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The Fiscal Council in the Hungarian Fundamental Law

Sketch on the Development of the Institution and the European Union Practice

SUMMARY: In the first decade of the 2000s it became evident that in order to prevent the overspending of Hungarian budget management – which was quite detached from actual performance – executing the current budgets in a more disciplined manner was not enough. Regaining and maintaining financial stability became a strategic issue that required constitutional rules and high level legal norms relying on these rules to consistently regulate public finances. The initiatives directed at changing the situation became more and more valuable as indebtedness continued to intensify, and consolidation programmes failed. The consequences of the financial crisis that erupted in 2008 – leading to a situation bordering on sovereign default – also contributed to the making of a law on the rules of fiscal responsibility and its institutional guardian. Eventually public finances were given a worthy place in 2011 in the Fundamental Law, then the regulation was supported by the Stability Act enacted later at the year-end. The consistent enforcement of the Fundamental Law – enacted five years ago – has become a key guarantee of Hungarian financial stability. This study briefly summarises the antecedents of the regulation of public finances in the Fundamental Law, and describes the major considerations of Hungarian constitutional regulation and the related Stability Act, and the main characteristics of the work of the Fiscal Council. It briefly compares the conditions prevailing in Hungary with the similar regulations of other EU countries and the ways that tasks and institutions are interpreted by their independent fiscal institutions.

KEYWORDS: fiscal policy, crisis management, debt management, budgetary stability

JEL CODES: B15, E62, H15, H61, H63, L38, P48

In order to properly evaluate the significance and effects of the public finances texts¹ of our Fundamental Law – effective as of 25 April 2011 – and the provisions² of the consecutive Act CXCIV of 2011 on the Economic Stability of Hungary (the “Stability Act”), also promulgated in 2011, and to describe the operation of the Fiscal Council (the “Council” or “FC”), besides some interpretative notes we should also pay attention to the relevant

regulatory background as well as refer to international practice.

THE ROAD TO THE PUBLIC FINANCES CHAPTER OF OUR FUNDAMENTAL LAW

This study expressly deals with the development of the domestic operating model. We shall not judge whether the decisions of the fiscal councils operating between 2009–2010 or those operating since 2011, were professionally

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sound, nor shall we review their correlations with fiscal policies and especially not deal with concrete cases. The scope of this study does not allow us either to describe in more detail the large-scale regulatory, structural and organisational changes that transformed the operation of the public finances system as a whole after the entry in force of the Fundamental Law.

Interpretation of rule-based fiscal policy

The concept of “rule-based fiscal policy” means more than regulatory compliance regarding the preparation and execution of the central budget.³ *“Rule-based budgeting sets the framework of fiscal responsibility through the rules of procedures and transparency and the mechanisms of supervision and sanctioning.”* (Kutasi, 2012, p. 1). Essential elements of the system are as follows:

- fiscal policy rules, that determine balance targets and the planning requirements serving their achievement;
- rules of procedure, that ensure fiscal discipline and transparency (for example, impact assessments and obligations to issue opinions);
- transparency norms (for example, accrual-based accounting, financial reporting system);
- institutional guarantees to ensure the observance of budget policy and rules of procedure, embodied in institutional functions for the control and transparency of the processes.

The international experiences of the application of the system seemed to indicate that the trend showing in the past decades in quite many emerging and developed countries and embodied in budgetary overspending, an unsustainable budget and the growth of public debt, could be reversed. (Oblath – Szapáry,

2006) A rule-based budgeting and a financing that is built on it involves a better harmony of tasks and resources, and is clearly shown to moderate the cyclicity of the budget. (Kopits, 2013) The lessons of the crisis complemented this “classic function” with the conviction that the introduction of a rule-based fiscal policy can be one of the tools of crisis management. (Reinhart – Rogoff, 2010; Kovács, 2013) (See Figure 1)

