The Fiscal Council's Opinion

on the Draft of the Year 2021 Central Budget Bill of Hungary

I.

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

According to § 24. of Act CXCIV of 2011 on the Economic Stability of Hungary and in harmony with the stipulations of Indent (2) Article 44. of the Fundamental Law, the Fiscal Council (henceforth: Council or FC) shall formulate its opinion on the draft central budget bill. In its opinion the Council may make observations and – in case it has fundamental objections concerning the draft document respectively its authenticity or enforceability – the FC may indicate its disagreement.

The Government submitted the document to the Chairman of the Fiscal Council that had been approved as the 2021 draft central budget bill of Hungary (henceforward: draft) as an appendix of *Minister for National Economy Mr. Mihály Varga's letter* (File no: PM/5/9/2020.) in which he asked for the opinion of the Council.

The Council formulated its evaluation on the draft by also taking into consideration the antecedents related to Act LXXI of 2019 concerning the year 2020 central budget of Hungary.

- In its Opinion 4/2019.06.03. formulated about the year 2020 central budget bill of Hungary the Fiscal Council evaluated the evolution of the world economy and those risks the sustenance of what might concern negatively the economic growth perspectives of the Hungarian economy. The Council found that „the revenue and expenditure appropriations of the draft document were fundamentally in harmony with the year 2018 preliminary facts and the data expected for year 2019 as well as the planned macroeconomic and public finance processes foreseen for year 2020." At the same time though, it was of the opinion that in order to meet the revenue appropriations it would be necessary to introduce additional economy whitening measures by the Government, beyond the realisation of the macroeconomic path. Additionally, the FC also stated that „the reserves set higher than in the previous years amounting to 1 percent of the GDP […] shall create appropriate guarantee to offbeat the external conditions presenting a threat for the fiscal balance, the possible risks and unforeseen expenditures". Against this background the Council evaluated positively the steps „aiming at the increase of revenues and holding back expenditures in fields that do not narrow economic growth as a result of what the path of the deficit might decrease significantly". In its Opinion the Council affirmed that – by taking into consideration the safety reserves as well, it considered „the targeted 1, 0 percent GDP proportionate deficit for year 2020, calculated by the EU methodology (ESA 2010) well founded and attainable." This, at the same time, was in harmony with the Maastricht criteria as well as the identical 3 percent requirement stipulated by Point b) Indent (2) § 3/A of the Stability Act." At the same time, the FC indicated that „the structural deficit does not reach the targeted 1, 0 percent in 2020 however, it is very close to this thus it would be expedient to consider harmonising these values." In its Opinion the Council also stated that „the trend of the year 2019 debt indicator (68, 6 percent of the GDP) calculated with standard exchange rate and that of the year 2020 (65, 5 percent) presented by the draft bill was in harmony with the planned for year 2019 and the expected for year 2020 macroeconomic and fiscal processes and meets the (government debt rule) stipulation of Indent (5) Article 36 of the Fundamental Law of Hungary. The planned degree of decreasing the debt rate is in harmony with the stipulation of the European Union concerning government debt (the so-called „one-twentieth rule") as well." Beyond the above the Council also addressed the issue that „the FC considered it justified to introduce already in 2019 the measures aiming the improvement of productivity and efficiency as a result of what the economic growth exceeding the average of the European Union would be ensured not only in 2020 but also over the medium term."

- In its Opinion 5/2019.07.10. formulated for the final voting of the year 2020 central budget bill the Council established that „the degree of the government debt indicator foreseen for 31st of December 2020 according to Indent (3) § 3. of the uniform budget bill T/6322/846. about the year 2020 central budget is well founded and was established in harmony with the respective stipulations of the Stability Act”. In the Justification section of its Opinion the FC elaborated that „the body considered the planned decrease of the government debt indicator realistic and well founded as well as being in harmony with the expected macroeconomic and public finance processes”. In order to maintain the safe and favourable public finance processes the Council continued to profess it justified to follow a responsible fiscal management also in the future.

- It also belongs to the antecedents of formulating the FC’s opinion on the draft document of the year 2021 central budget bill that the financial government had informed the Fiscal Council about its budget related measures resulting as a consequence of the Covid-19 pandemic on April 8, 2020 in its transcript (PM 7865/2020) and the Council – with regard to the extraordinary conditions – formulated its Opinion 2/2020.04.16. in an online working session that was also published the same day.

When formulating its Opinion about the draft of the year 2021 central budget bill the Council was relying primarily on the written analyses and findings of the State Audit Office of Hungary and the Central Bank of Hungary dealing with the fiscal processes. Beyond these documents the Council also reviewed the economic forecasts prepared by the domestic research and analysing institutions as well as certain international organisations (European Commission, IMF, OECD, World Bank) commissioned by the FC Secretariat, other benchmarking market analysers also included. The Council did consider the contents of the Convergence Programmes of Hungary for the period of 2019 – 2023 as well as for 2020 – 2024 – relying on the preliminary data – and the major processes, characteristic features and background of the execution of Act L of 2018 about the year 2019 central budget as a basis. As regards the latter – on the basis of its Opinion formulated in harmony with of Point c) Indent (1) § 23 of the Stability Act – at the same time the FC shall also publish it in a separate document.

