Opinion of the Fiscal Council

on the draft of the amendment of Act XC of 2020 about the year 2021 central budget of Hungary

I

Antecedents, legal basis and publicity of the Opinion

In harmony with Indent (2) Article 44 of the Fundamental Law of Hungary the Council shall deliver its opinion – on the basis of § 24 of Act CXCIV of 2011 on the Economic Stability of Hungary (henceforward: Stability Act) – about the draft central budget bill, amendments changing the revenue and expenditure totals of the central budget respectively, amendments resulting in increasing the degree of fiscal deficit included. In its Opinion the Council may add its comments regarding the draft document. Additionally, in case the Council has fundamental objection regarding the authenticity or viability of the draft, it may indicate its disagreement.

On 9th of April 2021, finance minister, Mihály Varga forwarded the draft bill to the chairman of the Fiscal Council, that had been discussed and approved by the Government at its meeting held of 7th of April 2021 (henceforward: the draft) as an appendix of the minister's letter PM/5/3/2021 in which he was asking for the opinion of the Council.

In the course of formulating its Opinion the FC paid attention to the following antecedences related to Act XC of 2020 about the year 2021 central budget of Hungary:

- In its Opinion formulated about the draft of the year 2021 central budget bill No. 3/2020.05.21. the Council stated that „the decisive factor from the aspect of the planning of the year 2021 budget was the spreading of the coronavirus epidemic, the consequences of what have changed fundamentally the 2020 aspects of both the global and the Hungarian economy". Additionally, „the prognosis that served as a basis for the planning of the year 2021 central budget was built on the presumption that following a transitory recession, the Hungarian economy will grow in 2021." According to this „the strong fundaments of the Hungarian economy and the announced economy-political measures shall insure the continuation of the catching-up of the Hungarian economy". In its Opinion the FC also called the attention to the fact that „the risks affecting the year 2021 budget predominantly appear in 2020." Additionally, the Council emphasised that „the additional invigoration of the economy continues to be unavoidable also in 2021 together with programmes aiming at saving and creating jobs. The Economic Protection Fund (within it the Economic Protection Employment Fund created from the National Employment Fund) offers the cover for this. The Health Insurance and the Epidemic Control Fund are ensuring the necessary coverage, the operation of the healthcare system included (by incorporating the Health Insurance Fund). The draft is envisages significant amounts for family protection and homemaking measures, as well as for improving the revenues position of the pensioners." In the Justification section of its Opinion the FC indicated that the new type of epidemic having becoming a pandemic by March 2020 has redrawn substantially the international and financial processes and „the epidemic shall affect significantly the evolution of the year 2021 public debt as well". Thus, in its Opinion the Council acknowledged that the decreasing GDP proportionate gross public debt in the period of 2011 – 2019 shall, very likely, turn around temporarily in 2020: according to the draft budget bill the public debt indicator shall grow. Additionally, the Council expressed that „the decreasing trend of the public debt – following a transitory increase in 2020 – shall return and mitigate by the end of 2021."

- In its Resolution 5/2020.07.01. the Council – by granting its preliminary consent for the final voting on the year 2021 central budget bill – stated that „it considers the public debt indicator planned for 31st of December 2021 well founded" as it was in harmony with the macroeconomic and public finance processes that had served as a basis of the bill. In the Justification section of its resolution the FC explained that „in its opinion the risks endangering the realisation of the targeted deficit (the possibility of emerging unfavourable economic situations due to the resurgence of the coronavirus epidemic and, related to this, the need for significantly more crisis management expenditures) might affect the expected evolution of the public debt as well". Thus, in order of maintaining the safe public finance processes, the Council deemed it important to consistently enforce provident and responsible fiscal management.

- In its Opinion No. 6/2020.09.30. about the execution of the year 2020 central budget ac and the expected evolution of the public debt – based on the data of the first half of the year and the data of the processes in July-August-September months – the FC found that the latest governmental and analysers' expectations foresaw an approximately 5 percent decrease compared to the previous year. Thus, „The Council agreed that in this situation the amendment of the fiscal goals became a necessity to thus ensure for the Government a bigger elbow room to control the epidemic and dimming the economic recession".

