



Day of the meeting	Agenda item	Speaker
<b>16 November 2006</b> (diary number: 32)	<b>General debate on the Budget Bill of the Republic of Hungary for 2007 (No. T/1145)</b>	<b>Dr. Árpád Kovács, President</b>

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

'Dear Madame Speaker!  
Dear National Assembly!

The budget is our common cause. Perhaps, this is the most important economic policy document, which affects the life, present and future of the entire society. Its development, debate and execution provide a challenge for the intentions, conscientious professional work and the assumption of responsibility.

We are aware of the fact that there is a lot at stake. And we can also be sure of the fact that it is up to us whether we grab the opportunity or not, and in this respect none of the professional institutions are outsiders. The question is whether we are able to release the balance related tensions of the public sector, to consistently carry out the undelayable reforms in order to catch up with other countries. This can be fostered by constructive debates, forward-looking decisions, the firm orchestration of implementation, as well as the appropriate will, the political will and the realisation of professional ideas in a supportive way and a consensus in mind.

The Hungarian economy has been in a dire state several times; problems that culminated in near state bankruptcy slightly over a decade ago are the first to come to mind. The manoeuvring space and possibility were and are extremely narrow, and stabilisation and development required and require a turn in economic policy then and now, too. Fortunately, today's economic growth cannot be compared to the growth experienced in that period, the external balance is not in a crisis situation, and the current rate of inflation is not an unsolvable problem. At the same time, however, the situation is similar, or in fact more difficult due to the critical balance, or rather imbalance of public finances. The budget deficit is unsustainably high, which also increases

public debts, which increasingly burdens the budget due to the growing interest costs. Today every eighth Forint, i.e. a total of HUF 1,100 billion of central budget expenditures is spent on interest payment, which means that the burden is enormous.

In order to create the new balance, the underlying causes must be eliminated. The evolution of the required change has been practically put on a forced path due to the acceptance of the convergence programme by the European Union. The budget for 2007 should foster the consistent implementation of stabilisation, and sustainable growth on this basis.

Dear National Assembly! Ladies and Gentlemen! While forming an opinion please take into account the SAO's limitations of power and scope, even though the National Assembly encourages the SAO year after year to utilise the possibilities given by the narrow SAO scope to the maximum to support the National Assembly in economic and public finance issues that are subject to opinion forming rather than auditing. In fact, this is a unique role both in Europe and worldwide, and I keep emphasising that our responsibility is very specific in this respect.

This is why I dare to say that the declining level of employment in 2007, the given activity rate of the society, the number of employed people affect fiscal positions, too, and – if we follow this path – we can easily face constitutional issues as per who is eligible for what benefits, and what share of these benefits and how can we undertake.

Dear National Assembly! Based on our audit and opinion, what are the major guarantees of the budget proposal that could foster progress, and what are the inherent risk factors? In relation to the guarantees and the technical preparation of the budget we are of the same opinion as the Minister of Finance in many respects. Compared to the budget proposals of the former years – and I emphasise, assuming the same tax payment discipline, and taking the level of social stability as is – VAT, personal income tax and registration tax revenues represent a smaller risk factor. Relying on model calculations we believe that deviations of around 2% can be forecasted compared to the appropriations. The differences can be affected first of all by changes in wages and incomes accompanying staff fluctuations, and fluctuations in earnings in the public, and naturally in the competitive sector, too.

Making claim for completeness I would like to mention that it can cause some uncertainty in our opinion, and consequently in the parliamentary debate that for a few tax types the SAO received detailed calculations only with delay, wherefore it could not form a comprehensive and well-founded opinion on revenues from these taxes. Furthermore, the SAO cannot assess the next year risks inherent in certain tax revenues the realisation of which depends on the decision of the Constitutional Court, e.g. the so called minimum tax, which forms part of the corporate income tax, and the contribution payable by credit institutions, which total around HUF 80 billion.

