



Session	Agenda	Presenter
27 June 2012	Introductory speech of the President of the State Audit Office of Hungary to the Budget Bill of Hungary for 2013 as well as the relevant SAO opinion- T/7655, T/7655/2	László Domokos President

LÁSZLÓ DOMOKOS, President of the State Audit Office of Hungary:

‘Thank you for the floor. Honourable Mr. Speaker, Honourable Mr. Prime Minister, Honourable Mr. Minister, Honourable Members of Parliament, Ladies and Gentlemen,

The State Audit Office of Hungary prepared its opinion on Hungary’s 2013 budget appropriation bill in accordance with the legal provisions and rescheduled planning.

The submission and discussion of next year’s budget, and the SAO’s comments on the draft budget differs from the practice of previous years in many respects. The majority of deviations can be traced back directly or indirectly to the fact that the international economic and political climate around Hungary has not been this uncertain since the political transformation. The international system and economic structure surrounding Hungary is crackling. Today, we have to realistically consider scenarios that just a few months ago would have been inconceivable. This makes things extraordinarily difficult with respect to the budget and planning in general.

Uncertainty brings out the need in people to find security. This is true for taxpayers, simple employees, domestic small-, and medium-sized enterprises as well as large international corporations and international financial organisations. This need and the now higher esteem of predictability led to the government’s decision to bring the 2013 budget appropriation bill in front of the Parliament now instead of the autumn.

Naturally, this also refashioned the SAO's order of work, as we were forced to amend our audit plan.

At the same time, we welcomed the early submission of the budget as it serves a goal the SAO also supports. Namely, it allows Hungary to clearly prove and demonstrate its commitment to fiscal discipline. For one, this made it possible to bring the European Union excessive deficit procedure to an end and ease the financial pressure on the Hungarian State. On the other hand, it makes 2013 a more predictable year for Hungarian citizens, and it strengthens internal confidence as well. The best way for the SAO to contribute is with a budget opinion drafted on the basis of strict professional standards.

Esteemed Ladies and Gentlemen,

The SAO's commenting rights is often misinterpreted, so allow me to briefly sum up what our opinion on the budget is truly about. We provide answers to two sets of questions. One deals with the substantiation of the budget. Were applicable legal regulations and planning obligations observed in the course of drafting the bill, and were fundamental planning documents prepared? The other assesses risks. Are the appropriations feasible and realistic? And are the basic requirements of transparency and accountability met?

In other words, the SAO does not comment on either macro-economic forecasts or budget objectives. I feel I have to emphasise this because, as we saw last year, many people did not understand what our findings referred to and drew conclusions that were not supported by our Opinion. It is important to point out that the Opinion of the State Audit Office of Hungary reports on the situation at a given moment, after which the budget drafting procedure is continued. This means that as time goes by our critical observations will have, hopefully, become irrelevant. Our opinion serves the ultimate purpose of helping the National Assembly pass the best budget possible.

The SAO is Hungary's only non-governmental organisation that has insight into budgetary processes throughout the entire year. We don't just see statistics and charts, but also have in-depth knowledge of what's behind the figures, what the real processes are. This makes the State Audit Office of Hungary qualified to give an opinion on the draft budget even in such a short time, something it has been doing for 22 years now.

Progress has been made compared to last year, but there are also areas where the situation has deteriorated. Problems typically arise with the new tax types and the areas where structural changes took place, which I

would like to come back to in my discussion of the detailed findings. As a preface to that topic I would like to underscore one thing: in our mind the fact that deficiencies exist doesn't mean that the areas affected are the weak points of the budget, rather that there is still room for consultation in these areas.

Debates about the appropriations will only resolve once the National Assembly has adopted the main figures of the budget. And that's how it should be, because the SAO is not an auditor in this process, rather it's taken on the role of advisor to the National Assembly. We point out deficiencies, call attention to the risks, and we also indicate which pieces of legislation should be adopted as quickly as possible, and which parts need fine-tuning. Our Opinion, therefore, serves as a kind of guide for the Members of Parliament and a call for the Government to rectify any deficiencies.