- In its Opinion 3/2021.04.15. about the execution of the central budget act and the evolution of the public debt – based on the processes of the whole year – the Council stated that „the accrual-based year 2020 deficit of the governmental sector, according to the EDP report was 1, 8 percent of the GDP, that is higher than the targeted original 1, 0 percent and the 3, 8 percent targeted deficit increased in August". „It was the healthcare and economic protection that made the increasing of the targeted deficit necessary." Apart from this statement, the FC also laid it down that „the fiscal management of the past year – being harmonised with monetary measures – altogether ensured adequate background for managing the extraordinary situation created by the coronavirus epidemic, for health protection and the supporting of the economic reconstruction. The restorations of the economy to the sustainable growth path, the softening of the negative consequences of the pandemic and health protection remain targeted goals requiring fiscal management that also bolsters competitiveness while not forgetting the catching up of underdeveloped regions." In its Opinion the FC also pointed out that „following the return of economic growth restoring balance remains important, i.e. the decreasing of the fiscal deficit and the public debt."

When formulating its Opinion about the draft the FC took into consideration the calculations prepared for the body by the Ministry of Finance as well as the contents of the Convergence

Programme 2020-2024 for Hungary. Beyond these the Council also reviewed the economic analyses and evaluations prepared by international organisations (European Commission, OECD, IMF, World Bank) and other, significant market analysers.

The Council shall inform about its Opinion the Speaker of the National Assembly, the Government and shall publish this document on the website of the National Assembly.

II Opinion of the Council

At its meeting held on 15th of April 2021 discussing the draft amendment of Act XC of 2020 about the year 2021 central budget of Hungary the Council formulated the following Opinion:

1) In the course of formulating its opinion on the authenticity and viability of the draft the council considers the extraordinary circumstances and the state of emergency caused by the epidemic. Its opinion is being formulated with regard to these circumstances.

2) The Council notes that in harmony with the EDP report published on 1st of April of the current year the amendment of the act increases the targeted deficit calculated by the ESA methodology from 2, 9 percent of the GDP to7, 5 percent. The changing economic conditions since the adoption of the budget act, the health protection and economic support measures introduced in the meantime and the changing framework of the EU fiscal frames for 2021 – 2027 made the amendment of the act necessary. The Council agrees with the increasing of the targeted deficit as the third wave of the coronavirus epidemic makes it necessary to establish fiscal support exceeding the originally appropriated share for healthcare and the economy. Simultaneously, the Council is welcoming the fact that the fiscal deficit is more moderate than in 2020, i.e. following the economic restoration it is focusing on establishing balance. In March 2020 the European Union activated the general exemption provision of its Stability and Growth Pact that allows a deficit exceeding the Maastricht criteria with regard to the extraordinary situation also in 2020.[1] The Council is acknowledging that due to the extraordinary situation the Government establishes also in 2021 the same flexibility as regards the Hungarian fiscal regulations and, simultaneously, it recommends amending accordingly the Stability Act.

3) The Council notes that as a result of the amendment of the revenues and expenditures presented in the draft bill shall increase the cash deficit of the public finance central subsystem in 2021 to HUF 2.288 billion that is less than the 7, 5 percent and consistent with the ESA deficit as shown in the EDP report amounting to HUF 3.990

[1] Statement of the Commission for the Council about the utilisation of the general exemption provision of the Stability and Growth Pact (20th of March 2020), Declaration of the finance ministers of the EU member states about the Stability and Growth Pact in the light of the state of emergency due to COVID-19 (23rd March 2020). The letter of the European Commission to the finance minister of Hungary (19th of September 2020). Statement of the Commission to the Commission: a year following the outbreak of the COVID-19 epidemic: fiscal political response (3rd of March 2021).

billion. According to the draft in the 7, 5 percent targeted deficit, calculated by the EU methodology, they are also considering the changes amended by the Government within its own competence, as well as the changes realised automatically, thanks to the demographic and other processes. They are mentioning this in the general justification section however, this is not supported numerically. The Council deems it justified that according to the draft bill, the actual degree of the budget deficit (HUF 3 990 billion) be recorded, as the evolution of the public debt and the realisation of the public debt rule can be judged only on this basis.

4) The Council notes that according to the draft bill and in harmony with the expected growth of the Hungarian economy, in accordance with the stipulations of the Fundamental Law, the GDP proportionate public debt may decrease again in 2021, from the 80, 4 percent at the end of 2020 to 79, 9 percent. The Council deems it necessary to present the respective details to the National Assembly, in harmony with the evolution of the case deficit and Single Treasury Account (KESZ).

5) The Council notes that similarly to the last year, there are higher than usual risks for the economic and fiscal processes also in 2021, as a result of the coronavirus pandemic. Consequently, the Council acknowledges that the draft bill creates a greater elbow room for the health protecting and economy restarting measures of the government. At the same time, it deems it necessary that – should the evolution of the macroeconomic conditions allow this – a more ambitious decrease of the deficit took place, thus creating more favourable conditions for significantly improving the fiscal deficit in 2022 as well as for the sustainable mitigation of the public debt indicator.

