembly 27/05/2015

Mr. Speaker,

According to the stipulations of the Fundamental Law of Hungary the Fiscal Council is an organisation **supporting** the legislative work of the National Assembly and in the course of **the preparation of the bill**, it shall examine if the bill is well founded.

According to the stipulation of the Fundamental Law, prior to the submission of this bill for the **final** vote, the Council shall watch the compliance with **the government debt** rule. The Fundamental Law states that *„as long as the government debt exceeds half of the gross domestic product, the National Assembly shall accept only such central budget act that contains the reduction of the proportion of government debt compared to the gross domestic product."* The Council shall formulate its opinion on the realisation of this stipulation as this preliminary opinion is required for the submission of the bill for the final vote. In the meantime the FC has already dealt with formulating its opinion when it evaluated the draft bill.

Honourable National Assembly,

Consequently, my task today is to present the verbal justification of the Council's Opinion on the draft budget bill and address the response of the Government to the said Opinion.

Also please, allow me to share some brief thoughts concerning the use of the government debt formula, respectively its amendment that are closely related to the Opinion.

When formulating its opinion the Council was relying on the aspects that the State Audit Office and the Central Bank of Hungary had drafted for the FC especially for this purpose. The Council also considered the forecasts of various analysing institutions as well as the projections of independent experts and benchmarking international organisations.

The Council formulated its Opinion on the draft budget bill for the Government at its meeting held on 8th May 2015 and forwarded it to the Ministry for National Economy that had submitted the draft, and made it available also for the public.

Honourable Members of the National Assembly,

Now, at the beginning of the general debate, when upon the authorisation of the Council I'm going to share with the honourable House the essence of the FC Opinion, focusing on the implementation of the targeted deficit and the government debt rule, first I'd like to say some words about **the expected implementation of this year's budget,** as the basis for planning next year's budget – based on the experiences of relatively short period that has passed since the beginning of this year.

Both the international and domestic analysing institutions have continuously upgraded their growth-related expectations for 2015, in the first quarter of 2015.

The Government has also increased its earlier forecast of 2, 5 percent to 3, 1 percent.

According to the Council's Opinion the economic growth that started in 2013, and to reach the outstanding 3, 6 percent growth rate that has exceeded well the average of the EU in 2014, may continue also in 2015, although at a bit decreasing rate.

The Council was on the opinion that the external conditions of sustainable growth were basically favourable. The FC took into consideration that, although volatile, the oil prices are low, there is ample liquidity at the money markets, the prosperity and confidentiality indexes keep improving, the economic performance of the EU is moderately expanding, the rate of inflation will very likely remain low and the effect of the asset purchase programme of the European Central Bank is tangible.

As regards internal conditions, the Council sees those positive as well. While looking at year 2014 as a whole it was the exports and investments that represented the pulling force of the economy, by the last quarter of 2014 consumption has already joined the earlier pulling forces. The decreasing debt burden – thanks to the accounting with the banks – the one-time credit as well as the termination of the exposure to the volatile exchange rates – thanks to changing foreign currency loans to forints - and the growth of wages experienced in the past months of the year might strengthen further the expansion of household consumption in 2015.

The labour market processes also show an improving trend. Employment by now has continuously exceeded 4 million. The expansion can be detected decisively in the private sector.

Thanks to the measures introduced by the Government, activity rate has grown to 59 percent while unemployment rate decreased to 7, 8 percent.

Witnessing the good performance of the economy so far, as well as the yield of central measures aiming at the whitening of the economy and supposing that no significant fall will occur in the remaining months of this year as regards the output, it can be expected that the tax and contribution revenues turn out to be more favourable than the forecast.

As a result of the structural transformation, endeavours of the Government expenditures – first of all the social and welfare entitlements, the supports of the ever widening public works scheme included – will expand a little less than the GDP while, interest expenditures, parallel with the improving opinion concerning the risks threatening the country, will decrease.

Having jointly analysed the above factor the Council considered the 2, 4 percent targeted deficit for year 2015 viable.

Coming to the **2016 budget bill** allow me first to go into some details concerning the **authenticity of the Draft.**

According to the Stability Act: „*The Council […] can make observations respectively – in case it has fundamental objections as regards the authenticity or feasibility of the draft – it shall indicate its non-concurrence concerning the draft”.*

The draft bill did not contain such objectionable rules, tendencies that would have justified the general non-concurrence of the Council as regards the document submitted for an opinion.

However, in its resolution the FC has also expressed that the Draft was not in harmony with the stipulations of the **debt formula** described in the Stability Act that came into force on 1st January 2015 and should have been considered for the first time when formulating the 2016 budget bill.

Unlike the starting point of the Fundamental Law and the respective, so-called „1/20" EU stipulation, the debt formula prescribes the measure of the quantified change of government debt and not that in proportion to the GDP.

According to the debt formula, calculating with the difference of the rate of inflation planned for 2016 (1, 6 percent) and half of the growth rate (2, 5 percent), government debt would be allowed to grow by merely 0, 35 percent.