The SAO's Opinion was already shorter than usual last year, but this year's Opinion is even more concentrated and focused, which is also supported by our new methodology. The goal of our Opinion is to point out risks. The basic budget processes and figures are included in the budget appropriation bill. The draft budget and the SAO Opinion together constitute a whole; therefore it is worth studying and useful to study these two documents together.

Honourable National Assembly,

It's an unusual and unfamiliar risk that the SAO has to assess the feasibility of the appropriations of a budget that will start six months from now and end a year and a half later. It's very difficult to foresee anything for such a long time-frame, considering especially that we only have partial data for the first five months of the basis year, i.e., this year. This is not a challenge for only the State Audit Office of Hungary and the Administration, but also concerns every professional and institution, whose job entails forecasting. This was pointed out particularly well at the State Audit Office of Hungary spring conference entitled "Public Debt and Economic Growth". One of the presentations' conclusions was precisely that because of current economic and international uncertainty, it is impossible to draw up forecasts even a few weeks before the end of a given year, let alone a year and half earlier.

We must learn to live with uncertainty more and more. This means that we must manage risks, i.e. we have to set aside funds for unexpected events, rainy days, as it were. This holds just as true for public finances as it does for a family budget.

The scale of necessary reserves in a family or the State budget is not determined primarily by how much money and revenue we have at the moment, rather by how uncertain the future is in front of us. The fact that the savings of Hungarian households increased significantly during the economic downturn can be traced to this. The Hungarian State must also present a similarly cautious attitude, but the situation of the government and the National Assembly are further complicated by the fact that the adequate size of the reserve is unclear. The reserve must be sufficient to cover the consequences of unexpected economic events, but if reserves are too large, they stifle internal consumption and the economy, which only makes things worse. These two aspects must be equally weighed.

Ladies and Gentlemen,

Allow me to briefly present our main findings and observations related to the 2013 budget appropriation bill. Above all else, I would like to emphasise that the compiling and structure of the bill complies with statutory requirements, as well as the rules pertaining to public debt reduction as set out in the Fundamental Law and the Stability Act. According to the bill, the expected rate of public debt at the end of 2013 will be 76.8%, down from the 78.0% rate expected for 2012.

One of the specialities in the 2013 budget is that some of the important economic policy decisions will have been removed from the Budget Act. The budget must adapt to the provisions of the Fundamental Law and the Stability Act, and also to deficit targets as a result. In this regard, the bill in front of you is consistent with legal compliance related expectations.

Unfortunately, however, this year we have once more had to come to the conclusion that the legislative framework underlying the appropriations is unavailable or in some respects deficient. Certain tax laws and legal regulations were not prepared, their discussion is still ongoing. This can be explained partly by the early debate of the budget, the short deadline set for ending consultations, but this inadequacy remains a risk factor nonetheless. That is because this means that the exact method of reaching the deficit and debt targets and the range of the measures ensuring compliance with these targets are not fully known with the necessary level of detail. Furthermore, it is also a risk factor that we only had limited multi-year projections, balance sheets, balance indicators, detailed tables, written justifications at our disposal when compiling the report, even though these are also required by law.

The budget appropriation bill figures with a total expenditure of HUF 15 477 billion and a total revenue of HUF 14 799.7 billion. Our audit

covered 88% of total revenue and 82% of total expenditure and covered 11 budget headings. The planned deficit of the central sub-system of public finances is HUF 677.3 billion. It is our opinion that the deficit target can be maintained, but there are multiple risks that must be reckoned with.

In terms of compliance with the budget, developments in the macro-economic situation and the international environment pose the greatest risk. Due to this uncertainty, it's particularly important for financing ideas to be well-elaborated and supported figure-wise.

In case of uncertainty, the significance of reserves increases, thus we paid particular attention to this area during the audit. The total amount of central budget reserves is HUF 300 billion. This is lower than the value planned for the present year, but higher than typical values of recent years or projected utilisation in 2012.