Most of the revenues planned to be yielded in connection with state property are based on prudent estimates and are well-founded, and – this already affects the expenditure side, too – we believe that even with the strict conditions of convergence we could successfully revise the plans for appropriations that can be exceeded without the mandatory modification of the appropriation. The ratio of such appropriations did not grow in 2006. Within this – and this is extremely essential – the planning of family, social and normative housing subsidies that are regarded as a determining factor in terms of social justice and cohesion can be qualified as balanced. In terms of strengthening competitiveness, catching up and development it is of utmost importance that according to the data available to us, the budgetary funds required for the utilisation of EU funds can be regarded certain.

It is a totally different issue to evaluate the fairness of the funding and the costs of the institutional system performing the most important state tasks that account for 30% of the central budget – acknowledging the reserves, but not including the EU funds. The significant reduction of our costs is one of the main pillars of the convergence programme. Unfortunately, we could not learn about performance requirements and task analyses utilising such requirements that serve as a foundation for the decided governmental staff cuts. For the lack of such requirements and analyses the risks of structural changes and the unfavourable impacts of public finance restrictions may come to the foreground, underlying the fact that staff reduction in itself, without the reconsideration of the task structure can hardly provide a long-term, satisfactory solution.

The requirements of the convergence programme are theoretically present in the budget proposals of both social security funds – and I emphasise that I am talking at theoretical level. It can also be seen

here that the budget subordinates everything to meeting the balance requirements; based on the documents that were made available to us, the planned revenues will probably be realised, at least from the financial bridges of the central budget. However, the benefit budget of the Pension Fund indicates that the possibilities are very limited, paid contribution provides coverage only for nine months' pensions as opposed to 13 months in 2007 – as I have already indicated in relation to employment – and the funds required in the remaining four months are supplemented by the state from different revenues.

The risks of implementing the appropriation of the Health Insurance Fund could be cut back by the fast enforcement of the measures and legal regulations – naturally, fitting a close concept – that would be in line with the convergence programme, entail expenditure cuts and create long-term sustainability.

The regulated sources of the local governmental subsystem of public finances somewhat increase compared to the appropriation approved by the National Assembly for 2006.

Target subsidies and earmarked subsidies are practically of the same size as last year, however the government channels the implementation of development programmes to EU frameworks as much as possible; it increases the necessary appropriation and makes the accessibility requirements more stringent.

In line with the objectives of the convergence programmes, the role of regions is strengthening, and we hope that there will be changes developing disadvantaged small regions. I find it especially significant, because most of the resources available from the first national development plan were won by the central region. This is the region that had financial absorption ability, and seemingly this imbalance will also be maintained in the second phase of the national development plan. In addition, development subsidies financed from the budget will increase, however, and this is a fact, this is primarily and first of all related to the metro construction in the capital.

Nearly three quarters of revenues from the central budget will be granted on the basis of normative applications, and the ratio of the own revenues of local governments will slightly decrease in expenditure funding.

In the past years not too many debt consolidation procedures were launched. Half of the local governments can maintain their solvency only from supplementary subsidies granted to local governments suffering from a lack of funds, or by taking out loans again and again. The indebtedness of local governments is growing, the depletion of assets cannot be felt in terms of financial indicators as long as asset re-evaluation is under way, however it is significant in terms of real assets.

Task performance by multifunctional small regional associations is further encouraged. This, as well as the promotion of regional cooperation by financial means must be highly valued. However, these modifications by themselves cannot implement a turnaround in the financial management of local governments. Such a turnaround requires system-scale and political cooperation, changes built on consensus that – I emphasise – cover the definition of the contents of public tasks to be performed, and the reconsideration of the proportions and structure of resources serving task implementation, not only in the local governmental sector. It is inevitable to provide a clear answer in a certain sense in terms of self-support and social care.

