



Day of the meeting	Agenda item	Speaker
25 October 2007 (diary number: 100)	General debate on the Budget Bill of the Republic of Hungary for 2008 as well as the relevant SAO opinion (No. T/3860, T/3860/1)	Dr. Árpád Kovács, President

DR. ÁRPÁD KOVÁCS, President of the State Audit Office of Hungary:

‘Madam Speaker,
Honourable National Assembly!

The Public Finance Quarterly contains an edifying analysis about the domestic budgetary processes under the title “How did we get here?”

Recently, the budgetary system has been evaluated by many people, many times. The State Audit Office of Hungary has also evaluated it several times.

However, today’s question is how we can move forward, and what we should do for balanced public finances, sustainable growth and development. As far as we can see, the bill on next year’s budget is trying to more or less answer this question and find the way out amidst the restricting factors.

According to the intentions, next year’s budget is an integral part of the balance-creating process, the main direction, focal point and ratios of which are specified by the convergence programme. In order to succeed on this road we need to implement management, regulatory and institutional modernisation, as it has been expressed by the Minister of Finance.

The international professional literature and financial practice affix the label ‘time-inconsistency’ to the fact that politics is confined to the time span of election cycles, wherefore it is difficult for governments to enforce a long-term rational and stable economic policy and on that basis a reasonable budget policy containing acceptable compromises.

We can all agree that for such reasons the past years have brought about unfavourable processes in Hungary too, and not only for the budget, but also for strategy development and the implementation of

structural reforms. As it is shown by a few foreign examples, medium-term thinking is given preference in order to offset the budgetary tensions, i.e. multiyear budgeting is used and additional institutional guarantees are brought into the system.

Often it happens that an independent organisation is incorporated into the budgetary system to control and evaluate the thorough preparation of budgeting and the reliability of the macroeconomic forecasts to be used for such purposes. And what may be the most important of all; they use restrictive rules that prevent overspending and at the same time strengthen budgetary responsibility and discipline.

Especially in the framework of said efforts, the incorporation of certain elements of modern public finance regulation into the Act on Public Finance has been put on the agenda in the past few weeks, which is a positive step according to the State Audit Office of Hungary.

However, for the lack of a new act on the comprehensive renewal of the public finance system, as well as on fiscal responsibility and discipline, the supplementation of the existing legal regulations can hardly guarantee the development and sustenance of a strict fiscal policy and the institutional obstruction of budgetary overspending.

The need for the prudent adaptation of the comprehensive and cutting edge methods of budgeting and public finance management is unanimously accepted in professional circles. This need is also reinforced by the theses on the regulation of public finances, published by the SAO, and special thanks are due to the National Assembly for having supported this document.

However, the application of proven international solutions can be really beneficial only if it is supported by professional, social and political consensus. The only road to evolution and the improvement of the balance is the comprehensive modernisation and renewal of our budget system.

Within this framework we must also change the current situation, in which the budget is planned and the professional acts are developed practically independently from each other, and according to my personal experience gained at the meeting of the Constitutional Committee, this is still a practice in the National Assembly of the Republic of Hungary. Therefore, it is inevitable to introduce guarantee rules and mechanisms at legislative level which may help us prevent

public finance overspending and deficit growth. Furthermore, we must be aware of the price of each act containing professional decisions.

For the creation of the professional and content conditions required for the development and introduction of the novel regulation, the State Audit Office of Hungary is cooperating with the financial administration in order to provide maximum assistance in the renewal of the budgetary system by relying on its intellectual base and audit experiences. The Public Finance Theses developed by the SAO and approved by the National Assembly can be utilised and incorporated into legislation by the Government under the guidance of the Ministry of Finance.

Upon the request of the Minister of Finance staff members of the State Audit Office of Hungary also participate readily in this work. Within the framework of this process the SAO has also developed the draft of the new Public Finance Chapter of the Constitution, prepared partial studies for the regulation and should a relevant decision be made, it will also do so for the renewal of the office in charge of laying the foundations for the budget. We set up a working group to ensure that the new tasks could be performed as soon as the new act comes into force. The staff members of the Ministry of Finance are also involved in the work of the group, and negotiations are under way about these issues.