In the framework of its authorisation and following its practice used so far the Council examined the draft of the year 2021 central budget bill of Hungary and its macroeconomic background as an entity and analysed the details, the revenues and expenditures of the draft bill from the aspect of the balance and the implementation of the government debt rule. In this process the FC did consider the resolution of the Council of the European Union that – having in mind the extraordinary situation – had imposed the escape clause concerning the EU level fiscal regulations.

By harnessing its authorisation received from the Fundamental Law of Hungary and the Stability Act as regards issues of distribution and provision once again the FC had not taken a position.

The Council shall inform about its Opinion both the Speaker of the National Assembly and the Government and shall publish it on the website of the National Assembly.

II

The Opinion of the Council

In harmony with § 24 of the Stability Act on 21st of May 2020 the Council discussed the draft of the year 2021 central budget bill of Hungary and formulated the following Opinion by uniform decision.

1) As regards the authenticity and viability of the draft of the year 2021 central budget bill of Hungary the Council has no such fundamental objections that would justify the indication of disagreement.

2) From the aspect of planning the budget of year 2021 the spreading of the coronavirus is a decisive factor, the consequences of what have changed fundamentally the perspectives of both the global and the Hungarian economy in 2020. As regards the evaluations of the 2020 economic processes the known international and domestic forecasts differ considerably however, they are uniform concerning the outlook of having a growth period again by 2021. The forecast that served as a basis for the year 2021 budget was built on the expectation that following a transitory economic recession, Hungarian economy shall grow in 2021 (by 4, 8 percent) and the economic performance in 2021 shall exceed the level of that of the year 2019. According to the Council the strong fundaments of Hungarian economy and the announced economic measures might ensure the continuation of the economic convergence of Hungary. The Council has not considered the option of having to face a newer and serious wave

of the pandemic within a short time as this would call for a budget with a completely new structure.

3) According to the Council the revenue appropriations of the draft document are in harmony with the macroeconomic forecast that served as a basis for the bill. At the same time, due to the uncertainties of the economic forecast they imply certain risks as well. The Council deems it necessary to make additional calculations concerning those planned revenues (excise tax, levies, lost revenues due to tax allowances) that do not depend directly on the indicators of the economic forecast. The expenditures are reflecting that programmes intended to further the recovery of the economy, aiming at preserving jobs respectively, creating new jobs also in 2021. The Economy Protection Fund (within it the Economy Protection Employment Fund created from the National Employment Fund) shall offer the cover for such programmes. The Health Insurance and Protection Fund against the Pandemic are ensuring the necessary resources of operating the protection services and the health care provision system (by incorporating the Health Insurance Fund). The draft is foreseeing significant amounts for family protection and homemaking measures as well as improving the revenues of those retired.

4) The Council agrees with the aim of having the year 2021 ESA deficit comply with the 3 percent requirement stipulated by Point b) Indent (2) § 3/A of the Stability Act and that it shall not exceed the same EU reference value however, should approach this value in order to ensure the budget expenditures and tax incentives needed for the boosting of the economy.

   As regards the 2, 9 percent GDP proportionate targeted deficit foreseen for 2021, it is viable according to the opinion of the Council if appropriate saving measures are taken in those fields where the appropriations shall decrease compared to the year 2020 appropriations. Beyond this the FC deems it indispensable to plan the open top expenditure appropriations safely.

5) As to the viability of the targeted deficit the Council identified some risks as well. The free reserves amounting to 0, 5 percent of the GDP are able to cover the risks only partly. At the same time a larger reserve would distract resources from the economic growth. The Council calls the attention to the fact that the risks affecting the year 2021 budget present themselves mostly in 2020. Thus the FC recommends establishing a more significant reserve in the budget that ideally would be eligible for unlocking after

March 31, 2021. Marking the appropriations at the level of the individual chapters, spending of what would be subject to the prior decision of the Government or the National Assembly only in case the year 2020 economic and fiscal processes turn out to be in harmony with the forecasts of the Government – or better - would be an expedient tool. Thus it would be possible to avoid both the excess reserve building and having the decision maker forced to freeze the appropriations or to increase the mid-year revenues, in case of an unfavourable turn of events.

6) The Council finds that structural deficit[1] shall not reach the targeted 1, 0 percent in 2021 either. At the same time, it sees that beginning with 2021, by returning to the high economic growth rate this criterion of the structural deficit also shall be fulfilled within the foreseeable future by continuing the programmes to stimulate the economy.

7) The Council finds that the shift of the macroeconomic path also shall affect significantly the expected measure of the year 2020 government debt indicator[2]. Thus the FC acknowledges that the decreasing trend of the gross GDP proportionate government debt of the period of 2011 – 2019 shall temporarily take a turn in 2020: according to the draft budget bill the measure of the GDP proportionate government debt indicator shall grow to 72, 6 percent. The Council deems it important that following the temporary growth in 2020, the decreasing trend of this indicator returned and by the end of 2021 it shall decrease to 69, 3 percent. The planned 3, 3 percent decrease offers adequate room to manoeuvre to meet the stipulation of the government debt rule prescribed by the Fundament Law and Indent (2a) § 4. of the Stability Act, even in case either the government debt or the GDP shall take a slight downturn.

