



Date of the meeting	Agenda	Speaker
3 November 2008 (diary number: 170)	Introductory speech of the President of the State Audit Office of Hungary to the Budget Bill of the Republic of Hungary for 2009 as well as the relevant SAO opinion (No. T/6571, T/6571/1)	Dr. Árpád Kovács President

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

“Madam Speaker,
Mr. Prime Minister,
Honourable National Assembly,

Fulfilling its legal obligation the State Audit Office of Hungary prepared on time its first opinion on the original budget appropriation bill. Following the harmonization on appropriate levels this opinion contained the detailed findings of the on-site audit; findings regarding the preparations of the ministries included. In a short time we forwarded this document to the Ministry of Finance. On 14 October we presented the National Assembly a study prepared by our research institute that included also the scenario built on the latest information as well as an analysis, which, based on the numbers of the appropriation bill, referred to higher risks.

As the Minister mentioned, due to the well-known fact the macro-economic programme and the principal numbers serving the basis of the next year appropriation bill had to be corrected. We received the revised appropriation bill on 18 October and presented our opinion on it to Ms. Katalin Szili, Speaker of the Hungarian Parliament on 22 October. Upon the request of the Committee on Budget, Finance and Audit Office we also commented the proposal of revision the Government intended to submit to the National Assembly.

In harmony with our legal obligation I am going to deal with the submitted bill on the agenda. I am also going to add some commentary remarks to the corrected proposal and avoid repeating our written opinion or the details of the study of our research institute.

In anticipation, I would like to underline that from fiscal-professional point of view we agree with the definition of the goal in the general explanation of the appropriation bill, according to which the target is to have the economic output and the living conditions approach the EU average in a sustainable and ever accelerating way, while creating the conditions of development based on sustainable equilibrium. At the same time the corner numbers of the revenues in

the new version of the submitted bill that is lying before you, were heavily questionable as, according to our opinion, they did not reflect well enough the problems and the possibilities of handling those problems that served as the explanation for the need to of revise the original bill.

Compared to the earlier one, the new proposal did not show significant changes concerning the major appropriations, the structure of revenues and expenditures, as well as reserves, despite the fact that the existing circumstances would very likely enforce such changes – like it was proven by the ideas of the revised package, referred to as the ‘third variant’. This recognition is manifested by the fact that is otherwise worth of support, namely that in the centre of the corrected recommendations of the Government we can find conditions, which compared to the recommendation submitted on 18 October with the aim of putting the issue of ensuring the stability of the national economy in the focus, concern such changes of the macro path that even under the present circumstances they might promote the improvement of the balance of the public finances, the creation of opportunity in respect of the immediate fiscal and foreseeable field ahead. True, the price would involve significant sacrifices in the field of real economy, the narrowing of the development possibilities and the social risks involved.

Reacting to the latest problems of world economy required unusual solutions in the closing phase of activities forming and planning the appropriation bill, however, apart from the atypical closing phase the planning process itself did not meet the respective regulations in every aspect, even prior to this phase. Instead of a planning process built up from grassroots, focusing of the realization of the professional tasks and being based on seeking political-professional compromise, this fall once again it was rather the cutting back of the core numbers, which had been formulated as a result of compromises.

Having in mind also the changes concerning the budgets of the different chapters that lie before us, thus composing the start-up bill and which, under the circumstances and obviously could not have been controlled and evaluated by means of auditing, the SAO is on the opinion that the fairness of the above appropriations cannot be identified. This was so even if it is favourable that the appropriation bill has already met the majority of the legal regulations concerning the presentation.

However, the parliamentary discussion has not been helped by the fact that the document did not contain information on long-term obligations, nor on expenditure items involving commitments for several years and in the given situation we especially missed the presentation summing up major appropriations important from the point of view of mid-range planning and important in respect of the outlook for the next three years. As a result of the lack of expected appropriations for 2008 in the major book of the appropriation bill, makes it difficult to have a clear vision. Similarly to the earlier practice, the document contains merely the appropriations approved for 2008, thus it is

exactly the expected values that would serve as the basis of the planning itself, which are missing.

Full range and detailed calculation materials for formulating an opinion were not available in case of the withdrawn appropriation bill either. Apart from this we could only get acquainted merely with the outlines of several regulations awaiting approval. The existing planning method is like this these days. In other words the renewal of the method is urgent but we could also say that even if with considerable difficulties, thanks to our cooperation with the Ministry of Finance, in certain elements we can bridge over these problems – for the time being. The need to change however is urgent – as the Minister of Finance mentioned earlier – and I can only emphasize that personal cooperation and team spirit cannot compensate systematic work.

The daily changing events and effects of the financial world crisis leaning towards recession are practically unpredictable as it was mentioned here several times, thus caution is justified. Under the circumstances it was unavoidable to count with the high risk of the realization of the appropriations in respect of the total types of tax already in case of the new version of the bill. This very strict, very conservative and security seeking attitude succeeded even when we commented the planned third version and I listed these remarks item by item yesterday at the meeting of the Committee on Budget, Finance and Audit Office.

