Opinion
of the Fiscal Council
on the draft bill of the 2017 central budget of Hungary

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

According to the stipulations of § 24. of Act CXCIV of 2011 on the economic stability of Hungary (henceforward: Stability Act) the Fiscal Council shall formulate its opinion on the draft central budget bill. In its opinion the Council may make comments and – in case it has objections as regards the authenticity or feasibility of the draft budget – it shall indicate its non-concurrence concerning the draft bill.

Mihály Varga, Minister for National Economy forwarded the draft bill approved by the Government as the draft 2017 central budget bill (henceforward: draft bill) to the Chairman of the Fiscal Council as an attachment of his letter dated 13th April 2016, file no. NGM 10745/2016. asking for the opinion of the Council.

The Council formulated its evaluation by taking into consideration the FC antecedents related to the 2016 central budget bill, as follows:

- on the basis of a number of earlier Opinions prepared by the Council and upon the recommendation of the Government, the National Assembly amended the so-called debt rule (debt formula) stipulations of the Stability Act. The 2016 central budget bill was formulated by taking into consideration the new rule[1]. Thus a budgetary correction of excess proportion that would have presented and obstacle for economic growth became avoidable.

[1] According to Indent (2a) of § 4 of the Stability Act, in case from among the predicted inflation rate and the real growth of gross domestic product at least one does not exceed 3 %, the value shall be determined in the Central Budget Act in a way that the decreasing of the government debt indicator compared to the reference year should reach minimally 0, 1 percent.

- in its Opinion no. 4/2015.05.08. on the 2016 draft central budget bill of Hungary the Council determined that the 1 percent decrease of the year 2015 debt indicator planned for the end of year 2016 and calculated with unchanged exchange rate, according to the Stability Act was in harmony with the economic and budgetary processes of year 2015 and those, planned for year 2016 and meets the stipulation of Indent (2) § 13/A of the Public Finance Act.

- In its Opinion no. 6/2015.06.19. concerning the uniform budget bill no. T/4730/604. on the 2016 central budget of Hungary, the Council stated that „the GDP and government debt expected for year 2015 and the GDP planned for the end of year 2016 were based on realistic prognosis.” In the Justification section of its resolution, the FC explained that it considered the decrease of the debt rate feasible, despite the risks surrounding the targeted deficit thus, by all expectations, the government debt rule stipulated by Indent (5) Article 26 of the Basic Law of Hungary will be met in 2016.

Apart from the findings of the written evaluations[2] prepared by the State Audit Office of Hungary and the Central Bank of Hungary, the Council also took into consideration the updated economic forecasts of domestic analysing institutions[3] commissioned by the FC Secretariat (Economics and Social Statistics Analysing and Research Institute of the Budapest Corvinus University, GKI Economic Research Inc., Századvég Economic Research Inc.), international organisations (EU, IMF, OECD) as well as evaluations prepared by other market analysts.

The approval of the budget in the first half of the year increases predictability for the actors of the economy. As a consequence and at the same time, when formulating the present Opinion the Council could take into consideration only the preliminary data of the 2015 budget implementation as well as the data of the first quarter of the budgetary processes of year 2016.

Accordingly, the Secretariat of the Council prepared a working paper for the evaluation of the 2017 central budget bill that – in harmony with the FC’s Rules of Procedure – that was followed by reconciliation with the experts of the SAO and the Central Bank of Hungary. The draft document submitted to the Council was built on these steps.

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[2]Following the submission of the draft budget bill to the National Assembly, the updated analyses shall be available on the FC website.
[3]The analyses can be found in complete form on the FC website.

Apart from the opinion-formulating mechanism and work schedule built on the respective stipulations of the Stability Act, in the course of formulating the structure and contents of its decision the Council took into consideration that those should be comparable to its former, similar documents. According to its authorisation the FC examines the draft bill and its macroeconomic background as a unity; it analyses the details of the draft bill, the revenues, and expenditures from the aspect of the implementation of balance and government debt rule and shall not enter into particulars of distribution policy.

The Council shall inform the Government and the Speaker of the National Assembly about the contents of its Opinion. The FC Opinion shall be available on the National Assembly's website as well.

II.

The Council's Resolution

At its meeting held on 21st April 2016 – on the basis of the documents submitted by the Government about the draft bill of year 2017 central budget – the Council formulated the following Opinion:

1. As regards the authenticity and feasibility of the draft of the 2017 central budget bill the Council has no such fundamental objections that would justify the indication of non-concurrence concerning the document submitted for formulating and opinion.