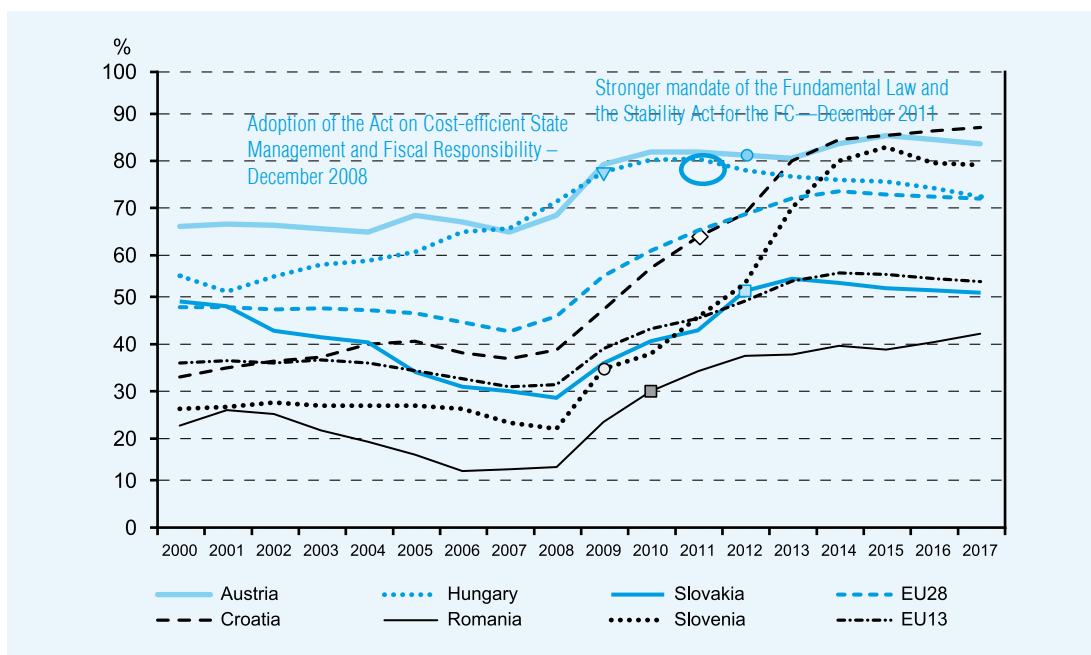
Domestic antecedents leading to the introduction of rule-based budgeting, the Act on Cost-efficient State Management and Fiscal Responsibility

Following the increasing problems of Hungarian public finances that destroyed the competitiveness of the real economy, in the second half of the last decade it became obvious for the trade forums, then for the policymakers that the budgeting practice prevailing since the economic transformation (planning built on bargaining mechanisms, political promises and dogmas) excludes the chance of following a path of sustainable development. (Antal, 2004; Csaba, 2007; Györffy, 2009)

Growth potential deteriorated; the so-called potential growth – calculated without one-off effects and the effect of external funds – was close to zero. Income-side, typically non-realised fiscal adjustments were made. (Kovács, O., 2013) Since the political and economic transformation, Hungarian fiscal processes have been determined primarily by election cycles, as opposed to other countries, where changes in the budget balance more or less followed economic cycles.⁴ (Karsai, 2006; Györffy, 2009) It only made matters worse that the attempts at fiscal consolidation lacked the system approach, the chosen development function proved counter-productive, and there

Figure 1

PUBLIC DEBT-TO-GDP RATIO IN SOME EUROPEAN COUNTRIES AND THE TIME OF ESTABLISHING THEIR INDEPENDENT FISCAL INSTITUTIONS



Note: the Czech Republic and Poland are missing from the diagram. The reason for this is that at the time of the economic transformation the level of public debt-to-GDP ratio in these countries – due to forced, political reasons – was rather low, therefore they did not consider it necessary to set up a fiscal institution independent of the government. Their public debt level has doubled since then, but it is still below the 60 percent Maastricht limit. The issue of setting up such an institution, however, is on the agenda in both countries.

Source: ECFIN, FC Secretariat

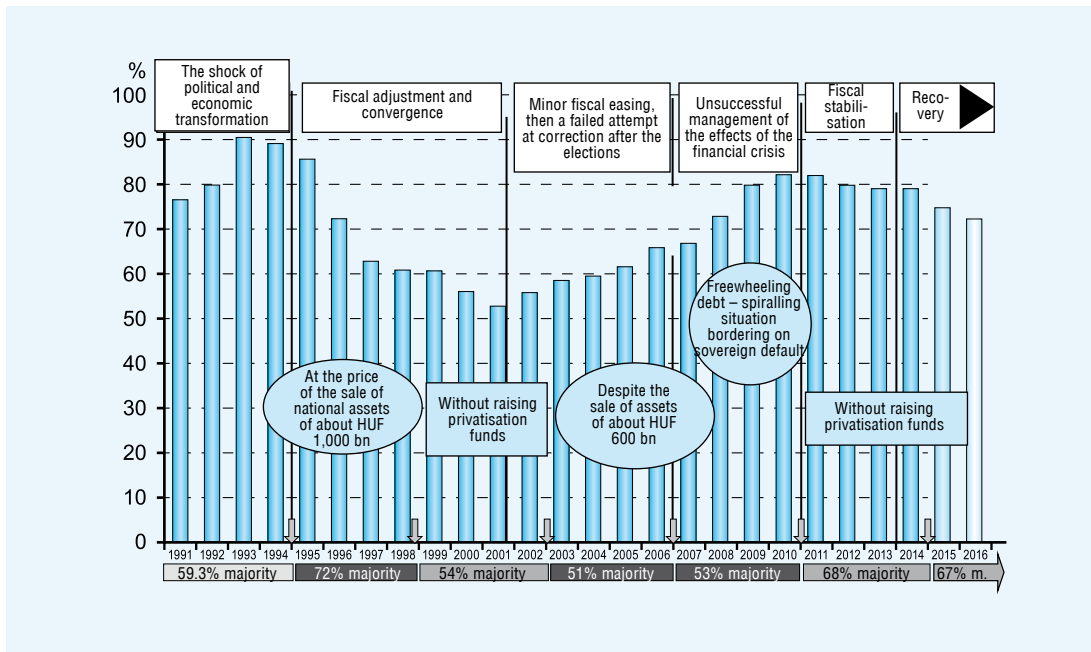
was no internal commitment regarding even how to reach the numerical deficit and debt targets. Budgetary expansion, balancing on the verge of fiscal unsustainability continued. (See Figure 2) And poorly substantiated planning in itself became one of the barriers to the disciplined execution of the budget. (Báger, 2006; Antal, 2004; Muraközy, 2011) It was this realisation that started the professional initiatives that urged the re-regulation of fiscal finances.