8) The FC authorises its chairman to publish the body’s Opinion regarding the draft document as well as present the said Opinion to the plenary session of the National Assembly as it is related to the submitted bill.

[1] The balance of the governmental sector adjusted from the effects of the economic cycle and individual items (Point e) § 1 of the Stability Act)

[2] A… ratio taken to one decimal to be considered in the course of the execution of the stipulations of Indents (4) and (5) Article 36 and Indents (2) and (3) of Article 37 of the Fundamental Law that
- contains in its numerator the value of the government debt and,
- in its denominator the gross domestic product calculated in harmony with the Council of Europe resolution (§ 2 of the Stability Act).

III

Justification

1. Authenticity of the draft bill

According to Indent (2) § 24 of the Stability Act the FC may make observations regarding the draft bill respectively – in case it has fundamental objections concerning the authenticity of viability of the draft – it may indicate its disagreement. The Council considers that there is no impediment to prevent the granting of the body's agreement.

2. Expected macroeconomic processes in 2020

As regards the decisive processes and tendencies of the global economy (European economy included) in their analyses benchmarking international financial organisations were already forecasting the slow-down of the growth rate of world economy in 2020 and 2021. The International Monetary Fund (IMF) forecasted a global growth rate of 3, 5 percent in 2020 while the World Bank thought a 2, 5 percent growth rate was possible and OECD visualised a 2, 4 percent growth. According to the evaluation of the European Commission published in February this year (winter evaluation) it was visualising a moderate growth rate (and inflation) as regards the performance of the European economy. Thus it mitigated its original expectations for year 2020 altogether to 1, 2 percent in case of the Euro-zone and to 1, 4 percent concerning the whole of the Union.

However, the coronavirus pandemic and its consequences have changed fundamentally the conditions and direction of the global growth rate. This new type of epidemic that became universal by March 2020 has redrawn fundamentally the international economic and financial processes. Certain forecasts presumed a drastic world economic recession exceeding the 2008 financial crisis. IMF's April prognosis predicted a 3 percent shrinking of the world economy. In case of the USA economy they forecasted a recession of 5, 9 percent, for the whole of the EU and regarding the Euro-zone 7, 1 percent respectively 7, 5 percent while as regards the German economy the prognosis was a recession reaching 7, 0 percent in 2020.

The Hungarian Government built its year 2020 central budget on the assumption of having a GDP proportionate growth rate of 4, 0 percent. In their 2019 fall evaluations concerning year 2020, international organisations were calculating with a slowing rate of sustainable domestic economy growth i.e. 2, 4 – 2, 5 percent compared to the outstanding results of the previous years of 4, 9 percent. In February 2020 the European Commission expected a growth rate of 3, 2 percent from the Hungarian economy while in January this year, IMF foresaw a 3, 3 percent growth while by April predicted a 3, 1 percent decrease.

However, the coronavirus pandemic has greatly rewritten the forecasts for the Hungarian economic growth. The available 2020 forecasts based on calculation models regarding economic performance, are spreading from + 3, 0 and – 7, 0 percent. Thus, in the course of formulating its opinion about the year 2020 macroeconomic path the FC could rely on the consensus of macroeconomic analysers to a lesser degree. The expectations of the government (regarding the numbers of the basic path of the budget) presume a GDP proportionate decrease of 3 percent. This conservative forecast – with regard to the expectations of other institutions and experts – can be accepted as a basis for the planning.

Hungarian economy grew by 2, 2 percent in the first quarter of 2020. A smaller share of this growth was made up from industry, the major part from market services. According to the available data the growth rate was high in the first two months of the year however; the economic consequences of the coronavirus pandemic (international and domestic restrictive measures, the interruption of supply chains and the decreasing demand) resulted in considerable slow-downs beginning with March. This was a decisive factor in all sectors of the national economy but especially in case of services relying on personal attendance, mostly in the restaurant sector and tourism.

The unfavourable consequences of the coronavirus pandemic markedly prevailed as regards employment by the last month of the first quarter. The average monthly number of employees turned out to be 4.442 that meant less by 56 thousand than in February. The statistics of the changing unemployment numbers are reflecting yet the effect of the coronavirus only partially however, the FC is counting on a temporary increase in the number of unemployed that might be decreased rapidly once the economy shall restart and the effects of the governmental programmes are being felt.

In the total of the first quarter the consumer prices grew by 4, 3 percent (by 4, 7 percent in January, 4, 4 percent in February and by 3, 9 percent in March). The fact that as a result of the increased excise duty tobacco good became more expensive by 11, 3 percent has contributed to the increasing inflation rate. The inflation slowed to 2, 4 percent by April, primarily thanks to the falling oil prices.

The strong fundaments of the Hungarian economy and the economic measures introduced to support the economy make it possible that the coronavirus pandemic would be followed by a rapid recovery however; in this respect the performance of Hungary's commercial partners shall be playing a decisive role, apart from the duration of the pandemic.