2. According to the Council's judgement the draft bill is based on a well-established macroeconomic forecast. Following the dynamism of economic growth since 2013 – the annual 2, 9 percent in year 2015 – the 2016 economic growth might be around 2, 5 percent. The 2017 budget is built on a 3, 1 percent economic growth that – considering the expected increase of incoming EU funds and other growth factors, primarily that of consumption – can be regarded as solidly founded.

3. The revenue and expenditure appropriations are basically in harmony with the macroeconomic forecast, the preliminary implementation of year 2015 and the expected trends of 2016 as well as with the governmental actions listed in the draft bill. However, even with these considerations the increase of the VAT and personal income tax appropriation – compared to the preceding year – can be regarded as stretched and the further increase of the efficiency of tax collection is necessary to ensure the implementation of the increased appropriations.

4. On the basis of the macroeconomic course and the budget appropriations the Council establishes that the 2, 4 percent GDP proportionate targeted deficit for 2017 – calculated by EU methodology – is in harmony with the economic processes described by the draft budget bill and the planned revenue and expenditure appropriations. The targeted public finance deficit is in harmony with the correction arm of the fiscal regulations of the European Union and Point b) Indent (2) of § 3/A of the Stability Act. However, with the

increase of the targeted deficit the structural deficit shall also increase. Hence, the Council considers it justified that in the justification part of the bill the Government should present that the targeted deficit according to the budget bill meets the criteria of the EU concerning the structural deficit as well as the requirement stipulated by Point a) Indent (2) . § 3/A of the Stability Act arising from the above regulation.

5. The Council considers it positive that the central budget separates the operational and accumulation budgets as well as that of the EU developments, as this contributes to the transparency of the processes and the separation of costs laying the foundations for long-term growth from current expenditures.

6. The Council finds that the trends of the year 2016 debt indicator (73, 5 percent of the GDP) and of the year 2017 debt indicator (71, 9 % of the GDP) calculated at unchanged rate and according to the stipulations of the Stability Act, are in harmony with the economic and budgetary processes expected for year 2016 and those planned for year 2017. This means that the debt rule stipulated by the Basic Law of Hungary shall be met. The planned and expected measure of the debt-rate decrease is in harmony also with the stipulation of the European Union as regards government debt.

7. The Council deems it necessary that the draft budget bill provided three types of reserve systems for unforeseen tasks, expenditures or possible arrears if revenues - i.e. beyond the HUF 120 billion reserved for Extraordinary Governmental Measures, the HUF 50 billion reserved for the Country Protection Fund and the chapters - shall create stability reserves as well, similarly to the practice introduced in 2016. Apart from this, from the aspect of government debt rule implementation, the planned decrease of the government debt indicator means an implicit reserve as it is higher by 1, 5 percent that the 0, 1 percent stipulated by the Stability Act. According to the Council, from the aspect of the 2017 targeted deficit it is not the prescription of Point b) Indent (2) § 3/A about the 3 percent ceiling of the GDP but the requirement according to Point a), Ident (2) of § 3/A that has the stricter stipulations as regards the determination of the mid-range budgetary goal. Thus the Council would deem it practical if in the Justification section of the bill the Government presented, with regard to what type and measure of risks had it planned the reserves.

8. The Council hereby shall authorise its Chairman to publish its Opinion as regards the draft budget bill and present the Opinion before the National Assembly, with regards to its relations concerning the submitted draft bill.

III.
Justification

According to the Council's judgement the draft bill of the year 2017 budget continues the process promoting the validation of the combination of stability and growth. To this end it is necessary to ensure the sustainable growth of consumption, the stimulation of investments and the significant utilisation of EU resources for what the draft creates the budgetary conditions while, at the same time, it keeps the public finance deficit below 3 percent as well as the decrease of the GDP proportionate government debt.

The Council formulated its Opinion upon the evaluation of the following factors:

The Authenticity of the Draft

According to Indent (2) § 24. of the Stability Act the Council „may make comments and – in case it has objections as regards the authenticity or feasibility of the draft budget – it shall indicate its non-concurrence concerning the draft bill." In the Council's opinion the resolutions, tendencies and appropriations are adequately supported in the draft bill thus the FC can give its general consent concerning the submitted document.

The Expected Implementation of years 2015 and 2016

The economic growth that started in the previous years and has significantly exceeded the EU average, continued in 2015 (2, 9 percent) and it is expected to reach 2, 5 percent in 2016. Also, authoritative domestic analysing institutions expect the same result as regards the 2016 economic growth.