Thinking progressed – both as regards the nature of the rules and the institutional guarantees for their observance – in two directions, and the different views were confronted with each other at conferences and consultations.

One initiative was associated with the State Audit Office.⁵ The findings of the organisation proved that the leakage of public finances due to structural reasons or politically motivated overspending may not be remedied subsequently, by control means. In the wake of the many amendments, the regulation of the operation of public finances was fragmented, and its highest – constitutional – level was essentially missing. It was evident as a consequence that in order to achieve any substantial change the management of public finances as a whole must be rendered regulated, transparent and predictable. However, due to the political dividing lines and the circumstances of the coalition government – encumbered with internal

Figure 2

**CHANGES IN GOVERNMENT AND IN PUBLIC DEBT IN HUNGARY
(AS A PERCENTAGE OF GDP)**



Source: Hungarian Central Statistical Office, Ministry for National Economy, FC Secretariat

disputes – the agreement on the necessity and usefulness of a comprehensive re-regulation proved insufficient for the realisation.

The new professional initiative in the spring of 2006 was focused on the prevention of the most important cause of fiscal tensions, overspending,⁶ and considered the adaptation of the elements of so-called rule-based budgeting – an approach already applied successfully in international practice – expediential in the solution of domestic problems as well.⁷

In 2007 and 2008 an intense professional dispute developed on the major elements of its system of rules, and especially its institutional arrangements, which dispute moved more and more in the direction of concrete solutions. The proposal of the Ministry of Finance – as a kind of adaptation of the concept of the US Congressional Budget Office⁸ – wanted to set up a Parliamentary Budget Office.⁹ There were

long-continued discussions on the concept. According to its opponents, it failed to give an adequate answer to the fundamental question of how the indivisible policy-making authority and responsibility of government and Parliament can be reconciled with professional control. (Kovács, Á., 2007) According to other opponents, the critical precondition for the observance of the rules – that we manage to introduce the reform steps affecting the tax system and the big distribution systems in a “critical mass” – was missing. Besides, this view was considered problematic in terms of simplicity, transparency, feasibility and efficiency as well. (Kopits, 2007b)

After the proposal of the Ministry of Finance was abandoned, the view that set the introduction of a framework aimed at the moderation of the deficit bias and the prevention of overspending as its goals became

exclusive. Although there was agreement to the extent that it is an Independent Fiscal Institution (“IFI”) that could provide the adequate institutional guarantee of rule-based budgeting, there was a keen debate on the conditions for the professional foundations of its operation. There were two major proposals for the latter.

According to the initial view formulated in 2006, it is not another large-capacity team of macro-economic analysts that would guarantee that the body will provide substantial opinions. It is rather the experts themselves who are regarded on the basis of their careers worthy of functioning as the chairman or a member of the Hungarian IFI (envisaged to be called Fiscal Council). It was also thought to be helpful if the members at the same time head legally independent organisations of high social prestige (SAO, MNB), where analysing capacities are already available without any new, expensive developments.

According to the other idea – represented by the experts of the then government parties as well as the MNB and foreign (IMF) opinion leaders – it was the creation of an independent work organisation with significant macro-economic analysis capacities and reporting to the FC only that could adequately guarantee professionalism and “independence”.¹⁰

The question is whether the views concerning the professional background or legal status of the independent fiscal institution were based on some international (European) *best practice* or not. The answer is that no such “best practice” existed or exists either then or now. The ability of being an institutionalised guardian of the rules is important, and this can be implemented in the individual countries based on public law tools of different strength, relying on different values of trust and authenticity (prestige) and organisation-wise, differently associated professional support, using different public

law or institutional tools. This service may become a useful part of financial policy and fiscal practice (the annual implementation of financial policy) as the logical consequence of a framework and the consistent enforcement of its rules. The guarantees are to be interpreted together with the rules set up for controlling government deficit, the prevention of overspending or the limitation of investment expenditures (Benczes – Váradi, 2011), and the state structure and fiscal system of the given country. (Török, 2011) There are many examples in international practice where the analyses on which the decisions of a body are based are obtained from the business sector or from other independent institutions (audit office,¹¹ national bank¹², expert work group).