Pursuant to a recommendation by the Fiscal Council, the amount for the Country Protection Fund increased from HUF 50 billion to 100 billion. This is a step in the right direction. Central reserves, however, can only provide appropriate coverage in conjunction with heading reserves. The generation of reserves is not mandatory for headings, and of the 11 headings audited by the SAO, only three generated reserves. The recommendation stipulates an appropriation of HUF 100 billion for extraordinary government measures, which is in accordance with statutory requirements.

The less favourable than expected development of 2012 is a considerable risk. Freezing a part of the reserves in 2012 was the right decision, and the revenue increasing measures mentioned in the recommendation will also be required in 2013, along with the curbing of expenditures. In the spirit of prudence, the bill does not reckon with an agreement being struck between Hungary, the IMF and the EU. If the agreement is concluded after all, debt service burdens could prove to be lower than planned. This represents a sort of hidden, implicit reserve in the budget.

We found 58% of overall tax revenue in the budget to be substantiated, i.e. corroborated by relevant legislation and calculations, and feasible. Based on this, the extra tax of financial organisations, mining rent, eco-tax, energy providers' income tax, rehabilitation contribution and extra taxes, value added tax and excise duty are substantiated.

We found items covering 12% of the tax appropriations to be feasible, albeit only partly substantiated. This is the qualification we assigned to corporate income tax, gambling tax, telecommunications tax, insurance tax, residential stamp duties and vehicle tax. Of the items appearing in

this category, we must single out insurance tax. In the case of this particular tax, the calculations and the legislative background required for introduction were prepared, but the National Assembly is yet to pass the legislative act. In the case of telecommunications tax, a change occurred due to a motion to amend after the bill was adopted, which affected revenues planned for 2012. The crudeness of the statute creates uncertainty with respect to 2013 revenues as well.

SAO returned a qualification of 'unsubstantiated' to 30% of tax revenues. This means that these appropriations are risky because of an inadequate legal and mathematical background, and revenues will be lower than planned according to our estimates. Among tax appropriations we almost automatically categorised as risky the new taxes which the government has committed to, but for which relevant legislation has not yet been created or necessary estimate benchmarks are missing. Credit institution rent, company vehicle tax, simplified entrepreneurial tax, vehicle registration tax and other household tax appropriations, as well as the special tax on the cessation of the legal relationships of private persons, the electronic toll, and the largest household tax item, personal income tax were also found to be unsubstantiated. The personal income tax appropriation is a risk factor because according to our estimates the government's calculations for this year, i.e. the basis for the 2013 budget, are incorrect. We qualified the appropriation for the financial transaction levy to be unsubstantiated as well. This followed from the fact that the National Assembly has not yet adopted supporting legislation and background calculations are only available for a considerably smaller revenue plan.

Naturally, every new type of introduced tax entails some risk, because the feasibility of collecting the budgeted revenue amount may only be assessed on the basis of empirical data. However, there's more to this in the case of the transaction levy, because the HUF 283 billion represents almost one per cent of the GDP. This massive tax amount may even affect the behaviour of economic operators. For example, it may impact the development of certain macro-economic indicators, such as GDP or inflation, and may therefore indirectly influence the possibility to achieve fiscal targets.

Honourable Members of Parliament, Ladies and Gentlemen,

Allow me to continue with the experience the SAO gained during the audit of the expenditure side of the budget. Naturally, we will not be commenting on feasibility in the case of expenditures, thus our Opinion only explores the substantiation of appropriations.

According to our audit, out of the direct central budget expenditures 56% was substantiated, 37% partially substantiated and 7% unsubstantiated. Substantiated items include student loan interest subsidy, State guarantees and indemnity, extraordinary expenditures, social security guarantee and contribution, and claims management costs. The current support of enterprises, housing subsidies, other budgetary expenditures and international accounts were qualified as partially substantiated. The social policy transport fare subsidy – which replaced consumer price subsidy as of July this year – was qualified as unsubstantiated because the required government decree has not yet to be drafted.