3. The expected fiscal processes of year 2020

The consequences of the coronavirus pandemic are fundamentally influencing the budget via two channels. On the one hand, the slowing down of economic growth is mitigating the tax bases and makes the decrease of specific taxes unavoidable. On the other hand, managing the health emergency and the economic consequences shall result in the increase of expenditures. As a consequence, the Government increased it targeted fiscal deficit for year 2020 from 1, 0 percent of the GDP to 3, 8 percent.

Simultaneously with the proclamation of the state of emergency on March 11, 2020 the Government announced the introduction of an economy protection action plan to thus offbeat the depth and duration of the crisis. The targeted measures, partially implying burdens for the budget, are playing a decisive role in preventing the lasting decline of production capacities and repelling the worsening of long-lasting outlooks. Recognising the necessity of state intervention the Council of the European Union entered into force the escape clause for fiscal regulations.

In order to finance the measures taken to combat the pandemic and the economy protection measures the Government established three new funds. The grand total of the Fund for Measures to Combat the Pandemic and that of the Economy Protection Fund amount to HUF 663 billion, respectively HUF 1 345 billion. These amounts were created by the reallocation of the budget, the utilisation of the free reserves of the Country Protection Fund, the partial centralisation of the subsidies given to political parties, the full centralisation of the local governments' revenues from vehicle tax as well as by increasing the taxes paid by retail commerce and the financial sector. The Fund to Combat the Pandemic ensures resources for purchasing medical devices, the single wage supplement of health care professionals and the extension of family allowances expiring during the crisis. The Government will use the resources of the Economy Protection Fund to finance the realisation of the economy protection action plan. This includes the tax waiver of sectors most closely affected by the crisis (tourism, catering, passenger services) in the form of remission of contributions and taxes for a set period, supporting employment with reduced working hours, wage benefits for people employed in engineering and development jobs, supporting investments of small and mediums size businesses. According to the Convergence Programme the total of the expenditures related to protection measures against the pandemic, together with the supports for the economy and the resources left with companies in the form of tax reductions, shall exceed the amount of the revenue creating measures thus, altogether they will increase the deficit. Beyond these measures the liquidity of households will be assisted by a moratorium on loans and promotional loans (supported partially by the guarantee of the government). The introduced Hungarian measures align with the international trends (saving jobs, offering promotional loans to businesses, tax reliefs, guarantees and other reliefs). Apart from the above the Fund for Supports Against the Pandemic from the European Union was also established that shall serve the receipt of the supports against the pandemic that might arrive from the European Union.

The measures announced by MNB (Central Bank of Hungary) constitute the other part of the economy protection package. Growth Scheme Go (NHP Hajrá) available for micro, small and medium size businesses is ensuring cheap and stable loan resources worth of HUF 1 500 billion in a way that can be used in a wider circle than earlier, thus helping the mitigation of the consequences of the coronavirus pandemic on the economy together with strengthening this sector, as well as its further growth. Additionally, MNB has also amended certain parameters of the Funding for Growth Scheme and this might assist further the increasing of the liquidity of the corporate bond market. Beyond this, MNB paid historic high dividends amounting to HUF 250 billion in the budget in April 2020 that shall ensure additional resources for public finance amounting to HUF 48 billion and it shall increase the accrual based balance of the budget as well.

According to forecasts making international comparison possible, the effect of the coronavirus pandemic on Hungary's economy is less than the average however and even so, it shall be significant. The GDP data of the first quarter is reflecting this by showing a slow-down compared to the previous data however, within the European Union it belongs among the more favourable results. In order to maintain the lasting convergence of Hungary and apart from the slowing down/stopping of the spread of the epidemic and the re-starting of the economy it is also necessary to have the domestic economy return to its growing path, to continue the capital intensive development of the economy, the switching to innovative production and further strengthening competitiveness in the third quarter.

Having in mind all the above the FC considers that the expectations of the Government regarding the year 2020 processes are realistic and are an appropriate basis for planning for year 2021. At the same time, the Council also perceives certain risks too. In case the re-starting of the economy will be quicker in the third quarter than the expectations of the Government, its effect on the year 2020 budget would also be more favourable than expected.

According to the data of the first four months of the central subsystem the public finance deficit – without local governments – amounted to HUF 727, 4 billion that is significantly higher than in the previous years. The growth of the cash deficit was fundamentally the result of the higher EU expenditures (HUF 842 billion) and the lower EU revenues (313, 2 billion). Apart from the above, part of the expenditures related to the protection against the coronavirus pandemic also appeared in this result (they spend about HUF 400 billion on purchasing medical devices). Taxes burdening consumption as well as the taxes and contributions related to wages and salaries have grown significantly in the first three months of the year however, by April the dynamics has slowed down considerably and the amount of social contribution taxes and contributions also was less than a year before. The smaller tax rate also contributed to this result. From the aspect of fiscal processes it is favourable that both the revenues from value added tax and personal income tax grew in April. As regards the revenues the effects of the coronavirus pandemic are expected to have stronger impact on the May and June results as they shall be founded on the economic processes of April and May.