The external conditions of sustainable growth are basically favourable: the oil prices fluctuating at a relatively low level, the improving economic prospects, and the economic performance of the moderately growing EU (and within it the German economy).

On the basis of the analysis of macroeconomic trends of 2015 and the first quarter of 2016 the Council finds that the expectations concerning the economic growth in 2016 are well established. The cyclic character of utilising the EU transfers does somewhat hold back the expansion of the economy in 2016 (but it can exert a positive effect again in 2017). It is the building industry where the decline of output is most noticeable (by the beginning of 2016 the drop was close to 20 percent compared to the high performance of the previous year). The recovery of consumption – thanks to the further increase of household incomes contributes to the gaining of momentum of consumption and this supports the growth. Apart from the low profit environment the investment activity of companies – and within this circle, of small and medium size businesses – is encouraged by the development loan programme of the Central Bank of Hungary, targeting especially investments. The introduction of the preferential housing VAT set at 5 percent, together with the expansion of Family Housing Allowance and the introduction of National Home Building Societies will give an impetus to the real estate market and the building industry. Thus it is expected that the investment rate of Hungary will remain above 20 percent also in 2016. The recovery of the demand of foreign markets has supported growth in the past few years relying primarily on manufacturing transport equipment and – to an increasing degree – on the expanding capacities of the network of the related domestic suppliers.

Positive trends could be detected recently on the labour market. The number of employees has grown and between December 2015 and February 2016 and it reached more than 4, 2 million (higher by 117 thousand than in the previous year). In the same period the employment rate of the 15 to 64 age group approached 65 percent. It is especially favourable that the expansion could be detected primarily in the private sector. The lasting economic growth is paired by low consumption index and this is exerting a positive influence of consumption. Apart from the above, the increasing demand for higher wages of the employees working in the public finance sector can also be detected.

The measures of the Government introduced with the aim of whitening the economy earlier (the online linking of cash registers to the tax office and the use of the Electronic Public Road Trade Control System – EKÁER), as well as the improvement of the targeted tax inspections was already tangible in 2015 when the tax and contribution revenues of the budget were significantly over fulfilled (by HUF 550 billion compared to the original appropriation). As a result of the above and the containment of expenditures the public finance deficit – calculated by EU methodology – was significantly, i.e. by 1, 9 percent, lower in 2015 than planned. The trend of the government debt rate was also favourable (75, 3 percent) as it has declined by close to 1 percent in comparison to that in the previous year.

The positive revenue tendencies appear in the data of the beginning of 2016 thanks to what a significantly lower cash-flow deficit presented itself in the first quarter than the size of the deficit last year. As a consequence of this and the expected trends the 2 percent targeted deficit is feasible moreover, an even lower deficit might be reached and this would favourable affect the decline of the government debt. In case of the latter, apart from the ESA-deficit calculated by EU methodology, attention should be paid also to the cash-flow deficit that affects more directly the size of the debt.

Evaluation of the Goals and Conditions of Year 2017

Expected Macroeconomic Indicators

Once again the draft budget bill is calculating with a dynamic, 3, 1 percent GDP growth. According to the draft this is adequately supported by the resources of growth: the volume of household consumption will grow by 3, 1 percent while the gross fixed capital formation will grow by 9, 1 percent. Through the latter the investment rate could reach again the more than 21 % measure. The expansion of employment will continue (in total by 1, 8 percent, and by 2 percent in the private sector), and the gross average wages' growth is 5, 1 percent. The dynamics of export will also remain (6, 3 percent). The implementation of the Irinyi János Plan would also promote the additional growth of industry and foreign trade.

According to the draft budget the recovery of consumption is assisted by the planned 1 percent inflation rate as well. Pensions will be increased in proportion to this, according to the legal stipulations. The rate of inflation considered in the course of the planning is lower than the average of the forecasts available for the FC. According to the Councils opinion the appropriations are feasible even if the inflation will be somewhat higher. However, a higher inflation level would proportionately increase the pension expenditures.

