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of the Fiscal Council

courtesy translation

THE OPINION OF THE FISCAL COUNCIL
on the draft of the central budget of Hungary for 2013

I.

Antecedents of the Preparation of the Opinion, its Legal Basis and Publicity

In harmony with the contents of Item 44 (2) of the Fundamental Law and according to § 23 and § 24 of Act CXCIV of 2011 on the Economic Stability of Hungary the Fiscal Council (further: the Council) gives an opinion on the draft of the central budget.

In its opinion the Council can observe and – in case it has essential objections regarding the draft's accuracy or its being appropriate for execution – register its non-concurrence.

Minister for National Economy, Dr. György Matolcsy sent to the Council the 2013 budget document that has been accepted by the Government of Hungary as a draft on 31st of May 2012. Because the above document arrived as a „non-public draft", when summarizing its opinion, the Council also took into consideration this classification.

The Council has formulated its opinion, together with its recommendations aimed at mitigating the fruition risks, being aware that

– the Hungarian Government will repeatedly discuss the draft of the central budget on 13th of June 2012 and will finalize the bill considering the opinion of the Council as well and will submit the finalized version to the National Assembly,

– the Chairman of the Council is also going to delineate the Council's opinion before the National Assembly.

The Council formed its opinion relying on the analyses of the State Audit Office of Hungary and of the Central Bank of Hungary, just like on the opinions of the experts whom the Chairman of the Council asked as well. The Council consulted also staff members directing the draft budget planning several times, asking for and receiving supplemental information and exchanging working papers.

II.

The Opinion of the Council

At its meeting held on June the 8th 2012 the Council unanimously formulated the following opinion:

1. Regarding the accuracy of the draft of the central draft budget and its being appropriate for execution, the Council has no fundamental objections that would justify registering fundamental non-concurrence concerning the submitted document.
2. Regarding the macroeconomic forecast that is part of the draft, the Council has identified certain risks. Apropos of this the Council proposes the Government to prepare an alternative macroeconomic forecast to enable the handling of the management of macroeconomic risks and, that the alternative forecast should take into consideration the processes that would endanger the start up of economic growth. On the basis of the forecast – by keeping the deficit target unchanged – the Government should ensure the increasing of the appropriation of the Country Protection Fund in proportion to the emerging risks respectively, its correction with the aim of mitigating budgetary risks.
3. In respect of the grounding of certain revenue and expenditure estimates the Council detected deficiencies; in case of certain uncapped estimates, it established the danger of considerable transgression. Hence, the Council recommends that the Government should endorse in time those rules and regulations that would ensure the revenues respectively, the savings of the expenditures that are listed in the Széll Kálmán Plan 2.0. The Council also recommends the Government to reconsider uncapped expenditure estimates that have been judged risky, and to take measures to mitigate the danger of transgression.
4. In case of the observance of the measures identified under item 2, the Council considers the attainment of the deficit target in the draft, together with the predomination of the debt regulation, realistic. The Council will evaluate the latter in a separate procedure, prior to the final vote on the central budget draft.

III.

Justification

The Council formulated its opinion on the basis of the evaluation of the following four, complex issues:

1. The reality of the 2012 and 2013 macroeconomic forecasts that are part of the central budget draft;
2. The validity of the revenue side of the budget;
3. The over-fulfilment of the expenditure estimates;
4. Compliance with the deficit target and debt regulations

1. The reality of the 2012 and 2013 macroeconomic forecasts that are part of the central budget draft

1.1. Risks of the expected accomplishment of the 2012 base year

The Council lays it down that the following factors confirm the reasonability of the riveting of attention incorporated in the unanimous resolution of the Council passed on 12th of December 2011: the 2012 economic processes, the realisation of the central budget so far, the vulnerability of the economy, the economy’s output lagging behind the expected trend, the maintaining the distrainment of the reserves and the necessity of additional budgetary correction.

Following the 1,7% GDP growth in 2011, it is expected to decrease in a lesser degree in 2012 – contrary to the earlier expectations and the factors considered in the course of the planning of the 2012 central budget.

According to the evaluation of the Council, despite that the 2012 economic output will expectedly be lower than the governmental forecast that served as the base of the 2012 planning, in case of the full and timely implementation of the new measures outlined in the Széll Kálmán Plan 2.0, the so far implemented and the additional necessary budgetary corrections, together with not using the distrained budgetary reserves, the 2,5% budgetary deficit target can be maintained in 2012.

However, the Council calls the attention to the fact that part of the measures undertaken with the purpose of maintaining economic stability, weakens the possibilities of dynamizing the economy and worsens the 2013 macroeconomic outlook.

The Council does not wish to undertake the task of giving a more detailed analysis of the 2012 procedures as, at the moment of preparing this opinion, only data of the first quarter are known.

The Council shall analyse the economic performance of the first six months of the year in July 2012 and this analysis can be utilized in the course of the General Assembly debate on the central budget.