After long labour, at the end of 2008 the act on responsible fiscal management was enacted.¹³ The act put a limit to the increase of budget expenditures as compared to the GDP, based on so-called baseline projections.¹⁴ The making of the law may be regarded as a significant intermediary step on the path of regulation leading to a more cost-efficient and responsible domestic fiscal management.¹⁵

In the course of the reconciliations concerning the positioning within the state structure of the institution, acting as guardian of the rules, the sections of the law that would have given possibilities for sanctions and direct intervention to the FC gradually wore away.¹⁶ To enforce its opinion, the FC “*as most similar institutions, have [had] to resort to the tools of persuasion rather than compulsion*”. (Kopits – Romhányi, 2010, p. 573) At the same time, the new institution was given the opportunity to build a background organisation of significant capacities. According to the adopted regulation, “*as a kind of combination of the Swedish and American models, the work of the council that consisted of independent experts is [was] supported by their own team of professionals*.” (Kopits – Romhányi, 2010, p. 573)

THE MAJOR ELEMENTS OF RULE-BASED BUDGETING IN THE PUBLIC FINANCES CHAPTER OF OUR FUNDAMENTAL LAW; THE STABILITY ACT

The two-thirds mandate developing as a result of the Parliamentary elections of 2010 provided an opportunity for the recreation of the entire Hungarian legal system, including setting out the major rules of the previously mistreated public finances as constitutional requirements. For the creation of laws that constitute solid guarantees for fiscal stability, and in view for this, placing the operation and positioning of the independent fiscal institution (as a guardian of implementation) on new foundations, invest this body with mandates that enable it to coerce – where necessary – the observance of constitutional rules.

The act on fiscal responsibility and the changed conditions regarding politics and executive power

The opportunity for the all-inclusive re-regulation of finances with a system approach not only gave a chance to take steps towards the reduction of the deficit bias of the central budget, and resolve the daily operational problems of public finances (e.g. the indebtedness of local governments), but also provided an opportunity to radically transform the entire organisational system of planning, implementation and control and transcend the previous arrangement, which had been characterised by compromises and half-measures. The changes indicated the strengthening of the role and responsibility of the government in line with the “good government” concept. (STUMPF, 2014) At the same time, according to a study that may be regarded as the corporate opinion of the

Council, “*The government [...] could relinquish the preparation of macro-economic prognoses and the prognoses on all mandatory (tax and expenditure) items, or may as well delegate this activity to an external organisation. [...] The government could get rid of even the suspicion of political intervention if it gave over this task to a completely independent institution.*” (Kopits – Romhányi, 2010, p. 585) This declaration concerning the unity of financial decision authorities and responsibilities obviously differed from the government’s approach.

The government’s intention to change the – budget policy, procedural and institutional guarantee – norms of rule-based budgeting was motivated by several different factors. First, it was an express intention of government to set out the complete re-regulation of public finances, and the related major norms in so-called cardinal (two-thirds) acts. Second, the application of the “ceiling act” in practice forced the work organisation of the FC and the financial apparatus of the government to cooperate in the series of tasks connected to the macro issues of balance and at the same time to the micro problems of elementary budgeting in an interdependence that was doomed to malfunction even technically and in terms of the timely fulfilment of data requirements. Third, the declared opinion concerning the FC made it evident that the government had a radically different approach concerning the role and positioning of the institution.

The need for the re-regulation of the framework – in such a manner as is focused on the reduction of public debt-to-GDP ratio, subordinates the tasks of the FC to this and solves the professional foundation of corporate decisions (returning to the original concept) basically with the involvement of the analyst teams of the SAO and the National Bank of Hungary (MNB) – became prominent.

As the first step in the focus shift of the target system of rule-based budgeting, and

the transformation of the related institutional model, with the regulation made on the basis of the petitions of the members of Parliament submitted in the course of the debate on the 2011 annual budget and appearing in the annual budget act,¹⁷ the budgetary resources of the work organisation of the Council ceased to exist, then decision was made on changing the operational and procedural rules as well.¹⁸ The presidents of the SAO and the MNB became members of the FC on their own right,¹⁹ and the analyst teams of the institutions headed by them received an opportunity to provide professional support. (Domokos, 2012)

The public debt rule of the Fundamental Law and the Stability Act

The second, decisive step in placing the operation on new foundations was constituted by the Fundamental Law of Hungary, adopted on 18 April 2011, in so far as it put the reduction of the year-end ratio of public debt as compared with the gross national product in the centre of the budgetary policy by introducing the new so-called public debt rule and connecting it strongly to annual budgets.²⁰

The third step in the reformation of the Hungarian application of rule-based budgeting was the Stability Act adopted on 23 December 2011. This cardinal act gave a framework to the organisation, tasks, authorities and work of the FC.²¹ The Stability Act – focusing on combatting public debt – formed the enforcement of the budgetary policy target set out in the Fundamental Law into a procedural norm. It gave the Council – enabling it to enforce the observance of the public debt rule – as an “independent fiscal institution” a public law role in the process of drafting the annual budget act, or a “veto right” to put it simply, in so far as in addition to providing opinion

prior to the submission of the draft budget, the prior approval of the body is also needed for the closing vote of the budget bill.²² They can allow a budget bill to get to the closing vote only if it satisfies the requirement of the Fundamental Law concerning the reduction of public debt-to-GDP ratio.²³ If the FC refuses to grant its prior approval, the procedure has to be repeated until the proposal submitted to the body satisfies constitutional requirements, and the Fiscal Council gives its prior approval necessary for the acceptance of the bill.

