Opinion of the Fiscal Council on the draft bill on the central budget of Hungary for 2023

Summarizing the opinion

Pursuant to Act CXCIV of 2011 on the Economic Stability of Hungary (hereinafter: the Stability Act, or the Gst.), the Government sent to the Fiscal Council (hereinafter: the FC, or Council) the draft bill on the central budget of Hungary for 2023, ensuring that the period specified in law for forming the opinion is available to the Council. The Council notes in its opinion that the 4.1% economic growth included in the draft budget bill is in line with the known domestic and international forecasts. The Council considers that the expected economic expansion can be achieved if the epidemic does not return, and the effects of the war conflict remain within the range known at the time of planning and a further deterioration of the external trade balance can be avoided. These factors present a downside risk to the budget.

The Council supports efforts to improve the balance and reduce government debt and deficit as a share of GDP. The body welcomes the fact that the draft is in line with the government's goal of strengthening financial stability and maintaining fiscal discipline, expecting an accrual-based approach (ESA) of a deficit of 3.5% of the GDP by 2023, followed by 6.8% in 2021 and 4.9% in 2022. The Council calls for reaching the 3% deficit target as soon as possible.

It welcomes the idea that in the draft the government will try to adjust taxes to the load-bearing capacity and that taxes on households and labour will not increase. The implementation of expenditure-side measures without a reduction in family incomes is essential for a credible and well-founded implementation of stabilization.

The Council notes that the planned structural deficit as a share of GDP is 4.5 percent, which is 1.0 percent higher than the MTO. The FC explains that the regulations concerning the MTO have been suspended by the Council of the European Union due to the COVID-19 epidemic.

According to the Council, the revenue and expenditure appropriations are in line with the macroeconomic developments expected for 2022 and projected for 2023. The Council explains that spending cuts will have a significant impact on reducing the budget deficit, given that the 2023 budget will focus on maintaining the utility price caps, supporting families and protecting the elderly. In addition, defence and law enforcement protection and the assistance of refugees play an important role.

The FC draws attention to the need for an agreement between the government and the European Commission to access the EU budget of more than € 40 billion for the 2021-2027 budget cycle. At the same time, the Council raises the issue of reviewing the pre-financing method of EU funds.

The Council notes that the declining trend in the government debt ratio will remain sustained and will decline from 76.1 per cent at the end of 2022 to 73.8 per cent by the end of 2023, according to the draft budget bill.

Response of the Government to the comments and suggestions raised

Compared to the draft bill submitted to the Fiscal Council, the bill submitted to the National Assembly contains minor numerical differences; among other things, the revenues and expenditures of the Defence Fund and the Utility Fund were finalized. At the same time, both the 3.5% ESA deficit and the cash flow deficit of the central subsystem, as well as the government debt are unchanged from what the Fiscal Council has reviewed and commented on.

In response to the Council's proposal to achieve a deficit level of 3% in share of the GDP as soon as possible, the government has supplemented the standard text of the bill. Accordingly, if the overall performance of the economy is expected to grow above 4.1%, the additional revenues associated with the surplus should be used to reduce the deficit and thus the government debt. In other words, faster-than-expected growth could automatically lead to lower deficit levels - regardless of whether EU rules are expected to allow higher deficits in 2023.

In addition, the government confirms that it has already set a deficit target of 2.5% for 2024 according to the EU methodology.

The Council noted that a detailed derivation of the structural balance was not included in the draft. The Council requests that this be included when submitting the bill. Said table below shows the derivation of the structural balance in 2023:

Derivation of the structural deficit in 2023

(GDP %)

		2023
(A)	Budget balance	-3,5%
(B)	Output gap	-1,0%
(C)	Cyclic component	-0,5%
(D)	Extra profit taxes	1,0%
(E)	Land revenue	0,4%
F=(A)-(C)-(D)-(E)	Structural balance	**-4,5%**

Differences are due to rounding.

According to the FC, the effects of the tax revenue-raising measures announced on 26 May 2022 are already reflected in the planned revenues however, their detailed substantiation is not included in the draft. The Council considers that this needs to be remedied when the bill is submitted, in line with the planned amendments to the tax laws.

The tax changes and their details will be included in the amendments to the tax legislation. The budget bill forms an integral part with the amendments to the tax legislation. At the same time,

the main elements of the changes are presented in the so-called chapter detail, which is part of the bill submitted to the Parliament.

The Council points out that spending cuts will play a significant role in reducing the budget deficit, but this is not explained in the draft law. The Council asks for this explanation to be included when submitting the proposal.

On the expenditure side of the budget, the government reviewed public investments in determining each appropriation and decided to postpone several investments that had not yet entered its implementation phase. This was possible without deteriorating growth prospects due to the high level of government accumulation expenditure in international comparisons and the high level of retail and corporate investment. The government has acted similarly in reviewing some discretionary, non-investment and accumulation expenditures.

The Council notes that the chapters in the draft do not yet correspond to the new government structure and states that it needs to be replaced before the bill is submitted.

The chapter order, appropriations and regulations of the submitted 2023 budget bill already reflect the new government structure. However, those institutional and, in some cases, chapter-managed appropriations that are shared between several ministries and for which an agreement between the transferring and receiving ministries is being drawn up, are still included in the transferring portfolio in the bill. Their share within the total budget is low.

To reduce the financing burden on the state, the Council proposes to differentiate the pre-financing of the EU development funds for 2021-2027, to encourage beneficiaries to borrow instead of the advance.

The government stipulates that, pursuant to the law, advances paid to *public sector beneficiaries* (including state-owned companies and local governments) must be kept in an account by the Hungarian State Treasury until they are actually used. That is, the advance has no effect on either the accrual-based deficit or the government's need for funding. Thus, a possible tightening would not lead to an improvement in the state's budgetary position but, at the same time, it could delay the implementation of supported projects.

There are already different amounts of advances for *beneficiaries in the private sector*, depending on the size of the company and the activity being supported. Any tightening of the rules must consider that in a higher than before corporate interest rate environment, any tightening will not lead to a slowdown in supported projects or jeopardize economic growth.

The Council noted that the nominal government debt would increase significantly above the deficit level in the draft bill, for which the draft bill does not provide a justification. The Council also calls for this to be replaced when the bill is presented.

The growth of government debt is affected by factors other than the central government's cash flow deficit. In 2023, the draft budget law envisages a very significant financial reserve stock

of over HUF 2,000 billion at the end of the year, given the uncertainty in the financing needs and financing possibilities outside the budget. Government securities issued to increase these reserves increase gross nominal debt beyond the deficit levels.