By contrast, the rate of the nominal growth that was calculated in the Draft was 3, 3 percent.

The nominal difference is more than HUF 700 billion, i.e. this is the extent by which expenditures should have been cut, respectively revenues should have been increased. This would involve hard-to-predict negative consequences as regards public finance and - via it - economic growth.

On this basis we have already recommended the thorough supervision of the debt formula and now – emphasising the dangers of having an effect of opposite consequences regarding the original purpose of the introduction of the debt formula – we deemed it necessary to either delete or amend this rule.

The Government's proposal to change the formula is on your table. It is not my task to deal with the substantial issues concerning the changing of the formula this time however, would you please allow me to expound a more general remark.

When there is a crisis it is the public sector that absorbs the bigger part of the shock while in the rising period it mitigates the formulating of new stability risks that could lead to a crisis. The processes of our days prove that together with the major part of Europe we have reached the period of recovery from the crisis that had erupted nearly a decade ago. No doubt that the budgetary policy and procedural regulations, together with controlling the observance of these rules have been playing an important role.

While rules are born with the intention of handling crises however, they should also promote recovery or, at least, should not mean an obstacle for the recovery. Thus it would be reasonable if, as regards the regulations and their respective implementation, flexibility and adaptation to the changing conditions prevailed and, if necessary, the necessary adjustment took place without any delay.

Apart from this and being familiar with the draft budget bill, the Council had to focus the attention on another legislative issue.

It had to refer to the non-realisation of the Paragraph of the Stability Act that comes into power on 1st January 2016 according to what: *„The measure of payment obligation debiting a business organisation, based on its performance, shall be assessed independently from the tax base, uniformly, in the same proportion of the tax base.„*

The FC deemed it necessary to establish harmony between the two laws here as well.

Honourable National Assembly,

Coming to the major number of the budget now, I wish to note that there are some minor departures between the Draft the Council gave its views on and the draft on your table and those concern mostly certain revenue items.

Accordingly, the great majority of the findings of the Council as regards the Draft are justified and correct also for the bill.

The Council examined the **macroeconomic course** that served as the basis of the draft of the 2016 central budget, by taking into consideration the 2015 – 2018 Convergence Programme and the professional analyses and projections made in the FC's competence.

As a result the Council reached the conclusion that the major macroeconomic assumptions were realistic.

The predicted 2, 5 percent economic growth, based on a conservative forecast, being somewhat more moderate than the 2015 numbers, and the 3, 6 percent expansion of household consumption are attainable.

The prospective slowing down of the growth is caused, first of all, by the decreasing EU development supports together with the set-back of investments as a result, as well as the decreasing communal consumption. The negative effect can be compensated significantly by the expansion of the Funding for Growth Scheme for the SMEs and the infrastructural developments financed by domestic public finances.

The Council had to note that the favourable trend of external conditions was also necessary to reach the set goal of economic growth. The economy of the EU should strengthen further, the geopolitical conflicts should not deepen, and the effect of the Greek debt crisis also should not infiltrate the money markets. The sustainability of the abundance of money market sources and the stabilising of the oil prices at a relatively low level would also have a favourable effect.

Honourable Members of the House,

Ladies and Gentlemen,

The Council established that the 2 percent GDP proportionate **targeted deficit of the public finance** in 2016 – calculated by EU methodology – was in harmony with the contents of the Convergence Programme of Hungary 2015 – 2018, that was published parallel with the draft budget bill, as well as with the economic processes presented and the revenue and expenditure appropriations based on the above.

The targeted goal is 1 percent less that the criteria setting the upper limit. This means that the requirement concerning the deficit shall be met even if the GDP or the deficit turns out to be less favourable than planned.

The Council presumes that by continuing the processes, pushing down the deficit to 1, 6 percent of the GDP by 2018 – as stated by the Convergence Programme – is viable.

The low deficit also contributes to realising the stipulation of the Fundamental Law to reduce the government debt rate.

On the basis of the completed analyses the Council was on the opinion that **the tax and contributions' revenues of the** 2016 **budget** reflected the relative stability of the tax system and were planned realistically. The latter is founded by the economic growth, as well the expected expansion of household consumption.

Apart from the above, the processes launched in 2014 and enhanced in 2015, like the expansion of employment and consumption, governmental measures serving the whitening of the economy, improving the tax inspections, etc. – shall exert their favourable influence. These shall then offer the possibility to mitigate the tax rates, like it is experienced in case of the personal income tax, the value added tax, the contributions and the special taxes of financial institutions.

Among the revenues the FC deemed it necessary to call the attention to the risks related to the appropriations „other revenues from selling and utilisation". Although the appropriation is way less than it was this year yet, due to the uncertainties regarding the realisation, it remains justified also in the future to thoroughly prepare the utilisation, as well as to plan carefully and implement the related investment. The purpose of the Government is right, concerning the established checks as regards the utilisation thereof.