The implementation of our intentions to foster evolvement and progress is also indicated by the fact that for issues known in advance by the competent committees of the National Assembly, and with the approval, support and assistance of the Minister of Finance, for the first time ever we prepared macroeconomic analyses, model calculations and a study processing the “expected best bad scenario” for 2008. The research group of the Research and Development Institute of the State Audit Office of Hungary also contributed to this study.

I would like to thank the committees of the honourable National Assembly for fostering the positive reception of this study, and for encouraging us to thematically deepen and further develop the thoughts on the basis of which we can highlight appropriate topics, sub-issues or larger aggregates.

We would appreciate useful pieces of advice regarding the depth, details and structure of such studies from the MPs and committees, either in the plenary discussions, or directly, since advice would be

beneficial even if in the future this task was performed by a separate organisation or by a council.

Ladies and gentlemen,

In the SAO audit on the closing accounts of 2006 and in my last, related parliamentary intervention I outlined the SAO findings and conclusions pertaining to the public finance processes of the recent years. I referred to the known correlations as well as to the fact that stabilisation and consolidation necessarily go with temporary growth sacrifices. Using the encouragement that was also confirmed in the relevant resolutions of the National Assembly, i.e. that the SAO should assist the legislative work with its comprehensive observations and recommendations, in the following I would like to remind you of some broader correlations.

We all know that similarly to the previous years, the main engine of economic growth is the expansion of exports capitalising on the favourable foreign trade situation. At the same time, the decline in the GDP growth can primarily be attributed to the demand-reducing measures of the Government in line with the convergence programme. I would like to emphasise that the more extensively the objectives of the convergence programme for the current year are implemented, the more the changes serving adjustment and the renewal of the large community supply systems are realised, the greater the hope that the macroeconomic indicators for 2008 and the subsequent years will be more promising, especially if the expenditure structure of the budget becomes more modern and the volume of expenses can be kept in check.

The Bill on the 2008 budget, as well as the SAO opinion thereon was necessarily influenced by other multi-year trends and background correlations. In addition, it was also a determining factor that as a result of measures complying with the convergence programme, the shortfall objective of the central budget for the current year would probably be achieved and the risk of social security overspending is expected to be lower. No significant deviation is expected from the planned figures.

Honourable National Assembly,

The sources that can be directly mobilised for putting the country on the path of sustainable and fundable growth (such as the significant influx of foreign capital, assets that can be privatised, and adequately

qualified workforce meeting the demands of the labour market), the sources that we could rely on in the past years have been almost completely depleted. I note in brackets that in countries that had to shift to the market economy, Hungary included, the capital attracting ability is largely influenced by what and for how much money can be privatised, and for how much money such assets can be acquired by the foreign customers. The imminent windup of the privatisation process reduces the capital attraction ability and the intensity of capital influx by itself. Continuing this chain of thoughts I cannot ignore the fact that the trust in the Hungarian national economy has recently declined both abroad and domestically, while trust is a very important, if not the most important factor that guarantees security and supports growth.

As I pointed out during the debate on the closing accounts last year, in relation to the evaluation of the plans for the future, of the chances, insecurity factors and risks we have to deal with, we should handle the restoration and the strengthening of confidence in our national economy in accordance with its invaluable significance. The new incentives of growth can include, for instance, EU subsidies, the modernisation of the infrastructure and last but not least, the beneficial effects of the renewal of the public finance system. In addition, a major growth and competitiveness factor could be a more defined shift towards a knowledge-based society. Even more efforts should be made in order to develop more extensively and to better appreciate the knowledge potential and innovative performance that are possibly the most important production factors of the 21st century, and said efforts must be also reflected in the budgetary figures.

This means that productivity, innovation, creativity, as well as adaptability are key issues in all fields of the public and private sectors. It would be important not to forget about the special budgetary requirement pertaining to the utilisation of EU funds. The essence of this requirement is that development should generate at least as much revenues that are needed to cover co-financing from the budget, as well as maintenance and amortisation. One thing is sure: new growth factors must be discovered and exploited while taking into account that their beneficial effects will probably become apparent with a certain postponement in time in the medium run. A precondition for balanced, sustainable and fundable growth and development – among the many factors that I do not wish to talk about now – is a favourable growth rate exceeding the restrictions, and that we should be able to renew the

public administration and the large supply systems, too, as soon as possible.

