

## **The Fiscal Council's Opinion on the Effects of the Coronavirus on Public Finance**

I. According to Point e) Indent (1) § 23 of Act CXCV of 2011 on the Economic Stability of Hungary “the Fiscal Council (henceforward: Council) “may express opinions on any issues related to the planning, the execution and the utilisation of public moneys in any other ways”. In harmony with its mandate the Council shall follow with attention the trend of the public finance processes and their respective compliance with the legal stipulations.

The present document is the summary of the opinions of the Council members based on the electronic harmonisation of the opinions expressed via online contact and was prepared by taking into consideration the position paper of the State Audit Office of Hungary dated 6th of April 2020 and the opinion of the Central Bank of Hungary as well as additional experts' input.

II. The spread of the coronavirus pandemic is one of the worst crises that have ever affected the countries of the world in peacetime. Its characteristic features and severe nature that is graver than any other crises, originates from the fact that it is directly threatening human health and lives, requires the temporary abandonment of customary social behaviour while it is affecting nearly simultaneously the whole world. Thus, there are practically no points of world economy that would act as a driving force for the others.

Reacting to the coronavirus thus requires rapid and forceful intervention in every part of the world. The Council shares the opinion of the Government that the interventions should be focusing on three major fields: managing the challenges facing healthcare, compensation of the negative effects resulting from the unavoidable slowing down of the economy and last but not least, the re-starting of the economy, following the emergency.

Thanks to the successful economic policy of the bygone decade and the efforts of the Hungarian economy our country is in a strong and resistant condition when reacting to the pandemic and its economic consequences. From the aspect of the budget the planned 1 percent targeted GDP deficit that is the lowest ever and, within this, the reserves amounting to nearly HUF 500 billion for 2020 offer considerable flexibility and room to manoeuvre. The GDP proportionate government debt (henceforward: government debt indicator) has been decreasing continuously since 2011 has also increased the room to manoeuvre as a result of what, indebtedness fell to a level existing before 2008.

The Council agrees that the budget has to be redesigned to offbeat the health and economic effects caused by the pandemic and – together with the liberating of the reserves and creating new funds - has been partly realised. This step, in different forms, is unavoidable in all the concerned countries as the lawmakers could not count with an unforeseen event of such extent.

The consequences of the coronavirus fundamentally affect the budget via two channels. The slowdown of economic growth and the tax relief offered to businesses in difficulties are mitigating

the tax bases on the one hand and thus, the tax revenues are lagging behind the planned amount. On the other hand, managing the health emergency and the economic consequences require an increasing amount of expenditures. The Council shares the opinion of the Government that even under the emergency the requirements stipulated by the Fundamental Law should be observed as regards managing public moneys. Thus, they should be used in a regular, transparent and accountable way in case of the necessary expenditures respectively, the encouraging the restart of the economy. The Government endeavours to create the cover for crisis management measures in such a way that it would not increase the deficit. The measures are financed primarily from reallocations, the utilisation of reserves, and the taxes of large enterprises operating in retail commercial sector, as well as from increasing the taxes of credit institutions. As a consequence it is mostly the economic processes and the revenue shortfalls that are affecting the budget deficit.

As regards the budgetary processes for year 2020 the length of the pandemic is playing a significant part thus, the macroeconomic forecasts prepared by various organisations are showing substantive differences. The cycle of the economic crisis as a consequence of the pandemic is uncertain and this is contributing significantly to the precise forecasting of the expected macroeconomic course.

The Council agreed that the Government wishes to keep the GDP proportionate budget deficit under 3 percent however, in case of worsening circumstances, they are ready to revise this. As a consequence of its task stipulated by the Fundamental Law, the trend of government debt is in the focus of the Council's attention. As a result of the continuous mitigation of the government debt indicator since 2011 the indicator decreased to 66, 3 percent of the GDP by the end of 2019. In 2020 however, the prolongation of the pandemic, the lasting slowdown of the economy and the greater than expected increase of the deficit might result in the temporary increase of the government debt indicator. At the same time, account must be taken of the fact that because of the crisis affecting the whole world, financing government debt will be more difficult. Obtaining external sources for this purpose would increase Hungary's vulnerability thus; the Council supports the endeavour of relying on domestic savings.