As regards the macroeconomic forecast of the draft bill, the Fiscal Council considers it well established, taking into consideration that the draft itself contains measures to invigorate the economic growth (investments and raising wages in the public sector). Starting with 2017 the utilisation of EU funds will stimulate economic growth again. It is important that, according to the adopted plans, 60 percent of the HUF 12 billion worth of EU resources available for our nation in the course of the 2014 – 2020 programme period, is targeted to increase and strengthen the economy via strengthening employment and competitiveness. It should be highlighted that as regards more than half of the seven-year supports have already been announced by the end of March 2016 and as regards the other half of the amount, the announcements will be completed in 2017 (thus, major part of the supports will be available by the end of 2018). The introduction of a complex tendering system and the advancing of the resources – established by the Government – also have a stimulating effect. The utilisation of the EU resources in the planned extent requires the disciplined execution of the stretched schedule approved by the Government.

Revenues and Expenditures of the Central Budget

The tax and contribution revenues of the central budget for the year 2017 are in harmony with the preliminary data of the year 2015 implementation, the expected trends of year 2016 and the outlined macroeconomic path. They are planning a high revenue growth as regards corporation tax, supposedly related to the growth of tax credits. Taxes to be borne by labour are in harmony with the foreseen labour market trends and the wage rises in the governmental sector. The appropriation of value added tax contains approximately HUF 180 billion (5, 4 percent) growth compared to the previous year, originating mostly from the ongoing whitening of the economy and the 4, 5 percent nominal expansion of consumption. The draft bill contains measures to promote the growth of revenues (introduction of online invoicing, expansion of linking cash registers to the tax office, encouraging the installation of additional ATM machines). Compared to the appropriation of the previous year they have significantly raised the personal income tax revenues (by 7, 8 percent). To increase the efficiency of tax collection the introduction of the above measures are necessary. The expansion of the services provided by the tax office also might positively influence the revenues. Growth and stability offer an opportunity for the introduction of significant and targeted mitigation and expansion of tax reliefs. When planning the appropriations they were counting with the effect of the above on tax revenues. On the whole the tax revenues were planned on a realistic basis, while the other revenues were planned in a conservative way. Compared to the previous two years, the latter do not have significant appropriations for the realisation of assets.

As regards the expenditure side, the most significant item is the raise of the wages of those working in the budgetary sector. The career programme shall continue in government offices, for educators, those employed by law enforcement, defence and those working in higher education, as set out earlier and will start for the employees of the National Tax and Customs Administration. They are going to raise wages in the health care and social provision systems as well. The Council deems it important to keep the harmony between the growing wages and the strict budgetary limits and performances.

The scheduled wage raises in the budgetary sector shall contribute to the sustainable growth of consumption that shall create a predictable environment for the development-related decisions of businesses. The Council sees the dynamic growth of investments described in the draft bill in light of this relation. Both the EU and own financed investment appropriations shall significantly grow compared to the 2016 appropriations. According to draft bill the expenditures related to the total of EU supported programmes shall increase from the HUF 1 432 billion in 2016 to HUF 2 239 billion, most of what are expenditures of accumulation character. Apart from this the value of own financed investments shall also grow.

The draft bill creates a cover for the large scale requisition of family housing support and the other, related supports as well as for the improvement of job creating programs and improving the living conditions of families in need (within the latter, with an emphasis on food services for children). The draft bill contains an adequate appropriation for eliminating the dangers threatening the security of the country – especially those related to the migrant crisis.

The FC deems it favourable that the expenditures of debt service (interest) – the consequence of government debt management – shall be more moderate (its proportion within the public finance shall decrease from the 8 to 9 percent in year 2010 to 5, 5 percent by 2017) and thus offer a room to manoeuvre for the gaining of field for supports in the field of public services, first of all supports promoting economic development. (The proportion of the latter function within the public finance shall increase from the approx. 14 percent in the 2010-ies to above 20 percent by 2017).

To assist the creation of a balanced budget the Council deems it necessary to create a programme aiming at the establishment of an efficient state and the savings originating from such a plan that would manifest in the long run.

Public Finance Deficit

The planned public finance deficit for 2017 calculated by EU methodology (ESA 2010)[4] is higher by 2, 4 percent than that calculated for 2016. This – by ensuring a safety reserve – remains below the 3 percent prescribed by the Maastricht criteria and the similar threshold set by Point b) Indent (2) of § 3/A of the Stability Act. The level of the deficit also helps the implementation of the requirement of reduction of government debt rule set by the Basic Law of Hungary. The draft bill counts with the large-scale requisition of EU supports that via domestic co-financing contributes to the increasing of the deficit. According to the draft bill the net cash-flow expenditures related to the EU supports might reach the amount close to HUF 700 billion in 2017. At the same time, from the aspect of Hungary's competitiveness and economic growth it is of primary importance that a significant proportion of EU supports shall be used already by the middle of the respective period. Namely, by this action economic growth can be more balanced on the one hand while on the other hand, infrastructural investments shall be realised earlier and thus domestic companies can get the supports earlier.