The State Audit Office of Hungary counted with the said factors and correlations when forming an opinion on the budget, and took into account the related uncertainties and risks as well. Our work was hampered by the fact that until the completion of the on-site audit, i.e. until mid September, the data and information provided to us were not comprehensive and final, and I especially thank the Minister of Finance for presenting these supplementary figures for informative purposes in relation to the chapter volumes. These figures would have been essential for the formation of the SAO's opinion. However, it is a fact that after the completion of the SAO audit, the Government modified several appropriations that were of key importance to the execution of the budget. We had only limited possibility to evaluate the effects of the modifications; the explanatory volumes on the chapters were prepared after the submission of the Bill. For the time being, this complies with the rules, yet we disapprove of this practice. It goes without saying that the SAO analysis and opinion cannot rely on the contents of the said volumes. It is also a fact that the financing plan pertaining to the management of the public finance shortfall can be prepared by November this year.

All this led, for example, to the fact – which I cite only as an illustration – that for the lack of time and information the State Audit Office of Hungary was again unable to calculate and evaluate everything. This is how it could happen that we made a mistake about the guarantee stock of Hitelgarancia Zrt. and the rate of return on completed collections. The total guarantee stock of Hitelgarancia Zrt. for 2004 equals – correctly – HUF 174 billion, and is expected to total HUF 326 billion in 2007, while the rate of return on completed collections is 19.6%. It must be added that it indicates good work performance and relations that I am sharing these figures with you upon the request of the head of Hitelgarancia Zrt., since he himself asked us to pick this error from among the tens or hundreds of thousands of figures and present it to the National Assembly. This means that the State Audit Office of Hungary exercised self-criticism and picked these three figures from among the hundreds of thousands of data. I hope that under the restricting conditions that are indicated by these three figures the National Assembly can utilise and modulate its opinion with our help.

Ladies and Gentlemen! In the following I am going to rely on the findings of the comprehensive audit of the thorough preparation of the planning work. Our report, which I am not going to present in detail, confirms that in line with the long-established practice, the budget policy has a small room for manoeuvre. This is almost a commonplace today, however, it must be stated since the major factors are so determining and numerous that it is simply impossible to proceed without knowing them.

The restricting factors and conditions are first of all related to the growing expenditures connected to debt servicing, the contributions and guarantees connected to the social security benefits, as well as the co-financing of EU funds. It deserves special attention that after 2008, the rate of debt repayment taken over from businesses in the Government's sphere of interest, or from the Hungarian Railways (MÁV) or the Budapest Public Transport Company (BKV) possibly due to loans taken with state guarantee may pose a high risk.

Inter alia, these factors and effects also make it uncertain whether the public finance shortfall can be kept under control, or this year's expected gross state debt of 61.8% and the calculated rate of 62.1% for 2008 can be maintained. Yet, it must be emphasised – and this is an essential factor – that the macropath indicators of the Bill comply with the figures laid down in the convergence programme and in case the macroeconomic trends forecasted during the planning process come true, the main objectives of next year's Budget Bill can probably be implemented.

However, making no claim for completeness let us see a few details on the revenue and expenditure sides, premising that these risks can be more or less offset by the reserve contained in the Bill. Based on the available documents, within the revenue appropriations of the central budget only nearly half of the customs and tax revenues could be concretely audited. It is a positive development that their feasibility can altogether be considered as low risk.

The realisation of the VAT appropriation is rather tight, according to the audit; however it seems to be feasible, thanks to several presumptive revenues.

In connection with the revenue appropriation it must be noted that the SAO audit on the evaluation of government owned real property indicated a high risk. At the same time, I must also refer to the favourable structural changes in the budget that improve

transparency: in line with the property act, expenditures and revenues related to state assets are now included in a new chapter. We find it imperative to prepare regulations and information platforms on the basis of which this act can actually function.

It is similarly positive that if we count with the realisation of the macroparameters serving as a foundation for planning, on the whole the calculation of the revenue appropriations of the social security funds cannot be questioned.

Based on the figures that were available at the completion of the on-site audit, the expenditure appropriations of the central budget can also be considered well-founded and realistic. It is also reassuring that the budget bill provides coverage for domestic co-financing required for the utilisation of EU funds and subsidies.