In case of specific revenues (regarding the personal income tax appropriation the growth exceeds the changing of gross wages and salaries while, in case of the corporate tax appropriation, due to the uncertainties concerning the decisive tax declarations and foreign currency accounts) the Council identified negative risks. The FC also expressed that the tax and contribution revenue appropriations might be realised, depending on the performance of the economy and the effectiveness of the measures introduced with the purpose of pushing back tax evasion respectively, that the related risks can be covered by the Country Protection Fund.

As regards the planning of the **expenditures,** the FC was on the opinion that it was in harmony with the stipulation of improving the balance of public finance. The expansion of social supports remains below the economic growth rate and this is compensated by the expansion of governmental expenditures used for public works.

Material expenditures were planned in an economic way. Interest rate expenditures might mitigate further – as a consequence of the lower yields – and parallel with the involvement of less EU resources, less co-financing is necessary.

The expansion of the public servants' career model is characterised with carefulness as, beyond carrying on with the raising of the salaries of teachers and workers of armed and law enforcement organisations, it will be only government officials who'll enter the circle of beneficiaries and only beginning with the second half of 2016.

Basically it was the European and world economy prosperity relations, as well as the European fields threatened by crises where the Council identified uncertainties and that's why it deemed it right that, compared to the previous year, the draft of the 2016 budget bill increased the appropriation of the **Country Protection Fund** significantly (altogether HUF 70 billion) however it considered it worth to think about further increasing this amount.

Apart from this, the FC was on the opinion that the security of the realisation of the goals to create a balance was wider thanks to the fact that the central chapters and the separated state funds also have to create a so-called **stability reserve** amounting to about HUF 35 billion.

Depending on the state of the public finance these reserves can be used only after October this year. Apart from the above the FC recommended – and not for the first time – that in order to judge the appropriateness of the reserves it should be presented, exactly what risks can be handled by them.

Honourable National Assembly,

According to the draft of the 2016 budget bill – in harmony with the Stability Act, i.e. calculating with standard foreign currency exchange rate compared to the hypothetical rate by the end of 2015 – the **government debt indicator** shall decrease from 74, 3 percent to 73, 3 percent by the end of 2016. Thus the stipulation of the Fundamental Law shall be realised. Taking the supposed exchange rates of the Convergence Programme as a basis, 1 percent remission can be expected also as regards the Maastricht debt indicator.

The FC identified a strong commitment in the Convergence Programme to push back the GDP proportionate government debt below 70 percent by 2018.

According to the Opinion of the Council the goals of the 2016 budget bill altogether are achievable both as regards the public finance deficit and the GDP proportionate government debt, as well as the outlined macroeconomic course that serves the grounding of the above goals.

Honourable National Assembly,

A detailed **response** was compiled this time as well by the **Government** in reaction to the Opinion of the Council. You can get yourself familiarise with this response at the end of the major tome of the bill so I'll be referring to it now only briefly.

First of all, we could read with satisfaction in this response that „*The Government shall initiate the amendment of the Stability Act as regards the debt formula in order to establish a budgetary policy that shall support more powerfully the economic growth by the simultaneous reduction of government debt. Thus, it shall establish the harmony requested also by the Council, prior to the final vote on the budget bill. As a* *consequence, the Fiscal Council can formulate its resolution concerning the approval of the budget by being already familiar with the amended regulations."*

However, we have not found any reference in the response to the establishing of the harmony with the resolution of the uniform rate of corporate tax that is also mentioned in the Stability Act.

Although the Government refrained from giving information of the expected risks that had been foreseen by them as well, it raised the appropriation of the Country Protection Fund by HUF 30 billion (to a total of HUF 100 billion).

The response contains detailed justifications concerning the achievability of specific revenues that the FC had judged as risky. In this respect, from among the concerned items they increased the appropriations of revenues from selling assets and that of specific taxes.

As regards the latter and thanks to the whitening of the economy, the re-evaluation of these items prior to submitting the budget bill made it possible to raise the appropriations of the personal income tax, the social contribution tax and other contributions as well as the appropriation of the value added tax; the latter, as a result of the expansion of hooking up online cash machines.

Honourable Members of the National Assembly,

Ladies and Gentlemen,

Finally, I wish to express my **thanks** to the Minister for National Economy and his staff for generously having supported our work. Even under the circumstances of doing the preparation and the planning in an unusual period and under difficult conditions, they made it possible for the Council to prepare its Opinion by doing substantial analyses.

I would like to thank the staff of the State Audit Office of Hungary, the Central Bank of Hungary and the FC Secretariat, together with the commissioned analysing institution and the staff of the individual economic institutions too for having supported the preparation of the multi-faceted, professional grounding of the Council's Opinion by their macroeconomic model calculations and sensitivity monitoring.

Thank you for your kind attention. I wish you all a good work session to discuss the budget bill that serves the development of the country as well as the related amendment motions.