III Justification

The FC did not find in the draft any questionable provisions that would justify the indication of any disagreement as regards the document.

The momentum of the **domestic economy broke** in 2020 however; its relapse turned out to be less than expected (5 percent). The coronavirus epidemic and its consequences are affecting the year 2021 macroeconomic and fiscal funds too. The degree of the expansion of year 2021 economic growth are encircled by greater than usual uncertainties that depend on the repression of the epidemic, the rhythm of the downsizing of the economic restrictions and the following reactions. The Council acknowledges that the draft bill is counting with an economic growth of 4, 3 percent that is more moderate than the respective stipulation of Act XC of 2020.

For 2021 the international financial organisations are calculating with a robust increase of the volume of world trade and are forecasting a 4 to 6 percent improvement of the world economy output (International Monetary Fund 6 percent, OECD 5, 6 percent, World Bank forecasting 4 percent expansion). Their forecasts as regards Hungary are predicting around 4 percent. (According to the prognosis of the International Monetary Fund, reviewed at the beginning of this April might increase by 4, 3 percent, the forecast of the World Bank calculated with a 3, 8 percent growth at the beginning of the year while the EU Commission predicted 4 percent this February). Some domestic analysers are predicting similar growth rates, while others are calculating with higher (even reaching 5 percent) growth rate. MNB is projecting an economic growth rate of 4-6 percent for 2021, depending on the lifting of the restrictions.

The previous year belonged to the **protection of health and economy.** Year 2021 might be the year of restarting of the economy although, the coronavirus remains present thus, the primary task remains the protection of human life also in 2021. In fact – apart from the existing international environment - each and every economic process depends on the degree of the vaccination coverage of the population, on how quickly the restrictions are lifted and if the new and unknown mutants of the virus can be restricted. Once the state of health emergency passes, the **government resolutions** implemented during the emergency concerning the budget **get repealed** thus, by the present amendment of the budget act **shall govern the conditions determining the decisions and measures** required to maintain the epidemic control and the re-starting of the economy.

It was the changing economic conditions, the measures taken in the meantime to protect health and support the economy, as well as the changing fiscal framework of the EU 2021 – 2027 that made the amendment of the budget act necessary. According to the draft document sent to the FC asking the body to formulate its opinion on it, the **revenue** grand total would increase by HUF 790, 3 billion while the grand total of the **expenditures** would grow by HUF 1.586, 8 billion, thus the cash **deficit** would grow by HUF 796, 5 billion. The draft is proposing changes in the following, **major** revenue and expenditure **balance sheet items** in the year 2021 central budget.

Based on the amendment of the budget act **the increase of the revenue appropriations** primarily is made up from the ***revenues of the EU programmes*** *higher* by HUF 906 billion. From this amount HUF 326 billion is related to the 13 percent advance of the reconstruction supports (EU Recovery and Resilience Facility – RRF), while HUF 38 billion is related to the 2021 – 2027 cohesion resources. The remaining part of the growth is related primarily to the REACT-EU revenues aiming at the crisis management and the re-starting of the economy and the 2014 – 2020 cohesion resources. Beyond this the ***personal income tax revenues*** might exceed the original appropriation by HUF 34, 3 billion that indicates the resilience of the labour market against the crisis as well. The increasing of the appropriation of ***the value added tax revenues*** by HUF 20, 5 billion and the increasing of the ***retail tax*** appropriation by HUF 10, 5 billion is justified by the higher than expected revenues in 2020.

Because of the targeted, transitory sectoral discounts, respectively the temporary reduction of the social contribution tax of the SZÉP cards the revenues from the ***social contribution taxes and contributions*** might be less by HUF 144, 5 billion than the original appropriation. In case of the ***corporate tax*** the appropriation shall be lower as well, by HUF 91, 8 billion partly due to the fact that at the time of the planning of the budget the tax base was lower than expected in 2020 and beginning with 2021, as a result of a multiple steps process, the development reserve will be eligible for use for the total profit. ***As regards fees,*** because of the duty exemption of residential real estates purchased by CSOK (Family Home Discount) the appropriation decreased by HUF 24, 6 billion; in case of ***tourism development contribution*** because of the exemption of the contribution respectively, because of the lower demand to be expected this year the appropriation decreased by HUF 22, 0 billion; in case of the excise tax, because of the evolution of the world market price of petroleum and the decreasing tax the appropriation decreased by HUF 14, 5 billion; in case of the ***rehabilitation contribution*** due to the targeted, temporary sectoral discounts and the temporary decline of the employment rate, the appropriation decreased by HUF 12, 6 billion.