The preliminary, accrual based data concerning the fiscal balance are showing a surplus of HUF 89 billion in the first quarter of 2020. The considerable difference compared to the cash balance originates from the different accounting methods of the EU supports. Namely, the advance payments remaining statistically within the governmental circle shall not be considered expenditures in the accrual based balance (it’s considered only later, at the time of the real utilisation and related to the real utilisation, but up to that point no cash realised EU revenues shall be considered as well).

4. Year **2021 fiscal goals and conditions**

4.1. Macroeconomic indicators serving as the basis of the planning

Following the 2020 temporary setback the draft is counting with 4, 8 percent GDP growth as regards the appropriations of next year's budget. The bill bases this on the probability that thanks to the expected rapid growth following the coronavirus pandemic the volume of household consumption will grow by 3, 1 percent and the scope of gross fixed capital formation (GFCF) – following the significant mitigation in year 2020 – by 5, 5 percent. Following the decline in 2020 the expansion of employment might continue by 1, 6 percent (in the private sector the pace of growth is expected to reach 2 percent while, in the public sector they are not counting with any changes). Gross average wages might grow further by 6, 9 percent (by 7 percent in the public sector and by 6, 3 percent in the public sector– thanks to the completion of the various career models). As a result of a major part of the foreign trade obstacles caused by the coronavirus and following the year 2020 decline, exports might expand by 10, 5 percent while imports by 8, 9 percent. The degree of consumer price increase is forecasted to be 3, 0 percent.

The Council examined the components of the macroeconomic path that served as the basis for the draft of the year 2021 central budget bill. In doing so the FC reviewed the contents of the 2020-2024 Convergence Programme of Hungary and was also considering the evaluations prepared by the Central Bank of Hungary, the European Commission and the IMF, together with the analyses prepared upon the commission of the FC Secretariat by researchers and experts. Depending on what GDP changes these documents had considered for 2020, the various papers suggest for 2021 a growth rate between 2, 9 percent and 7, 8 percent. The Council sees that it is equally difficult to predict not only the economic consequences of the coronavirus pandemic but also the measure of the „rebound". Namely, it is difficult to calculate the re-emergence of another wave of the pandemic as well as the dissolution of the actual tensions of world economy (oil, military, regional, commercial, etc.) and even more so, when would the economies of the countries heavily affected by the consequences of the pandemic recover.

According to the FC the 4, 8 percent GDP growth foreseen by the Government would be viable if the expansion of consumption will be in harmony with the plans and no administrative and supply side obstacles interfere with foreign trade.

Apart from the realised results so far and by safekeeping fiscal security, the draft of the 2021 budget bill is focusing on stimulating the economy, the supporting of branches exposed to the effects of the pandemic, the preservation of jobs, and creation of new jobs and the protection of the families and pensioners.

Aspects of the fiscal policy are implemented primarily via the central subsystem of public finance thus the Council was analysing the trend of the revenues and expenditures appropriations of this subsystem as presented by the draft bill.

4.2. Revenues of the central subsystem

The total – not consolidated – revenue appropriation of the central subsystem is HUF 21.875,4 billion that exceeds the preliminary realisation of year 2019 by 2, 0 percent, while the year 2020 annual appropriation by 2, 1 percent and the projected attainment by 2, 6 percent.

The tax reform implemented during the past, nearly ten years – the mitigation of taxes on labour and capital, introducing contemporary methods and technologies apart from administrative facilitations – ensured the whitening of the economy and the increase of revenues required for fiscal management. The multi-annual economic prosperity (the continuous growth of incomes and consumption) served as a good basis for this.

The *appropriation of the payments of entities* is HUF 1.783,7 billion that is exceeding the year 2020 appropriation by 5, 6 percent, (HUF 93, 8 billion); the projected commitment by 7, 8 percent (that is HUF 129,1 billion). As regards corporate tax that represents the biggest share by HUF 538, 5 billion and means an increase of 7, 5 percent i.e. HUF 37, 4 billion compared to the appropriation of the previous year (as regards the projected commitment this means an increase by 20 percent, amounting to HUF 90 billion). The explanation lies in the prevalence of the basis effect due to the economic decline that was the result of the coronavirus epidemic as well as the hopefully successful management of the economic consequences of the pandemic also in the long run. The appropriation of the special tax of financial organisations (HUF 61, 4 billion) shall drop to the 2019 level, following the one-time 2020 contribution imposed with the purpose of averting the consequences of the pandemic. The one-time additional payment in 2020 is deductible in equal instalments during the next five years. The appropriation of small business tax is exceeding the previous appropriations by HUF 10 billion (by HUF 7, 0 billion as regards the projected commitment). Although in this case the tax rate shall decrease however, the effect of the ongoing growth of the number of employees prevails. Following the year 2020 tax waiver the itemised tax of small taxpayers shall grow by

HUF 40, 6 billion compared to the projected realisation. The appropriation of the centralised other revenues exceeds the projected realisation by HUF 39 billion (7, 1 percent) thus reaching the amount of the original appropriation (the projected realisation in 2020 is HUF 545, 8 billion).