Debt service is one of the main burdens of the budget's expenditure side. The interest cost appropriation for 2013 comes to HUF 1 323.5 billion, which is 8.7 percent higher than that anticipated for this year.

I would like to call attention to something I have already mentioned in my introduction; namely that if the agreement between Hungary, the IMF and the EU is concluded, then savings on this line are probable. This doesn't simply mean that international organisations are offering Hungary lower than market interest rates, but also that this agreement would serve as a safety net that would, in all probability, result in the decrease of market interest premiums and a strengthening of the HUF exchange rate.

The amount of revenues related to State assets is fully substantiated, while there are certain unsubstantiated items on the expenditure side. Real estate purchases by the National Asset Management Company represent the most significant uncertainties among these items.

The contribution to the EU budget is HUF 283.6 billion, which is a growth of 7% compared to 2012. The central budget resource part of the EU grants is HUF 258.4 billion, which according to plans will be supplemented by EU funds of HUF 1555.9 billion. There are, however, multiple hazards in this area as well. From the national economy aspect, the fact that the utilisation of EU funds is below pro-rata performance represents a direct risk. If Hungary indeed wants to utilise EU grants available for the current seven-year period, it can do so until 31 December 2013 at the latest.

From a fiscal point of view, however, it is precisely the successful tender applications that entail risk because they may mean a larger amount of own contributions and fiscal expenditure. As an earlier SAO report pointed out, for years EU tenders were characterised by haste; and our reports on local governments made it very clear that, paradoxically, EU grants represented a financial risk for the budget balance of local

governments that utilised such grants.

Allow me to once again call attention to the fact that EU funds must be invested and not spent; and that the key to successful projects is thorough preparation. The benefit expenditures of the Pension Insurance Fund for 2013 will be covered from budgetary contributions. The Fund's budget can be met. The main appropriations are in line with the Széll Kálmán Plan and the Convergence programme. The only risk factor is the inflation-indexed pension raise, because inflation may potentially deviate from the planned figures.

The revenue of the Health Insurance Fund is feasible, but the HUF 69.7 billion cut in pharmaceutical subsidy entails risk. Background calculations and the regulatory concept are missing, and the fact that the subsidy scheme will be fundamentally altered is also a source of uncertainty.

Local government duties and financing this sector will be completely transformed next year. Some of the duties previously performed by local governments will be taken over by the State. A total of HUF 431.9 billion will be removed from the local government sub-system in grants and funds due to restructuring, even while financial tensions in the sector are already quite high. Reserves generated to decrease risks arising from structural transformation can only be utilised from May 2013 at the earliest and only for the purposes the government specified. The reduction in the amount of funds, even if coupled with higher levels of reserve generation, jeopardise the viability of the local government system, and we must also be prepared to handle extraordinary, special cases.

Honourable National Assembly,

The objective of the State Audit Office of Hungary is to facilitate the effective, regular and efficient spending of public funds. This is what we would like to accomplish with our opinion on the budget appropriation bill. As the advisory body of the National Assembly, our goal is for the Members of Parliament to pass the best, most substantiated and corroborated budget. This serves stability and is consistent with the interests of the country and the population.

We admit that the 2013 budget appropriation bill was created amidst great uncertainty and in a very difficult international environment. The budget must be prepared even in uncertain times, where predicting future events is difficult. Laws, rules and planning standards must also be observed even in such times. Otherwise, there is a chance that problems will arise during the execution of the budget; problems that should have

been dealt with during the preparation phase.

In a difficult economic situation it holds even more true that the government must simultaneously ensure that the budget deficit can be maintained, and that the budget is not overly stringent, so that it doesn't stunt economic growth. We must weigh our options and make the right decision, because the stakes are enormous. For this effort, I would like to wish you success in your work and in your discussions.

Thank you for your attention.'