The FC deems the targeted deficit feasible, in harmony with the above discussed, altogether realistic plans of the revenues and expenditures.

According to the opinion of the Fiscal Council the separation of the operational and accumulation budgets from the EU budget in the draft document was a positive step. According to this, the goal is that the state should operate without deficit (borrowing), respectively that

[4] ESA2010
Since the beginning of the1970-ies Eurostat and the member states have worked out their own European System of Accounts for the macroeconomic statistics and within it for the accounts of the economic sectors (the governmental sector included). The system of this idea that is being used presently is ESA2010. The ESA2010 system of accounts is described by an EU Council directive that has become part of the Hungarian legal system in the moment of Hungary's accession.
The governmental sector defined by the EU statistical standards includes a wider circle of organisations than public finance. The EU methodology functions differently from the public finance accounts – apart from the organisational positions – as regards the date, the value and the circle of transactions accounted.

only financing domestic developments and those realised from EU resources should create a deficit. In 2017 this would be realised by increasing the total targeted deficit, i.e. the budget will contribute to the realisation of huge amount investments.

From the aspect of the prevalence of the sustainability of government debt in the longer run as well as its security, the Council deems the endeavour of the Government to shift the course in the direction of a balanced budget also important.

At the same time the Council is of the opinion that the draft bill does not contain satisfactory information as regards the appropriate evaluation of the requirement of structural balance[5]. Beside the gradually improving macroeconomic environment the increasing ESA-deficit suggests that the structural deficit is increasing and very likely will exceed the target stipulated by Hungarian and EU regulations.

This however does not lead to an EDP procedure, according to the EU regulations. Taking into consideration this as well, the Council deems it justified that the Government should present in the justification part of the budget bill that the targeted deficit – according to the budget bill – meets the EU criteria as regards the structural deficit as well as the prescription of Point a), Indent (2) § 3/A of the Stability Act that is relying on the above regulation. It is also necessary that the budget bill should establish the measure and mid-year utilisation of the Country Protection Fund by ensuring the secure compliance of the respective law. In relation with this requirement the Council deems it also necessary that the justification part of the bill should show the aspects considered when planning the reserves.

Government Debt

According to the 2017 budget bill, in harmony with the Stability Act, i.e. in comparison to the assumed government debt by the end of year 2016 the government debt indicator – calculated by constant exchange rate – (foreseen by the end of 2017) shall decrease from 73, 5 percent to 71, 9 percent by the end of 2017. Thus, according to the draft bill, the stipulation of Indent (5) Article 36 of the Basic Law of Hungary shall be met. The size of the decrease might be lower than the 1, 6 percent mentioned in the draft (among others due to the fairly highly evaluated

[5] Structural balance: the balance of the governmental sector cleared of the cyclic effects of the economy and individual items (Point y) Indent (1) § 2. of the Public Finance Act).

GDP deflator) however, it shall ensure enough reserves even this way for covering the risks. In order to ensure that the decrease of the debt should prevail, apart from the ESA balance attention should be paid to the cash-flow deficit that affects the debt more directly, in the course of the execution of the budget.

The Council finds that on the basis of the expected budget deficit and macroeconomic trends the debt rate shall decrease sufficiently and thus the EU debt regulation[6] shall be met as well.

Other

Just like the practice employed in the previous year, the FC was building on their own evaluation of the implementation of the 2015 central budget in the second half of the year and the expected trend of the government deficit, as stipulated by Indent (1) § 23 of the Stability Act. Hence the Council in not planning to formulate a special opinion on the trend of the budgetary processes of the second half of 2015.

Budapest, 1st of April 2016

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[6] The debt rule of the European Union is defined by the Contract on the Operation of the European Union (EUMSz.) as well as the Resolution no. 1467/97/EK of 7th July 1997 of the Council. The Debt Rule of the European Union has been applied for Hungary for the first time since 2016. (In the three years following the moment when the country ceased to be covered by EDP, i.e. from 2013 to 2015 Hungary had to meet the temporary rule regarding the structural balance, instead of the regulation concerning government debt.)
According to the regulation the proportion of government debt to gross domestic product (GDP) shall not exceed 60 percent. In case government debt exceeds this reference number then the departure has to be decreased annually by one-twentieth part of the reference base of the previous three years.