Ladies and Gentlemen! It is a known fact that the Government submits the professional acts related to the budget separately, in compliance with the resolution of the Constitutional Court. This process had not ended by the time of completion of the SAO audit. This strongly contributes to the fact that the SAO could not properly analyse whether the budgetary appropriations were commensurate with the sectoral and professional acts, and it could not properly analyse the inherent risks. Opinion forming – just like the parliamentary debate, if you excuse me – is made difficult by the fact that the explanatory part of the budget proposal contains less and less material information year after year. For example, in the new convergence programme we lacked the quantified presentation of the impact mechanism of the reform measures, i.e. the so called feasibility studies; the budget bill for 2007 on the agenda of the National Assembly also fails to derive and summarise the financial impacts of the planned and already realised measures.

We acknowledge that it is a demanding and difficult task to plan and provide a quantified analysis about budgetary impacts that can be projected for several years, but it is very important that behind the figures – that are now available in an additional volume – one could rely on plenty of debate provoking thoughts based on relevant

background information during the parliamentary debate that forms the vision of the society and the economy alike.

This is why the government must take all efforts to provide a whole range of consistent time-series indispensable for the evaluations and decisions, including background information, too, so that the honourable parliamentary deputies could carry out the debate on the basis of such information.

Of course, I do not think that the National Assembly should be loaded with tons of figures pertaining to the tiny details. It is necessary to provide information that fosters decision-making about structural changes, developments, and the living standards of the populations, and that proves the implementability and sustainability of appropriations and economic indicators in the period after 2007. This is our common interest, and furthermore, this is what the EU organisations and other international organisations require.

In addition to increasing the performance of the national economy and the elimination of the imbalance as soon as possible, comprehensive and substantive financial information fostering transparency reflects the credibility of public finance management, and as such it is an important factor in the restoration of the trust of the money market. In this aspect we find our proposal very important, according to which the National Assembly should ask the government – for the sustainability and transparency of the budget processes – to limit, or rather ban credit or loan taking, or bond issuance for those business organisations that form part of the governmental sector according to the statistical methodology of the European Union. For if the current situation is maintained, the indebtedness of these companies may increase the deficit not approved by the National Assembly by hundreds of billions of HUF according to our experiences gained in the past years, and thus modify the figures of the budget by violating the National Assembly's budget right.

I am glad that the Minister of Finance has indicated that you would support this proposal of ours, and within a motion for amendment, the National Assembly may make this decision – in agreement with the government, and hopefully in agreement with the opposition, too.

I must note here, too that the SAO has repeatedly criticised the fact that the exact content, structure and compilation methodology of the budget proposal has not been determined yet. Presentation also follows

the practice established on the basis of common law, if you like, within the framework of which legal requirements are not fully enforced. As soon as these requirements can be renewed, modernised and linked to certain rules and conditions, (e.g. the conditions of submission), annual financial plans to be prepared in the future and the transition to rules based budgeting will most probably help the requirements of budgetary discipline, transparency, rules based fiscal frameworks and programme budgeting.

Dear National Assembly! In terms of the parliamentary debate it is of utmost importance to answer the question: how can the relation, harmony of the budget proposal with the long-term objectives – long-term underlined – of the convergence programme be evaluated? The public finance deficit indicators contained in the budget proposal are in line with the deficit appropriations specified in the convergence programme, the inflation path outlined in the convergence programme and the relevant forecast for 2007 are in harmony with the so called macro-path indicators of the use of the GDP.

At the same time however, the expected behaviour of the different income owners of the national economy represents an uncertainty factory. It is difficult to assess in advance the investments to be made in the competitive sector, as well as the impacts of cost curbing and tax evasion intentions, which naturally also include the application conditions for the internal transfer prices of multinational companies.

A considerable risk factor in the budgetary calculations that rely excessively on consumption by the population is how the population will respond to the fiscal measures. The impacts of the increasing living costs, the uncertainties of employment and keeping a job, changes in household consumptions, and those of more prudent saving and loan taking attitudes can only be assumed today. However, they should be given special attention in the parliamentary debate not only in terms of financial and economic correlations, but also – due to the diverse changes that occur already in the short run – in terms of the management of social acceptance and inclusion, too.