Based on the available documents and calculation the audit evaluated more than 97% of the direct expenditure appropriations of the withdrawn bill as observable. I had to mention this because the chapter volumes have not changed and this in itself has already indicated that major risks were and regrettably still can be found on the revenue side and in respect of public debt as well.

In case of the new bill, earlier, due to lack of time we could not make sure of the adequate backing of the appropriations with documents either. The balance of the changes on the side of expenditures represents considerable decrease compared to the withdrawn bill however, the major part of them, I underline this again, can be topped without the obligation of amending the appropriation.

With the aim of avoiding bigger troubles and to reinstate trust of the financial markets, the Government found the source of its compulsory steps to decrease expenses in the temporary cutback of wages and social allowances, without having presented the synergies and multilateral consequences of these steps and now, due to fiscal-professional risk reasons I partly agree with them. As we heard at the forum of the Committee on Budget, Finance and Audit Office: there was already no possibility to use the method of overall cutbacks. In other words it was impossible to resort to this method in case of the third bill as there remained nothing to cut back from. Yes, being squeezed by a crisis one has to attend to the structures, but I would add, not only by cutbacks, rather we should carry on and should not leave behind our attempts to modernize and transform existing systems.

The possibilities to judge the observance of the appropriations of the new bill are partly limited and present some problems. As we have already emphasized in connection with the previous version of the bill, I am stressing again the importance of concretely determining conditions of the utilization, the circumspect appropriation to reserves. Beyond the above the fiscal package worth of EUR 20 billion, the hovelling of this huge amount of credit-limit agreement serves financial security and the ability to finance matters, supposing, it will not contribute significantly to the increase of public debt. The moderate and foreseeing utilization of this credit-limit might also redeem our too burdensome credits. Let us not be fainthearted in this respect.

As the definition of the earlier referred goal of the general explanation has also mentioned, it is the economic-political endeavour aiming at the creation of the sustainable equilibrium of the system of public finances that stands in the centre of the corrected bill.

Macroeconomic indicators had to be corrected in comparison to the transformed bill and the contents of the convergence programme, due to the system of conditions that is difficult to review and understand as well as have become more and more unfavourable in the course of the past weeks. The moderate growth-rate, the exports and imports, the domestic and community consumption as well as the gross utilization of fixed assets and the higher inflation rate, all represent a changing macroeconomic field that is the result of being forced by the need to adapt to the new situation. Even so, the implementation of the above might be influenced by several factors that have a more forceful effect than before, not to mention the economic and – I would like to stress this again – social risks involved.

How do the risks of equilibrium and growth rate manifest themselves? In a telegraphic style I am going to refer to the most important factors, rather with the aim of giving information that would assist the parliamentary debates and the conservative, careful planning, instead of offering an analysis. Please, forgive me if – joining the Minister of Finance - occasionally I mention issues that might already be familiar.

As a result of the developments in world economy, the growth rate trends in the European economies that are significant for us are falling back; foreign demand for our exports that plays significant role has been decreasing within our GDP, too. This might considerably restrict our growth rate. The slowing down of the dynamics of our exports will set back employment as well, which then will shrink the volume of earnings. Apart from the latter, the conditions of credit accommodation getting stricter, which will also temper the consumption-related expenses of the citizens and of the enterprises as well. The regressive growth rate and thus the decreasing demand depress tax revenues and due to the significantly narrowing consumption indicators, this applies also to the taxes related to consumption.

One of the most important conditions of our economic development is cutting back inactivity and increasing the employment level. However, the latter is negatively affected by not only the consequences of recidivious growth rate; we should not forget here about those structural and quality-related obstacles from the aspect of workforce supply that can be overcome only in the long run.

In our dual-structure economy a considerable proportion of the exports (80%) concentrated at multinational corporate enterprises is only loosely connected to internal production processes. A significant fraction of the activities of the above range of enterprises has not become an integral part of the internal economy. Albeit, from the aspect of the macroeconomic leeway of next year's budget exports shall continue to be important; however under the circumstances its role is going to be less significant by the present exports structure, than it used to be in previous years. From the aspect of improving its structure it is especially important that domestic added value should increase within exports. In order to expand the leeway of our national economy this is just as important as the improving of the competitive conditions of small and medium size domestic enterprises, at least on the domestic market. Otherwise, due to the increase of imports-related demand and of the imports volume, the GDP grows only very moderately, the balance of the public finances and of the foreign trade gets worse. Thus it would be expedient to pay more attention to the equilibrium of public finances among the line of measures supporting growth rate, and this way contribute to the improvement of the operational conditions of small and medium size domestic enterprises.

Chances of catching up are also being threatened by the fact that the restriction of general government expenditures narrows the public sector market that are significant also when compared to the rest of Europe.

By all means, one of the key questions of next year's growth rate is the *pro rata* and effective utilization of EU funds. That is, under the present conditions we can count with growth, with dynamics only in the sector of EU funded investments. That is why it is important that – as the explanation of the modification proposal of the Government also emphasizes – we ensured priority to projects being realized by EU co-financing; first of all those, which aim to improve the operational and financing conditions of small and medium enterprises.