This authority partly binds the work of the FC to the current central budgets, and partly guarantees that the Government will consider in merit the verbal comments of the Council made in the planning phase, then represented at the plenary session of the National Assembly. The requirement set out in the Stability Act that²⁴ every six months the Fiscal Council may make comments on the execution of the act on the central budget as well as on the expected change in public debt also serves the aim that the criteria of the annual budget as set out in the Fundamental Law and in the Stability Act are realised.

This extremely powerful public law mandate – unprecedented in international practice – that constitutes a precondition for the acceptance of the act on the central budget may only be exercised adequately if it is applied subject to a simple, clear and transparent set of rules, and the FC carries out its preparatory commenting work subordinated to these rules. Since 2012 these transparent regulatory conditions have been available, and the required analyst capacities are ensured based on the professional background of the SAO and the MNB,²⁵ (Domokos, 2012) and additionally, starting from 2013, the establishment of the FC secretariat, also through the cooperating external professional partners arranged in an increasing measure by the secretariat.²⁶

The SAO is one of the few European audit offices whose task has been for quite a long time to provide preliminary opinion in the course of the budgeting process, prior to the Parliamentary debate. It constitutes a synergy that the results and experiences of the audits of the SAO are built into the decision-making mechanism of the Fiscal Council in a systematic manner in. From this aspect it is very important that in the course of its audits the SAO monitors the budgeting processes during the year, and due to its risk analysis based planning system regularly checks the institutions that have significant impact on changes in the annual budget. (Domokos, 2015) The professional background work of the research units of the MNB which also analyse fiscal processes on a regular basis is similarly important. This work also assists the activities of the Council in so far as it forms a bridge as it were between monetary and fiscal correlations, and expands the horizon of the examination of financial relations.

The position of the operation of the Hungarian Fiscal Council among the independent fiscal institutions of the European Union

It is an issue affecting the budgeting practice of the countries of the European Union whether the role of IFIs analysing and evaluating the macro-economy and the state budget should prevail focusing on current budget balances and/or medium-term processes. Although these institutions make such forecasting analyses of different depth everywhere – technically using their own or external resources – the orientation or professional approach of these or the time horizon of their forecasts are far from being consistent. Similarly there are no uniform standards regarding whether these documents

are publicly disclosed or not, or whether they remain at the level of a work document or become the official position of the Council.

Experience shows the picture to be multi-coloured in this respect as well, even if there is a marked effort on behalf of the professional organisations of the EU to establish a more uniform practice. There are countries in the EU (for example the United Kingdom or the Netherlands) where even today forecasting is a traditional or regulatory mandatory task and an integral part of the tasks of the IFIs, and there are also countries where the IFI publishes such documents on an ad hoc basis, whenever it deems this justified (for example Portugal). Summary *tables No. 1 and No. 2* attached to this paper also show the various solutions.

The content orientation of the professional foundation of the decisions, their timing, current and/or medium-term perspective cannot be separated from the type of “mission” the body is assigned by the place of the independent fiscal institution of the given country within the state structure, or whether it enforces its opinion on the strength of its “prestige” or through licences stronger than that, and what this opinion is directed at. (Jan-kovics, 2012) In the majority of the countries of the European Union an attention-provoking, advisory type, macro-analytical, technical forecasting (projecting) work without direct consequences tends to be more typical, which may be reinforced – with limitations – by the association of the given institution with the audit office or the Parliament, with different levels of opinion-provision mandates. (Adema, 2008; P. Kiss, 2011) The “Hungarian arrangement”, with its direct public law mandate connected to the current (annual) budgeting process and the related responsibilities no doubt represents an extreme point, and transcends the practice prevailing in the majority of European Union countries.