The Council is calling the attention that the budget regulations of the domestic fiscal frame shall be suspended for the duration of the special legal order and the sustained and considerable downturn of the national economy thus, it is possible to deviate from the stipulations of the obligation of decreasing the government debt indicator as well as that of the expectation regarding the 3 percent budget deficit. The EU fiscal framework also offers the possibility to deviate from the stipulations of the Stability and Growth Pact as regards the accrual based and structural public finance deficit. This was made possible officially following the so far unprecedented activation of the general escape clause, upon the decision of the Council of the European Union. Apart from the above the Fiscal Council is also following with special attention the trend of the domestic public finance and macroeconomic processes. The Council shall inform the Government and the public about its statement and opinion also in the future.

As regards the slowdown of the economy as a consequence of the pandemic, the Council considers it temporary. In case of handling adequately the emergency situation, the economy can return to the medium term economic growth course. The Council is appreciating the intention of the government to possibly avoid the chance of having the pandemic and the respective temporary fiscal measures affecting the public finance deficit and the government debt indicator significantly. Hence, they are planning the gradual introduction of measures to mitigate the effects of economic downturn as regards employment, social and pension entitlements and other, with special attention to the people's burdens and difficult prevailing situations.

III. At the time of adopting the year 2020 budget act in 2019 the document was calculating with and economic growth of 4 percent. The expected deviation from this target, together with the healthcare and economy protection expenditures, make it necessary to plan anew the budget, beyond the flexibility that the reserves present. The Council notes that despite the unfavourable circumstances the budget has access to additional resources that had not been considered by the act. From its result in year 2019 the Central Bank of Hungary (MNB) paid HUF 250 billion to the central budget. Additional HUF 128 billion was received by the budget from the concessions of the 5G frequency. From among the revenues HUF 48 billion of the total payment by MNB is improving the accrual based public finance balance while the rest of the amount can be regarded as financing resources this year.

As a response to the crisis, in the second half of March, the Government decided about the mitigation of tax and contribution tax burdens of employers and employees belonging to specific branches of the national economy in the first round, and this step alone might decrease the budget revenues by approximately HUF 100 billion this year.

The Council did receive the information of the Ministry of Finance about the Government resolution 69/2020. (III. 26.) making it possible to use the reserves of the central budget differently from the conditions stipulated by the budget act and the public finance act. Apart from introducing additional measures, serving the protection of the economy and epidemiological purposes, by government decree 92/2020. (IV.6.) they decided on establishing three new funds thus derogating from the 2020 budget act. The Council hereby is attaching the information PM/7865/2020. received from the Ministry of Finance to the present opinion of the Council.

The first is the Fund of Protection against the Pandemic, amounting to HUF 634 billion. The sources of this fund include the free resources of the former Country Protection Fund, the partial reallocation of the subsidies for political parties and the total of the motor vehicle tax revenues of the local governments, together with the increase of retail commerce and of the financial sector. The expenditures of this Fund are made up from the one time wage supplementation of health care professionals and the decided, respectively already realised purchases of healthcare equipment and investments. The establishing of the Fund itself has no increasing effect on the deficit as its resources are coming from reallocations of appropriations and certain tax measures however, there is no limit, thus during the year the expenditures might exceed the revenues.

The second is the Economy Protection Fund that was created as a new chapter of the budget amounting to HUF 1 346 billion. The two major items of this fund comprise the resources prescribed for the individual agencies from savings respectively, the revenues of the National Employment Fund that thus becomes part of the Economy Protection Fund. Expenditures of the Fund can be used for the implementation of the economy protecting and recovery measures/packages.

The third, newly created fund comprises the systemisation of EU Supports Against the Pandemic. This Fund displays the excess resources above the laid down degree of supports related to EU programmes and their respective utilisation. The grand total of the Fund at present is HUF 0 billion.

The creation of the above funds in total does not influence the budget balance as long as their utilisation does not exceed the amount of the attached resources. The Council shall closely monitor this together with the effect of the shortfall of revenues.

Budapest, 16<sup>th</sup> of April 2020

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Annex: Information of the Ministry of Finance PM/7865/2020

Mr. Árpád Kovács

PM/7865/2020

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Dear Mr. Chairman!

Please allow me to provide information on government actions directly affecting the implementation of the Hungary 2020 Central Budget Act related to the coronavirus epidemic.

In the same period last year, economic fundamentals have projected a stable, balanced and sustainable growth trend this year. As a result, the 2020 budget bill envisaged a dynamic GDP growth of 4%, moderate inflation of 2.8%, a deficit target of 1% of GDP and a budget reserve of 1% of GDP.

However, the current outbreak of the coronavirus pandemic is causing a significant economic downturn both domestically and internationally, leading to other than originally planned developments in this year's deficit and debt figures.