The increasing of the ***home building supports*** appropriation by HUF 120 billion is the reason why the **expenditures grew** and it was justified primarily by the expected increasing of the obtainable home building support available as of 1st of January 2021. According to the law amendment ***the expenditure of the fiscal institutions*** shall increase by HUF 26, 5 billion because of the compensation of the increased minimum wage and the guaranteed wage minimum. The ***expenditure of the professional chapter managed appropriation*** shall increase by HUF 143, 2 billion and this amount contains the excess expenditures of the earlier government decisions (for example, for road reconstructions, expenditures of asset management foundations, PPP redemptions of higher educational institutions, establishing of vaccine production, removal of illegal waste materials, recycling of waste materials).

Compared to the original appropriation, the excess expenditure under the title ***guarantee and contribution to the expenditures of the social security funds*** amounts to HUF 133, 7 billion. This amount is substituting the arrears of social contribution tax and social security revenues that are not arriving in the revenues of the funds however; it does not increase in a consolidated way the fiscal deficit as it also appears in the social security revenues. In case of ***supporting local governments*** they are counting with an excess of expenditures amounting to HUF 44 billion (from this HUF 38 billion goes to compensating the loses of business tax revenues). Expenditures of ***EU programmes*** will grow by HUF 450 billion. Approximately half of this amount goes to the planned expenditures in the frame of RRF (Recovery and Resilience Facility). Beyond this, the advance payments related to the 2021 – 2027 cycle shall also increase by more than HUF 400 billion. ***The central reserve of restarting the economy (****earlier economy protection programmes)* will be more by HUF 40 billion, to compensate the changing local business tax of micro and small businesses in settlements with more than 25 thousand inhabitants. The ***contribution to the EU budget*** shall increase by HUF 164, 9 billion due to the higher than expected economic growth of the previous years and the additional payment obligation due to Brexit.

The degree of the 7, 5 percent **targeted deficit calculated by EU methodology,** as described in § 4 of the draft bill, does not follow from the **cash deficit** calculated as above. The amended law is increasing the year 2021 deficit of the public finance central subsystem to HUF 2.288 billion that is lagging behind the 7, 5 percent presented in the EDP report and consistent with the ESA deficit i.e. HUF 3.990 billion cash deficit. Namely, the proposed amendments concerning the revenue and expenditures are presenting only those amendments that only the National Assembly is authorised to change and do not contain amendments executed within its own competence as well as the revenue and expenditure appropriations pending on the evolution of demographic and other processes, without any separate amendments. These are mentioned (without going into details) in the general justification section. The Ministry of Finance did go into details regarding the increasing of the 2, 9 percent targeted deficit to 7, 5 percent in its calculations presented to the FC. It would be justified to present these calculations also in the bill to be submitted by the Government to the National Assembly.

With respect to the extraordinary situation a deficit excessing the Maastricht criteria was made possible also in 2021 by the resolution of the European Commission. As regards the domestic regulations, creating a similar elbow room is allowed by the Stability Act only in case of the decrease of the GDP thus, it is justified to harmonise the domestic rules with the respective EU regulations by law and not resorting merely to the possibility of amending this stipulation by means of a simple regulation.

According to the respective stipulation of § 2 of the law amendment, the fiscal deficit and the financing processes as well as the expected evolution of the GDP, the **GDP proportionate public debt** shall decline from the 80, 4 percent at the end of 2020 to 79, 9 percent. The decrease of the public debt indicator in 2021 is supported by the fact that in 2020 the liquid deposits (KESZ and foreign currency) of the state increased to HUF 2.745 billion, the partial utilisation of what makes it possible that the net issuing and thus the public debt increase would be lower than the cash deficit. The mitigation of the debt indicator is in harmony with the debt decreasing rule stipulated by the Fundamental Law. The draft also does not present the derivation of the development of the debt indicator. The FC learned about this also from the additional information presented by the Ministry of Finance. According to this the public debt would increase from the end of 2020 amount of HUF 38.408 billion to HUF 41.153 billion by the end of 2021 while the GDP would increase from HUF 47.743 billion to HUF 51.497 billion, in the same period. By acknowledging the presented calculations and considering them well founded, the Council recommends that by showing this information as well and presenting the harmony of the evolution of the KESZ, the cash deficit and the debt rate should be part of the bill to be presented to the National Assembly.

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