Table 1

INDEPENDENT FISCAL INSTITUTIONS WATCHING OVER THE OBSERVANCE OF THE BUDGET ON 1ST JANUARY, 2016 IN THE MEMBER STATES OF THE EUROPEAN UNION EU-15 GROUP OF COUNTRIES*

	Country, date of introduction of fiscal rule	SE	UK	EZ	FR	DE	IE	PT	FI	DK	BE	AT**	NL	IT
		1997-98, 2007	1998, 2010	1998	2012	2010	2011	2012	2013	2010	1989	2013	1945	2012
Fiscal policy rule	Deficit limit			X		X	X	X						
	Structural surplus	X												
	Primary expenditure limit	X												
	Current balance		X											
	Average balance			X	X	X	X	X	X	X	X	X	X	X
	Efficiency analyses												X	
	Medium-term planning		X							X			X	
	Debt limit		X	X	X							X		
	Sustainability											X		X
Jurisdiction	Public finance	X	X	X	X	X	X	X	X	X	X	X	X	X
	National (central, federal)					X							X	
	Sub-national governments					X		X			X	X	X	
Basis of creation	Constitution					X								
	Law	X			X		X	X	X	X	X	X	X	X
	International agreement			X										
	Political, professional agreement	X	X											
Public law classification	Independent or parliamentary organisation	X	X	X	X	X	X	X	X	X	X	X	X	X
	Belongs to the executive branch of power													
Sanctions employed by IFI	Veto right													
	Loss of reputation	X	X		X	X	X	X	X	X	X	X	X	X
	Legal					X								
	Financial			X										

* The abbreviations of the individual countries: SE – Sweden, UK – United Kingdom, EZ – Euro-zone countries, FR – France, DE – Germany, IE – Ireland, PT – Portugal, FI – Finland, DK – Denmark, BE – Belgium, AT – Austria, NL – Netherlands, IT – Italy

** There are as many as two institutions in Austria, the Fiscalrat (Fiscal Council), based on the technical background of the Austrian central bank, and the Budgetdienst (Parliamentary Budget Office)

Source: authors' own editing

Table 2

INDEPENDENT FISCAL INSTITUTIONS WATCHING OVER THE OBSERVANCE OF THE BUDGET ON 1 JANUARY 2016 IN THE MEMBER STATES OF THE EUROPEAN UNION* – IFIS OF THE COUNTRIES ACCESSED IN THE 2004–2013 PHASE OF ENLARGEMENT

Country, date of introduction of fiscal rule		BG	EE	PL**	LV	HU	HR	RO	SK	SL
		1998	1998	1998	1990	2009	2011	2010	2012	2009
Fiscal policy rule	Deficit limit	X								
	Stabilisation Fund	X	X							
	Total expenditure limit	X								
	Average balance		X	X	X		X	X	X	X
	Debt limit			X		X	X	X	X	X
	Sustainability									X
Jurisdiction	Public finance	X	X	X	X	X	X	X	X	X
	National (central, federal)					X				
	Sub-national governments			X						
Basis of creation	Constitution			X		X			X	
	Law				X	X		X		X
	Political, professional agreement	X	X				X			
Public law classification	Independent or parliamentary organisation	X	X		X	X	X	X	X	X
	Belongs to the executive branch of power			X						
Sanctions employed by IFI	Veto right					X				
	Loss of reputation	X	X	X	X	X	X	X	X	X
	Legal			X	X	X				

* The abbreviations of the individual countries: BG – Bulgaria, EE – Estonia, PL – Poland, LV- Latvia, HU – Hungary, HR – Croatia, RO – Romania, SK – Slovakia, SL - Slovenia

** Operating as a government institution, the IFI of Poland has been “admitted” among these institutions in essence by the OECD in so far as it is invited to conferences; however, it is not regarded by the EU as an independent fiscal institution, and it is not invited to so-called ECFIN meetings.

Source: authors’ own editing

The recommendations of the EU Commission in the first years following the model change of 2011 demanded the “analysing capacities” of the Hungarian FC to be “strengthened”, as well as the preparation of medium-term forecasts. It should be mentioned in connection with this – recently fading – demand²⁷ that there are no regulatory barriers even today to the preparation of medium-term forecasts or their publication as the corporate opinion of the FC,²⁸ and the established practice is based on the FC’s own decision and its interpretation of the tasks deduced from the Stability Act. It starts from the fact that the public law mandate connected to commenting on annual budgets and on their incidental interim changes requires the body to deal primarily with stability risks at the horizon of the current and the following year, and to utilise the knowledge arising from medium-term outlooks and forecasts also starting from the system of interests and criteria of this perspective. Accordingly, the Council also utilises the medium-term macro-economic forecasts prepared by the analyst teams of the SAO and the MNB as well as of external experts²⁹, but does not raise these to the level of alternative corporate forecasts.

Thus the analyses supporting the work of the Council have a double time horizon. Partly as regards their main emphasis they are related to the planning and execution of the current budgets, and partly the medium-term sustainability analyses and macro-economic forecasts – as expert work materials – serve to support these. Therefore these latter do not serve as an operative goal, but as means.

Of course this approach also excludes the FC – apart from preparing risk analyses on the fulfilment of revenues – to express its opinion on direct distribution policy or tax policy issues. At the same time, according to the professional organisations of the EU, the ideal task list of IFIs in the long run should contain not only the preparation of regular, indepen-

dent forecasts, but also the more important recommendations regarding the evaluation of governmental impact studies concerning policy recommendations (for example, tax laws), and/or preparing white papers, and the regular and standardised ex-post control of the observance of numerical rules (for the time being there is only ex ante control). This requirement shows the intention to significantly enlarge the professional function of independent fiscal institutions.