It seems to me that within the social security expenditure appropriations, pension expenditures and health insurance cash benefits are planned as low risk items. In terms of in-kind benefits further expenditure cuts are carried out in accordance with the convergence programme; however I do not want to form a professional opinion on this. At the same time – and I would really like to stress this – the expenditure appropriations in both social security sectors can be regarded low, or even unrealistic compared to the expected tasks. The problems of calculating and disbursing benefits in the pension sector are well projected by these expenditure issues. On the other hand, in the health insurance sector the slashed appropriations for operational expenses do not ensure coverage for the expected structural changes. In addition, the insurance reform – the details of which were not yet available at the time of preparation of the SAO opinion on the budget – implies a serious, albeit not yet quantifiable risk factor due to its spiralling effects.

According to the Budget Bill, in 2008 the central budgetary subsidies available for the local governments will equal only 40.1% of all subsidies compared to this year's rate of 43.6%. However, according to the plans domestic co-financing and chapter based subsidies will significantly increase (by 27.2%), while own revenues will grow by 13.8%. Yet, it must be noted that regulated resources in this field will decrease by 3.7% compared to this year. The specific values of normative contributions and subsidies will remain the same under most legal titles of claims at nominal value. The relevant real values will also decrease.

We must face the fact that ultimately the real value of central subsidies provided for operational purposes will decrease according to the budget, even if development funds will significantly increase. However, it should be noted that we have to count with the fact that the operation of these developments will require additional funds in the future, and the relevant coverage must be definitely ensured, while the effects and resources are entirely unknown. Otherwise there is no sense in making these efforts.

The resource regulation of local governments will remain practically unchanged next year. In this respect the Bill forecasts the deterioration of the financial balance in this public finance subsystem. It is a problem beyond the local governments that the absorption ability required for the utilisation of EU funds is not adequate. It may have budgetary implications that there are no guarantees, or there are no sufficient guarantees either for favourably structured utilisation, or for the secure financing of future operation.

In addition to the findings of the on-site audits I would like to draw your attention to certain deficiencies in the preparation of the budget document. This is a recurrent issue and the Ministry of Finance introduces changes to these practices each year. The presentation of the Bill follows an established practice, developed over the years. Probably, it is not an easy task for you either to make out the document. We have indicated for many years that the contents and structure of the documents belonging to the Budget Bill should be regulated in a comprehensive manner. The general explanation also indicates that this is regarded important by the Minister of Finance who submitted the Bill. Renewal would make it possible to comprehensively adjust and set the content and formal requirements of the Bill, as well as to determine the information content required or sufficient for the parliamentary debate of the Bill.

The Bill more or less complies with the presentation related requirements laid down in the Public Finance Act; however certain shortcomings persist despite our continuous warning. We especially miss the summary presentation of the long-term liabilities, and the inclusion thereof in the main volume. For example, in the absence of this presentation we cannot explain to you what burdens and determinations are implied in projects implemented within the framework of PPP schemes, since we too, learn about the relevant data at a later stage, in the volumes containing the detailed presentations. I

respectfully ask the Minister of Finance to cooperate in the future so that said information would also be available in the summary volume.

The review and better understanding of the processes, and last but not least the preparation of the SAO opinion are considerably hindered by this delay and by the fact that the important time series and statements are regularly presented only in the chapter volumes.

I bring up these issues again and again, since they could be eliminated straight away in the new public finance regulatory system; budget planning could be based on new foundations, and this could also improve the conditions of the parliamentary debate.

Honourable Madam. Speaker,
Honourable Members of Parliament,

In connection with next year's budget I would like to draw your kind attention to some additional things for consideration. Some of them are explained in more detail in the document provided to you by the Research and Development Institute at the State Audit Office of Hungary.

I am starting out of the fact that in the next three years we will follow the ideas in line with the convergence programme too, and these ideas can be realised by the Government as well. However, I would like to say that the calculations and forecasts for 2009 and 2010 caution us, and in this respect I am especially happy about the fact that during the debate on the budget, when we were discussing a more prudent scenario indicating a danger zone, the Minister of Finance considered this as a gesture of help. I would like to share this critical remark with you because we should also get prepared for scenarios in which the events progress out of line with our intentions, and in which we cannot achieve those quick changes that we would like to see in 2008 and 2009. This means that we must have a script for handling inflation with another mechanism.