The total appropriation of *taxes levied on consumption* is HUF 6.672,6 billion that is exceeding by 0, 5 percent the appropriation of the previous year (by 7, 8 percent the projected realisation that amounts to HUF 484, 9 billion). Within this revenue group it is the value added tax (VAT) that represents the biggest share by HUF 4.982,2 billion, exceeding merely by HUF 12, 2 billion the appropriation of the previous year (by 8, 0 percent that of the year 2020, amounting to HUF 370 billion). The reason is that the projected realisation for year 2020 is affected by the decline of consumption in the first half of the year however, the expected re-starting of the economy shall strengthen consumption and the revenues shall reflect the growing turnover as regards revenues. Laying the foundation for the expected revenues requires keeping the VAT gap at a low level and to this end the strengthening of the legal framework, together with the continuing of introduction of measures and the practice of targeting the whitening of the economy also in the future.

The excise duty appropriation amounting to HUF 1.263,1 is more by 3, 0 percent, i.e. HUF 37 billion, compared to the previous year's appropriation while compared to the projected commitment by HUF 66 billion (5, 5 percent). Thanks to continuing the tax rate on tobacco goods and having the fuel consumption return to the usual level, the appropriation for 2020 is realistic. The appropriation of the financial transaction tax (HUF 218, 8 billion) is less by HUF 7, 5 billion than last year's appropriation however; it is exceeding by HUF 16 billion the projected revenues. As regards the rest of the revenue kind incomes (registration tax, etc.) the appropriations and projected commitments, they are in harmony.

The appropriation of *retail payments* amount to HUF 2.997,1 billion, i.e. it is higher by 3, 4 percent (HUF 98, 4 billion) than the projected amount compared to the appropriation in the previous year (by HUF 222 billion, i.e. 8, 0 percent). The appropriation of the personal income tax amounting to HUF 2.683,5 billion is higher by 2, 8 percent (HUF 75 billion) than in the previous year and by 7, 8 percent (amounting to HUF 195 billion) compared to the expected revenue. The reason for the considerable growth in revenues lies in the expanding employment parallel with the re-starting of the economy as well as the growing wages. The appropriation of revenues from levies lags behind that of the previous year by HUF 11 billion however, it is higher by HUF 25 billion compared to such revenues expected in 2020, on the grounds that the number of real estate purchases and selling vehicles shall grow again.

Social contribution tax and contributions represent a significant part of the revenues of the central subsystem. From this amount HUF 5.262,1 billion is due to the two social insurance funds in 2021. This is less by HUF 82 billion than the year 2020 appropriation however, it is more by HUF 301, 4 billion than the expected realisation in 2020. The latter was planned despite the fact that the degree of this tax shall decrease from 17, 5 percent to 15, 5 percent beginning with July 1st, 2020. As we don't know when production and employment shall get back to the level prior to the crisis, this represents a risk.

The draft bill has been counting with measures taken earlier. Altogether the tax and contribution revenues are in harmony with the planned macroeconomic parameters. If they are not met or met only partially, the consequences shall appear in the revenues; to the greatest extent in the value added tax, the social contribution tax and contributions, as well as in the personal income tax.

4.3. Expenditures of the central subsystem

The total, not consolidated expenditure appropriation of the public finance central subsystem is HUF 23.366,6 billion that is more by 3, 1 percent than the preliminary 2019 realisation and by 7, 2 percent than the year 2020 appropriation, while by merely 0, 7 percent compared to the expected realisation of 2020. Behind this conservative growth lies the fact that a number of such, one-time health-care related, expenditures occurred in 2020 and probably shall not be repeated in 2021.

Beyond the above, the medium term path of fiscal expenditures is in harmony with the earlier purposes identified by the Government, according to what it is advisable to continuously mitigate the share (the measure of redistribution) of public finance (more precisely: of the governmental sector[3]) in order to decrease the burdens of the economy. This idea is reflected in the Convergence Programme of Hungary for 2020 - 2024 where, opposite the share occasionally exceeding 50 percent in the year prior to 2016, by 2021 the consolidated

[3] Beyond the central and local subsystem of public finance it contains the data of the businesses listed under this title by the Resolution 479/2009/EK of the Council, dated 25th of May, 2019 as well.

expenditures (filtering out the accumulation between the subsystems) represent only 45, 9 percent of the GDP i.e. less by nearly 2 percent compared to the projected commitment for year 2020. According to the Programme, the degree of redistribution might fall to 40 percent by 2024.

From among the expenditures of the central subsystem being kept divided into three big groups, in 2021 they are planning to use more than the appropriation of the previous year (compared to 83 percent reaching nearly 84, 4 percent) for intermediate (operational) purposes, while for accumulation purposes financed by domestic resources the appropriation is less (8, 8 percent instead of 9, 3 percent) and for developments financed by EU financing also somewhat less (6, 8 percent instead of 7, 8 percent).