One of the reasons for the differences in approaches is that while the opinion of the EU Commission regarding the functioning of the individual fiscal councils relies on the contents of the EU’s Stability and Growth Pact, the operation of the FCs is based on national regulations. (Ódor, 2014) Of course these differences regarding in the interpretation of regulation and tasks do not exclude the FC from acting as a body to deal with the regulation development tasks arising in the course of the application of the Stability Act. Among these, the series of initiatives in 2014–2015 concerning the change of the so-called public debt rule of the Stability Act were predominant³⁰, when – having noted the indications of the SAO and the MNB³¹ as well as different expert opinions – the Council understood³² that the 2011 solution was going to become counter-productive as of 2016.³³ Finally the National Assembly – enforcing the opinion of the FC as well – set out a new regulation in the Stability Act.³⁴

The operation and decision mechanism of independent fiscal institutions correlates with the public law position and headcount of the FC and the professional support and/or organisational capacities associated with them. According to the requirement of the Stability Act,³⁵ for the three-member body of the Council to make a valid resolution, the agreement of two members is needed. The materials embodying the experiences

of the SAO and the MNB and their special analyses connected to FC decisions, as well as the papers of “external” experts – following preparations by the secretariat of the FC – will prevail in the opinion of the body. It should be emphasised that since the creation of the Stability Act the FC has been able to represent a uniform opinion at all times irrespective of the persons it was composed of³⁶.

The operation of the new system of rules and institutions requires resources and those resources can come only from the budget. In the practice of the other EU countries as well, effort is made to reduce the operating costs of the professional background capacities of the IFI. It is typical that the analyst teams operating in the background – which used to have more members previously – today tend to be smaller, and where possible, external analyst capacities are also used more often against the background provided by the base institutions of the IFIs.³⁷ Since 2012, the framework of the Stability Act has corresponded to the effort for the minimisation of costs, and the FC is exempted from the technical obligations of independent economy.³⁸

SUMMARY: SIGNIFICANCE AND FORWARD-LOOKING CHARACTER OF THE NEW REGULATION OF PUBLIC FINANCES

The favourable effect of the fiscal framework has also showed in the fact that through the introduction of financial rules and the efficient operation of the IFIs deficit problems have started to resolve. (Ódor, 2014) It can be seen from the diagram showing changes in the public debt ratio and the operation of independent fiscal institutions, and the tables summarising their operational features, that there is a definite correlation between the strength of the public law positions of IFIs and the success of anti-indebtedness ef-

forts. The Hungarian practice thus proves the premise of the European Union that regards the so-called numerical and procedural rules, and the institutions watching over the observance of such rules as one of the most effective tools of maintaining fiscal discipline and cost-efficient state management. (Besley – Scott, 2010; Franco, D., 2011) The domestic experiences of easing the new concerns caused by the crisis also prove that there is a correlation between the maintenance of financial stability and the consistent and adaptive application of a rule-based fiscal framework, where national characteristics are also taken into account. (Kovács Á., 2014) It should also be emphasised, though, that this contribution in itself would be insufficient to ensure financial stability. There are numerous factors and agents to maintaining financial stability successfully. Above all the disciplined fiscal policy of the Government, the control function of the audit office, which was renewed and received wider opportunities in 2011, and indirectly, through its boosting mechanisms, a more efficient monetary policy. (Domokos at al., 2015)

All this highlights the significance of the creation and application of the public finances chapter of the Fundamental Law and the Stability Act. For this reason also, it would be unjust to summarise the past five years and review the operation of the Fiscal Council by listing the decisions of the FC and detailing their content. Or to discuss how the Government responded to the risk signals (which decreased in number and weight in the wake of the results) included in these decisions, to the proposal for changing the macro-economic course of the budget, or to the occasional refusal of consent to the closing vote. Or to describe how the National Assembly took all this, and how many analyses have been prepared by the SAO, the MNB, or by researchers that assisted the body in making informed decisions, and what kind of interest has been triggered

by the publicity of the relevant resolutions at the different conferences and in the media. What is more, it is not decisively significant even from the perspective of the result, i.e. direct contribution to the creation and maintenance of domestic financial stability how the bilateral relationships of the Council have developed with the independent fiscal institutions of other countries, or with the committees of the OECD and the EU. However, indirect support led to building trust by the exchange of professional opinions, and by increasing awareness of the Hungarian system of rules and institutional operation after 2011.

The work of the Fiscal Council safeguarding the observance of the requirements of rule-based budgeting by applying a process focus has become an integral and unavoidable part of today's Hungarian fiscal management, which is much more important than the quantitative data characterising the work – and possibly even the methodology features related to the professional substantiation of

FC resolutions. Its efficiency, related to the simplicity of the framework provided by the Fundamental Law, then of the regulation, and the operation of the chosen institutional arrangement, have all contributed to the results embodied in the balanced operation of Hungarian public finances, the maintenance of the deficit well below the Maastricht criteria, the decrease of the public debt ratio, and the simultaneous implementation of stability and growth.