All in all, and with certain amount of simplification, the biggest risk is the effect of the international financial crisis on the real economy as a result of which a lower than predicted economic growth might occur as well. In this case the revenues of the central budget will lag behind the planned level too; moreover it might also happen that due to the effect of the changes in world economy certain expenditures would increase significantly more than the appropriation, first of all, for example debt service or expenditures related to unemployment. Thus, apart from further expenditure reducing steps of the draft modification that the Minister of Finance delineated and, which is to be submitted, we have to count with certain obscurity effects, which is in favour of strict reserve

management, of very cautious, let us not hesitate to say it, downright gloomy pondering of the social-economic effects. This will serve our security.

In this situation – having in mind also the robust fluctuation of investments, the taxpaying morals and the significant tax arrears, as well as the corruption pressure – deliberate, even administrative steps aiming at pushing back corruption and having the economy transparent, are of special importance.

The contents of the corrective recommendation, the direction of its changing fall in step with the requirements of the given situation. Its purpose cannot be questioned as the goal is to ensure the stability of the national economy and thus also the chances of development, despite the difficult to review nature and the multiplying effect of the worldwide financial crisis. As I have already mentioned and as it is written in our observations made for the Committee on Budget, Finance and Audit Office, the unequivocal regulation of the utilization of reserves – and here I do not mean the actual value – is still missing, while under the circumstances careful regulation would be especially reasonable.

According to our calculations, shrinking employment can be termed as underestimated and achieving several other types of taxes that affect the amount of revenues, is also questionable. The submitted bill and the planned third variant of the motion of correction are not reflecting well enough what influence the decreasing employment rate, and together with it, the increasing unemployment might exercise on other growth factors, and what would be the consequences of their interactions. It is clearly visible that restrictions are basically burdening the resources of the public sphere. Under the circumstances joint bearing of the burdens is understandable, however it should be worth of consideration whether it is worth to equally hold back and burden well and badly operating structures, and thus making high standard work - which otherwise and undoubtedly is very much needed - meaningless.

In the motion of correction the stretched targeted deficit and further decreasing of expenditures, at the same time the high level of interest rate alone, in themselves are unfavourable from the aspect of the GDP growth. However, in the present situation creating balance and the conditions of stabilization should come first, so that the results of the crisis management-character measures would set the foundations of the secure, sustainable and financial growth while, at the same time, bring closer the possibility of our joining the Euro zone. Even under the circumstances of crisis management we should not give up the modernization steps that would define our future, nor the implementation thereof, as in essence we know what would be necessary in the fields of local governments, administration and provision of public duties – just to mention two examples. That is why I put special emphasis on the lack of a three-year outlook.

Having in mind your requirements and encouragement expressed in parliamentary resolutions, we have made our best to formulate resolutions supported by our audit experiences, analyses, studies, which – based on the

results of concrete audit experiences – also support the promotion of the lawmaking and control functions of the National Assembly. In the spring of 2007, in terms of this intention we published our compilation titled “*Theses on the Regulation of Public Finances*” recommending it to the attention of the Government, with the aim to be using this working document in their work to modernize the budgetary system. By the studies of our research institute we also made efforts to call the attention to some major risk factors of the budget. Further, we aimed at supporting the Government’s work, as a result of which the bill on the budgetary responsibility was born.

All along we have emphasized, and here we underline it again, that in our opinion it is necessary to renew the budgetary planning and regulation thereof. To this end, it is also necessary to unify and modernize the financial information system of public finances, the more so that, as it is clearly shown in our opinion related to the budgetary document on the agenda, the prescribed background calculations and impact analyses are missing. Long-term effects of decisions are often unclear, even for the National Assembly – please, forgive me for using this expression. Often, the budgetary debate is focused on the modification of different quotas, appropriations, at each other’s expenses, while the most important structural and efficiency issues hardly get any limelight.

In order to have the prevailing budget act fulfil its mission to the best, the validity of the parliamentary debate on the budget and the well grounded informational character of the decisions have to be improved. The fact, that upon the request of the Committee on Budget, Finance and Audit Office we undertook to be at your disposal with our opinion made in a mere one and a half day, proves our commitment. In this line I would mention the ever deepening competition, the building of the knowledge-based economy and society, the harmonization of the economic, social, ecological dimensions of sustainable development that all represent new fields to give opinion on, in case you are counting on us in this respect. Apart from this we should also be able to utilize the advantages of our EU membership more effectively than up to now. All this requires a full-range economic-political concept, a perspective development strategy in the creation of which – if you consider it necessary – the State Audit Office of Hungary would participate and consider it as an honour. After all, upon the request of the Prime Minister, naturally, we also contributed to the convergence programme by giving an opinion on.

Stabilization and development presume, or rather require, that the harmony between the development in real terms and the budgetary, financial planning is being established and is sustainable. In order to promote this and also having in mind the recurring connections that came to the surface again in relation to the 2009 appropriation bill, once again, we stress the importance of establishing a reliably operating national economic planning system. I think that we shall be partners of the Minister of Finance in this endeavour.

Thank you for your attention.”