From a significant share of the expenditures of the *operational (intermediate) budget* amounting to HUF 19.718,8 billion, (i.e. 35, 0 percent) is allocated to the social security funds. The appropriation of the *Pension Fund*, amounting to HUF 3.915,3 billion, that is bigger by 9, 1 percent compared to the previous year's appropriation (by nearly HUF 330 billion) makes it possible in year 2021 to maintain old age security, the safekeeping of the living standard of pensioners and keeping the preferential retirement for women. The draft bill is also calculating with the effect of the gradual re-introduction of the pension for the 13th month – to be financed from the Economy Protection Fund. This means HUF 77 billion in 2021. The appropriation of the *Health Insurance Fund* amounting to HUF 2.905 billion is more by 8, 3 percent i.e. more by HUF 220 billion compared to the appropriation of the previous year. This amount includes resources intended for curative and preventive care that means more by HUF 138 billion. This amount makes it possible to continue the wage development of health-care professionals and social workers as well as the realisation of various investments and reconstructions. Other, additional resources are serving the purpose of increasing the efficiency of the health-care system and improving the sustainability of the financing system.

A quarter of the intermediate expenditures, HUF 4.678,7 billion (higher by 5, 8 percent, i.e. close to HUF 300 billion) is serving the operation of the *central fiscal organisations.* This offers the cover for the execution of earlier launched respectively, new career programmes. *Budgetary supports* representing a significant share guarantee also next year the realisation of the goals of the family protection action plan thus, the encouraging of families to have children, supporting families with children, especially big families, the improvement of the quality of lives of families, building new homes for these families, developing the nursery network and payment of childcare allowance for grandparents.

The *accumulation budget financed by domestic resources* amounting to HUF 2.046,9 billion is ensuring most of the resources – HUF 224 billion, respectively HUF 204 billion – for housing construction supports and public road developments. It also offers an opportunity to realise the Programme of Modern Cities, the Liget Budapest project, the Paks II investment, the Hungarian Village Programme and the Healthy Budapest Programme, as well as for the building of the new multifunctional sports and other events hall in Budapest. The development of the railroad system also gets a substantial amount as well as the development of bicycle paths and other tourism related developments, the modernising of energy and climate policies, developing the agricultural irrigation systems, supporting big families in buying passenger cars, defence and law enforcement investments. Developments already under way may continue in the framework of the National Public Educational Infrastructure Development Programme that has been launched six years ago.

The expenditures appropriation of the *EU development budget* amounting to HUF 1.600,9 billion exceeds the revenues expected from the EU by HUF 472 billion. The Hungarian budget shall advance a significant amount for these purposes even in 2021 thus HUF 250 billion for the cohesion operative programmes beyond 2021; the most for developing the economy and transportation. From the Széchenyi 2020 Programme of the period of 2014-2020 the amount of HUF 1.200 billion is serving the development of the economy and competitiveness, transportation and environmental protection and energy efficiency as well as regional and human resources development.

The *Economy Protection Fund* established in 2020 functioning individually as a budgetary chapter and amounting to HUF 2.550 billion is serving the protection and re-starting of the economy. The Economy Protection Employment Fund created from the National Employment Fund is an important part of this. Apart from the appropriations transferred from the chapters - the holder’s right over what remains with the technically qualified agencies – this Fund also contains reserves to be used freely in the amount of HUF 120 billion. Beyond the periodical EU resources of the 2014 – 2020 period that may be released respectively, that have not been committed yet, shall be used in 2021 primarily for implementing the Economy Protection Action Plan. The goals aiming the mitigation of the economic consequences of the pandemic period – in harmony with the above – shall be supported also by the supports available within the framework of the 2021 – 2027 period starting in 2021.

The new fund in the 2021 budget, *the Health Insurance and Pandemic Prevention Fund* serves the coordinated management of the prevention of the pandemic as well as that of the operation of the healthcare system. The backbone of the framework amounting to HUF 3.000 billion is the Health Insurance Fund. The revenues of the pandemic fund come from the revenues of retail tax and the total of the car taxation. A central reserve within the fund amounting to HUF 30 billion, that may be exceeded, shall ensure that no financial obstacles existed also in 2021 as regards the protection against the pandemic.

The free *reserves* representing slightly more than 0, 5 percent of the GDP, amounting to HUF 270 billion shall serve the purpose of strengthening and sustaining fiscal security as well as saving external risks in 2021 (in the year 2020 annual budget these represented 1 percent of the GDP). In harmony with the above the plans include HUF 120 billion within the Economy Protection Fund, HUF 30 billion in the Health Insurance and Pandemic Protection Fund while HUF 120 billion within the title of Extraordinary Governmental Measures.

4.4. Public finance deficit

The crisis due to the coronavirus pandemic in 2020 is an extremely unfavourable background for planning the year 2021 public finance balance. As a consequence of this fact, together with the effect of the crisis management and reconstruction measures on the budget, the government is foreseeing a 3, 8 percent GDP proportionate deficit, calculated by EU methodology, instead of the previously calculated 1, 0 percent for 2020. By reacting to the economic crisis that evolved parallel with the spreading of the coronavirus pandemic, the conditions allowing transitory exemption rules according to the opinion of the Economic and Financial Affairs Council (ECOFIN) make it possible that member states of the European Union temporarily shall not have to meet the respective original rules. For 2021 the Government plans again a 2, 9 percent GDP proportionate deficit, i.e. below the Maastrich criteria. The FC considers this feasible, in case the macroeconomic processes predicted by the budget shall be met.