In view of the existence of an emergency due to the epidemic, the deviation from the 2020 budget can be implemented by a Government decree, as the Government may suspend the application of certain laws, deviate from legal provisions and take other extraordinary measures during a state of emergency.

As a result of the pandemic the changing macroeconomic and fiscal conditions make derogation from the 2020 budget economically necessary, and the emergency situation makes such derogations legal.

By way of derogation from the 2020 budget, cover may be provided for the implementation of additional health and law enforcement tasks and measures that have increased as a result of the pandemic and for the introduction and maintenance of measures to protect the economy and employment.

Based on the above, the Government adopted Decree 69/2020. (III. 26.), which made it possible to use the reserves of the central budget differently from the conditions set out in the Budget Act of 2020 and the Public Finance Act. Thus, the reserves can be used without time limitation and expected deficit constraints. This measure also contributed to the extraordinary availability of resources for epidemiological control. Based on the decisions made by the Operational Staff by 3 April, the central budget provides HUF 380.5 billion typically to the Country Protection Fund (OVA) - most of which has already been disbursed to suppliers.

The Government adopted Decree 92/2020. (IV. 6.) created three new funds, also deviating from the 2020 budget. The first two funds contain domestic resources and expenditures for epidemiological control and economic restart, the third fund requires the presentation of realized (non-liquidity) epidemiological subsidies from the Union budget.

The funds are as follows:

#### Epidemiology Control Fund

As mentioned above, the source of expenditures on epidemiological control so far has been typically the HUF 378 billion Country Protection Fund (OVA).

In the interests of uniform management, OVA will remain the most significant source of control as an appropriation, but will become a separate budget chapter, renamed the Epidemic Control Fund (JEVA). The budgetary envelope of this fund is expanded by the partial redeployment of party subsidies, retail tax, the centralized part of the motor vehicle tax, the contribution of the financial sector and other redeployments. After the transfers, JEVA has HUF 633.5 billion in resources.

In order to deal with the epidemiological situation safely, we consider it expedient to open the JEVA framework from above with an emergency provision. This will allow the Government to spend virtually any amount on defence during an emergency.

#### Country Protection Fund

A new chapter called the Economic Protection Fund (GVA) was created by changing the titles of the 2020 Budget Act.

Savings from the ministries worth of HUF 922 billion will be transferred to the GVA's appropriations. This amount of about HUF 922 billion provides funds for the economic stimulus expenditures to be decided by the Government. The current National Employment Fund will become part of the Economic Protection Fund, increasing its financial room for manoeuvre. The total expenditure of the resulting Economic Protection Fund is HUF 1,345.7 billion.

At the same time, within the Fund, the previous rules of the National Employment Fund remain in force - so that, as a new rule, additional expenditures can be made at the expense of the balances of previous years and for job retention benefits

Transfers that would serve as a source for JEVA and GYA will, as a general rule, be decided by the minister responsible for public finance in respect of the chapters under the control of the Government.

#### European Union Emergency Aid Fund

To the best of our knowledge, it is not yet clear that Hungary will receive additional (i.e. more than before) EU subsidies in connection with the management of the epidemic and the economic crisis. However, a chapter will also be created to show potential EU funds received and their use.

The Extraordinary Government Measures (RKJ) appropriation or the Central Residue Fund (KMA) will continue to be available for the implementation of other (non-epidemiological) urgent government decisions.

According to the present ideas, the total expenditure of the 2020 budget - due to reallocations of domestic budget resources - would not increase significantly as a result of government decisions related to defending and restarting the economy.

At the same time, due to the different exchange rates presumed at the time of the adaption of the year 2020 Central Budget Act, by the unchanged Euro amount of EU supports the available amount of the supports is bigger in HUF by more than HUF 1 000 billion. Our goal is to use these resources to protect the economy as much as possible - that is, additional expenditures are expected in this area.

With the above new budget system, the Government aims to mitigate the negative effects of the epidemic on the real economy in addition to epidemiological control. Lower-than-planned growth, a worse labour market situation and tax measures to help businesses will result in a significant (depending on assumptions at least HUF 600 billion, but even substantially higher) tax revenue shortfalls than originally planned. As a result, a deficit higher than the originally planned 1% is expected. Although the EU Member States may deviate from the general government deficit rules this year due to the special situation, the Government aims to keep the deficit below 3%. However, debt reduction is not expected to be possible this year (but, given the special legal order, it is not even necessary); we are forecasting a slight increase.

Of course, we are constantly updating our forecasts based on the latest information available.

Please take note of my information.

Budapest, April 8, 2020

Sincerely,

Péter Benő Banai

State secretary

Ministry of Finance