1.2 Risks threatening the fulfilment of the macroeconomic forecast for 2013

International organisations expect stimulation of the world economy and judge favourably the growth potentials of the German economy that is of decisive importance from the aspect of Hungarian export. The balance of the current account shows significant surplus and by growing further in 2013 it might reach 4 % of the GDP. However, such expectations are not unsubstantiated as Hungary's avoiding the Excessive Deficit Procedure might strengthen investors' confidence in Hungarian economy. At the same time there are certain factors in the international environment - for example the features of the Euro-zone crisis – that represent a downward indicating risk. The occurrence of such trends might result a much weaker course than what the planners counted with and this would fundamentally affect the materialisation of both the revenue and the expenditure sides of the budget. We should be adequately prepared for managing such scenario.

The Council calls the attention to the fact that the tools employed for the implementation of the deficit targets are occasionally dysfunctional and their effect on growth is questionable. Partly due to these factors the risk premiums of financing are high; in regional comparison credit activity is the lowest and investment rate is the lowest as well. This represents severe growth risk and through this it has a negative effect on the achievability of the GDP proportional deficit and debt reduction targets.

2. The grounding of the revenue side of the budget

The risk mentioned under item 1 at the same time also means that in case they occur, the tax bases compared to the bases assumed in the draft budget will shrink, thus in case of the major tax types the incoming revenues will be lower than the amount the draft bill calculated with.

On the revenue side of the central budget the emphasis is unequivocally shifting toward sales taxes, respectively fees and dues that can be linked to turnover.

The Council calls the attention to the fact that the action mechanism of the legal elaborateness of the revenues listed in the budget, the level, the corroboration and the background calculation of those revenues, are uneven and occasionally inadequate. According to the evaluation of the Council – apart from the trend of the real economy processes – this has also contributed to the expected realization of the revenue side of the budget and is encircled altogether with significant risks.

3. The danger of the over-fruition of the expenditure estimates

In harmony with the Convergence Programme the draft budget contains additional decreases on the expenditure side of the budget. The changes of the expenditures' structure are following the Széll Kálmán Plan 2.0. The draft budget bill appropriates significant changes on the expenditures' side; apart from savings they are related to basic structural changes in ongoing local governmental task completion, respectively financing changes.

In the present stage of the planning and on the basis of the available information, respectively because of the unfinished state of a number of issues related to structural reforms, the Council cannot form an opinion on whether the level of the individual budget chapters, titles, appropriations make it possible to smoothly provide public task or how the investment, renovation, servicing and actuation expenditures affect real economy (for example, the trend of public orders) respectively, the situation of public institutions. However, the Council thinks it necessary to call the attention to the fact that these questions cannot be answered, poses risks.

According to the judgement of the Council, if no appropriate organisational measures accompany the restrictions even on such fields where social determinations prevail regarding achievement compulsion, or in respect of the level of provisions, the appropriation cut-backs that secede from the realities, or that posteriorly force additional financing needs that have not been planned, or that due to being unable to implement such need, would increase the hidden deficit of the public finance.

The Council expresses its concern on the presence of uncapped expenditure estimates in the present phase of the planning; in which cases based on the received background calculations, and on the basis of the processes lying behind, the transgression of the planned expenditures can be expected.

4. Compliance with the deficit target and debt regulation

In the Council's opinion the strategic economic goals of the Government, i.e. the development of a small, efficient state, low deficit and decreasing debt, improving employment and competitiveness are all indicating the right direction. As a result of the introduced measures the budget deficit will be low. The measures of the Convergence Program have convinced the European Commission that the deficit might remain permanently under 3 %.

According to the judgement of the Council the achievement of the deficit and debt reduction goals in 2013 assumes the full implementation of the measures announced in the Széll Kálmán Plan 2.0.

At the same time, in conjunction with the expected realization of the macroeconomic forecast being part of the draft, the Council calls the attention to the conjuncture risks that might result in downward indicating emission trends and that might cause substantially lower growth rate; as a result, in order to keep the balance, taking additional correctional steps might be necessary on both the revenues' and expenditures' sides of the budget.

Hence, the Council recons the preparation of such alternative macroeconomic forecast reasonable, that would take into consideration the processes endangering the pick-up of economic growth and, on the basis of the results of a less favourable forecast, maintaining the deficit target, would take care of raising the appropriations of the Country Protection Fund in proportion with the emerging risks, respectively its correction that would mitigate the budgetary risks.

In case of implementing the above measures the Council considers the achievement of the deficit target marked in the draft and the prevailing of the debt regulation realistic. Prior to the final vote on the draft budget bill the Council will evaluate the latter in a separate procedure.

Budapest, 8th of June 2012

Signed by:

László Domokos, Member if the Fiscal Council

András Simor, Member of the Fiscal Council

Dr. Árpád Kovács, Chairman of the Fiscal Council