As regards the feasibility of the targeted deficit the Council identified both for year 2020 and 2021 two-way risks concerning the macroeconomic conditions. The prolongation of the coronavirus pandemic or its possible flare up might result in a worse economic situation as a consequence of what we could count with fewer revenues and significantly more expenditures concerning the crisis management. However, on the other hand, in case of the rapid restoration of the economy, revenues might be higher beginning already in the second half of 2020. To manage these risks adequate amount and flexibly of usable reserves are necessary. The Council was pondering the possibilities. Increasing the amount of reserves might result in additional restraining of spending that might induce the decreasing of demand, thus present an obstacle for the improving of the economic performance. All in all, in order to increase flexibility, the Council deems it necessary to rethink the concept of reserve maintenance.

The Council deems it forward looking that within the central subsystem divided into three parts, the balance of the operation part is zero – for the fourth consecutive year – and cash deficit may arise only in the accumulation and EU budgets.

The planned GDP proportionate structural deficit is 2, 2 percent i.e. it is exceeding the 1 percent share defined for the structural balance of the medium term fiscal goal (MTO). According to the FC the derogation is justified by the need to create the resource required to restart the economy. On the other hand, the FC welcomes that by returning to the high growth path of the economy beginning with 2021 it shall get substantially closer to MTO. In the Council's opinion this goal might be attainable in the medium term by continuing the programmes targeted to strengthen sustainability.

Parallel with the above the cash deficit of public finance planned for 2021 is also high, HUF 1.689,3 billion (3, 3 percent of the GDP), compared to the year 2020 appropriation of HUF 412, 5 billion (0, 8 percent of the GDP). The 2021 value is mostly the consequence of the negative balance of the central subsystem (- 2, 9 percent, i.e. HUF 1.491,2 billion) mostly as a result of the lost revenues due to the crisis.

4.5. Government debt

The pandemic is strongly affecting the anticipated development of the year 2021 government debt. Following the decrease of the GDP proportionate gross government debt in the period of 2011-2019 thanks to the one-time effect it shall temporarily grow in 2020 and this growth is allowed by the Hungarian fiscal regulations with regard to the extraordinary situation. However, in 2021 the earlier tendency shall continue and the government debt indicator, according to § 2 of the Stability Act and referred to by the budget act, shall decline from 72, 6 percent to 69, 3 percent. Following this the large scale mitigation shall result in a below the 60 percent threshold result by 2024, in harmony with the stipulation of the EU regulations.

The year 2021 draft budget bill is in harmony with the government debt rule[4] prescribed by Indent (2a) § 4 of the Stability Act according to what the end of the year value of the government debt indicator shall be defined so that its annual decrease – by the validation of the respective EU regulations[5] - shall be at least 0, 1 percent. It can be established that in 2021 the EU regulation concerning the decrease of the government debt rate is expected to be met, calculated by two methodologies, i.e. by both the forward looking and the cyclically adjusted methods[6].

The risks identified concerning the viability of the targeted deficit are concerning the expected trend of government debt as well. Nevertheless, looking at 2021 the projected decrease of the government debt indicator seems to contain adequate reserves to ensure the realisation of the goal even under slightly less favourable economic conditions.

[4] Indent (4) and (5) Article 36 of the Fundamental Law describes the government debt rule as the most important element of rule-based budget. According to this stipulation the National Assembly shall not adopt such a central budget act as a result of what the government debt would exceed half of the GDP. As long as government debt is exceeding half of the gross national product the National Assembly shall adopt only such central budget act that contains the decreasing of the government debt in the proportion to the gross national product.

[5] The debt rule of the European Union is defined by the Treaty on the functioning of the European Union and the Resolution 1467/97/EK of the 7th of July 1997 of the Commission. The debt rule of the European Union has been valid for Hungary beginning with 2016. According to the rule the share of the government debt in proportion of the gross national product (GDP) shall not exceed 60 percent. In case the government debt exceed this reference framework, the difference shall have to be mitigated annually by one twentieth part compared to the reference framework of the previous three years („one twentieth rule").

[6] In case the government debt exceeds 60 percent the debt rule of the European Union stipulates that the difference from the reference framework shall have to be cut annually and in average by one twentieth part as a reference framework, based on the changes having occurred in the years that are documented by available data (retrospective rule). The stipulation of the debt criteria can be considered as fulfilled also in case the fiscal projection of the Commission indicate that the difference shall decrease according to the prescribed degree in those three years that include two years following such a last year concerning what data are available („forward looking rule"). Using the reference value of the adjustment of the debt rate the effect of the cycle on the decreasing of the debt shall have to be considered („cyclically adjusted rule").

Within the central budget debt the foreign currency denominated share has lowered significantly; from the approximately 50 percent in year 2011 to 17, 3 percent by the end of 2019. According to the draft bill this share might temporarily increase to 19, 4 percent by the end of 2020 due to issues in other currencies. However, in 2021 it will decrease again to 17, 6 percent. The retail securities having favourable conditions might ensure the high demand as a consequence of what the growth of the share of domestic financing shall continue.

21st of May 2020

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