Based on our audit experiences, and now, while forming an opinion about the budget we have come to the conclusion that tax changes serving as the basis for the 2007 budget and the convergence programme do not show in the direction of the real modernisation of the tax system. The system is complicated and its impacts are difficult to assess.

Apart from simplification it would be necessary to broaden the taxpayer base, to further strengthen the conditions and tools of auditing, as well as to radically curtail tax evasion possibilities. The introduction of tax changes mid-year, and the revision thereof shortly afterwards reduces predictability and weakens legal security.

The increase of tax and contribution burdens by itself – and not within the context of a larger scale tax reform – does not foster efforts aimed at the elimination of the underground economy. Tax changes carry special risks in this respect, too, while we accept that said revenues are expected to be realised in 2007.

Dear National Assembly, dear Mr. Minister, dear Madame Speaker! Convergence, catching up and balanced growth assume that we should place a greater emphasis of requirements that go with EU membership and the favourable opportunities than ever before. Apart from anything else, our active involvement in the European Union makes it extremely urgent to change the roles of the central government and the local governments: to establish of a converging, developing and service supplying state. This also seems to be a contradiction, since if we talk about self-support in slogans, and the main items of the budget represent the items of a supporting state, it is very difficult to decide what budget path may evolve in the longer run.

From the perspective of the European Union – compared to the practice of the older, more developed EU member states – it can hardly be argued that composing the regional and social institutional system at mezzo- and micro-levels (if I may say so) is still a task to complete. This is another reason for why the public finance reform should go together with the modernisation of public administration, or more broadly speaking: with the tasks inherent in the state reform. One cannot succeed without the other.

Probably we can agree – and perhaps you accept the opinion of a professional institute that relies on figures and documents – that it seems that we are not prepared enough for the shift in paradigm to be implemented in the use of budgetary funds as well as the radically changing task distribution among the central, local and regional levels.

Therefore, let me suggest in the debate on the budget that the rationalisation of the central public administration, as well as the development of regional public administration, and the renewal of the

local governmental system in line with the EU requirements should receive priority, and should not lack decisions made on the basis of a strategic approach and consensus. The concrete programmes of interrelated, coordinated steps and measures serving the changes have not yet been made or at least not known well enough in issues that would determine long-term, material and system changes.

The adaptiveness and competitiveness of the national economy will also strengthen as soon as Hungary can renew and make progress in this field, too, by adapting the EU's decision-making and funding mechanisms. However, compliance with the challenges of our age and the requirements of evolution following consolidation is hardly possible if intentionally or not we make public services uncertain, and make the system of state institutions regress driven by one-sided, short-term and austerity aspects.

On the contrary: we believe that catching up and development can only be achieved through budget security and transparency, as well as the modernisation of the state and public sector, and the modern rearrangement of constitutional rights related to the large supply systems, too. Public offices, civil servants and public employees play an indispensable part in this: administration is impossible without administrative organisations.

This is why I would like to close my exposé by calling your kind attention to the SAO experiences emphasised in our written material. These experiences, as well the lessons of our former audits highlight the fact that the reform-scale renewal of public finances – including the enforcement of budget security, discipline and responsibility – assumes the full-scale modernisation of the use of community funds, and the preparation of a new, comprehensive public finance act.

In extensive cooperation with the Ministry of Finance – and I can only indicate that in the process of preparing the budget bill we could meet the deadlines thanks to the extremely fair and good cooperation – the State Audit Office of Hungary must start work, on the basis of which the National Assembly could make use of the functioning of a public finance regulatory system of a new structure, representing a new way of thinking, and relying on the rules to a greater extent, and establishing various benchmarks. We intend to transfer the related suggestions and draft concepts to the National Assembly in the spring session, and then these issues will be solved, too.

I would like to indicate that we welcome remarks from the Minister of Finance regarding the utilisation of our suggestions. We believe that this helps reliance on our work... If you don't mind, I would close my exposé by saying that the point for every organisation and every individual is to know that their work is beneficial and sensible; i.e. they do not speak in an empty parliamentary session room, and the finance minister considers what they suggest.

Thank you very much for your attention.'