As far as the estimated economic growth of 2.8% is concerned, the budget contains a rather moderate risk for the next year, although our forecast contains even more prudent figures. The SAO audit considers the demand-reducing effect of the relatively high inflation rate of this year and of the next year as a remarkable risk. This risk can be aggravated by the apparent major indebtedness of the population and the depletion of reserves, which may drive the demand down in the following years. One of the uncertainty elements of the convergence

programme is the prediction of wages and demands. We are again unable to forecast anything with certainty. Should the wages grow quickly and at a relatively high rate, imports and prices will probably rise due to the rising demand.

In the past few years, and especially as a result of the latest restricting measures, the difference in the living standards and quality of life of the various groups of the society has increased. This raises the need for measures that can possibly or at least partially offset the measures adversely affecting the society. In this relation, due to the trend of decreasing real wages, it would be necessary to handle and – as you might accept it from me – communicate social self-support in a more prudent and low profile manner as the basic arranging principle of the renewal of the healthcare and social systems. I must also add that the same should apply to the reference to EU funds as the master key to all solutions.

Versatile and recurrent audit experiences prove – and therefore it is justified to highlight in the opinion on the budget as a problem going well beyond next year's budget – that the issues of the financial management and financing of local governments, together with their inherent social tensions as well have grown into a serious risk factor. The local governmental sector gradually exhausts its reserves they either deplete their marketable assets, or such assets are bound as surety for credits. Several SAO reports have indicated the fact that the centrally regulated revenues, i.e. normative subsidies and the transfer of personal income tax revenues are less and less able to cover the increasing costs of the mandatory tasks that are growing in number, too. The majority of the municipalities of villages and smaller towns suffer from the lack of resources and underfinancing, despite the subsidies they are given to counterbalance their disadvantaged situation.

In recent years the growth of indebtedness in this sector has accelerated. Long-term credits are accumulated by a few local governments. The issuance of a considerable number of private bonds is a new phenomenon primarily at county local governments. While relatively longer maturities and deferred repayment schemes certainly have advantages, they imply risks that hide the real load-bearing capacity, and these risks are far from being negligible. I am convinced that this issue must be solved by finding a solution with joint effort rather than taking administrative measures.

We must be aware of the fact that the concentration of fiscal and planning risks of public finances is growing at an increasing rate in the local governmental system. As a straightforward consequence, it should be figured out how to eliminate the tensions of local governmental financing and resource regulation that imply potential risks for the entire local governmental system.

Honourable National Assembly,

It might sound ridiculous, yet I have to remind you of the fact that the territory of Hungary equals 0.07% of the globe, the population of Hungary makes up 0.17% of the global population. The country's global GDP share is 0.2%, and Hungary's exports equal 0.5% of global exports. We are a small, open country extremely sensitive to foreign trade, which is changing almost incessantly. In addition, we are now also compelled to settle the problems of our budget and public finance system. This small country in transition and development and its national economy must find, stabilise and strengthen its place in the European and global arena.

At the same time, in some respects Hungary must comply with contradictory demands, the requirements of the nominal and real convergence programmes that often exclude one another, i.e. the requirements of joining the euro zone and economic convergence; it must face the major disparities in its territorial and regional development and it must meet the many-sided social challenges that are accompanied by tense budgetary requirements due to the demographic processes in place, just to mention a few tasks. All this is included in the budget, no matter if it can provide an answer, or not. The budget is actually about us, it is like a reflection.

How can we respond to these challenges? I am convinced that most probably by working out a wider scale, comprehensive convergence, development, management and institution modernisation policy showing beyond the traditional economic and financial policy, a policy that is very sensitive to social issues, as well as to the social impacts and risks of economic processes. The completion of the tasks and compliance with the challenges largely depend on the solid foundation of next year's budget, and its successful execution. Keeping this in mind the State Audit Office of Hungary has been cooperating with the Ministry of Finance and every governmental organisation.

We would also like to disclose our opinion to the National Assembly, both to the opposition and the governing party, accordingly. We

believe that by doing so we have fulfilled our obligation pertaining to commenting on the Budget Bill for 2008. I do hope that this opinion and the macroeconomic review submitted to the deputies for the first time ever, will foster the work of the National Assembly, and consequently it would be able to give a detailed opinion about the Bill submitted by the Government. Hereby, I would like to thank all my colleagues, the cooperating external experts, and naturally the staff members of the Ministry of Finance, and personally the Minister of Finance for their assistance and involvement in the preparation of these documents.

Thank you very much for your kind attention.'