Renewed five years ago, the “Hungarian model” of the rule-based budgeting framework will be able to operate successfully in the ensuing years as well, and not only due to its severe requirements, simple and transparent principles focused on the combat against public debt, and strong mandates for watching over their observance, but also due to its solutions adjusted to the European practice, its overspending bias moderating impact, its attitude shaping and trust building force and durability.

NOTES

¹ Article N (1) of the Foundation chapter of our Fundamental Law (“Hungary shall observe the principle of balanced, transparent and sustainable budget management.”) and Articles 36, 37 and 44 concerning public finances of its chapter “The State”.

² Act CXCIV of 2011 on the Economic Stability of Hungary

³ The Maastricht criteria may as well be regarded as “numerical and procedural rules” to be applied in an obligatory and uniform manner. Let us just consider the 3 percent deficit limit, or the 60 percent public debt-to-GDP ratio target, and the mandatory reduction of the excess by 1/20 per year that is supposed to lead to this target, as well as the European Fiscal Board, an independent fiscal institution of the

EU Commission set up with an advisory function in 2015 for the countries of the euro area. This body failed to start operation even after a year.

⁴ Gábor Karsai wrote in 2006: “... based on economic processes and the economic policy followed, the years under review [...] can be divided into clearly defined periods. Essentially it means that a stimulating, consumption-oriented, artificially anti-inflationary and consequently destabilising economic policy preceding the Parliamentary elections is followed by inevitable correction after the elections.” Karsai (2006)

⁵ The Parliament discussed the proposal at special committee level, and expressed its appreciation, but no concrete regulatory measures were taken, nor were the recommendations enforced.

- ⁶ The conference that hallmarked the start of the work was organised by the SAO and the MNB, and took place on 19 May 2006, between the two rounds of the Parliamentary elections, with the participation of Jacques de Larosière, former head of the IMF and the EBRD, and other foreign experts.
- ⁷ There were differences within the “mainstream” as well; whereas Gábor Orbán and György Szapáry proposed a fiscal council that was to make fiscal policy decisions, Balázs Romhányi and György Kopits proposed “a solution already working in several countries”, an institution “limited to supervision”. (Orbán – Szapáry, 2006; Romhányi, 2007; Kopits, 2007a; Kopits, 2007b)
- ⁸ “The government showed any interest in setting up a rule-based framework only one year later.” Kopits – Romhányi (2010) p. 576 The Congressional Budget Office (CBO) of the United States – which was taken as an example – as an independent federal institution is connected to the legislation of the US and operates with the goal of supplying the US Congress with fiscal and economic information. The mission of the CBO is to supply objective analyses and prognoses devoid of any political influence in order to support economic and fiscal decisions in respect of the federal budget to the Congress in the latter’s budgeting procedure.
- ⁹ In April 2007, at the conference organised by the Ministry of Finance and the MNB, the then head of government announced that – in light of the previous year’s poor fiscal performance and the low level of trustworthiness – he thought it necessary to introduce a rule-based framework. After this, in June the Ministry of Finance published the concept of a law on fiscal responsibility and the Parliamentary Budget Office (OKH).
- ¹⁰ Exponents of this view wanted to preserve the independence of the FC also by keeping it separate from other organisations independent of the government that participated in the external control of the substantiation of the preparation of the budget, first of all from the SAO. (Kopits, 2007a, 2007b)
- ¹¹ Among the countries of the European Union France, Lithuania, Latvia and Finland chose their audit offices as a background to build on.
- ¹² For example the Austrian and Slovakian IFI.
- ¹³ According to Act LXXV of 2008 on Cost-efficient State Management and Fiscal Responsibility, the major professional tasks of the FC were to prepare macro-economic forecasts, baseline projections for the budget figures and methodological recommendations relating to fiscal planning, forecasting and impact assessment. Also to prepare estimates, both following submission to Parliament and before the final vote, concerning the fiscal effects of the budget bills and supplementary budget bills as well as any other bills discussed by Parliament that may have an impact on the development of mandatory items.
- ¹⁴ The complexity of the fiscal policy rules of Act LXXV of 2008 concerning the central subsystem are indicated among others by the following issues. In the central budget the requirement of the balance of discretionary items for the year following the target year had to be specified. Based on the baseline projection for the mandatory items, the nominal value of the primary surplus could not be less than the primary balance target specified, in the previous year, for the year following the target year. The annual budget act also had to determine the primary balance target for the second year following the subject year in such manner that the primary balance target could not be a primary deficit. The real value of the government debt at the end of the second year following the subject year could not be expected to exceed the value of the government debt expected for the end of the year following the subject year, and also the real value of the government debt at the end of the second year following the subject year could not be expected to exceed

the value of the government debt at the end of the second year preceding the subject year. According to the transitional provisions of the act, the value of the primary expenditure total of the central subsystem of the legal government budgeted for 2009 could not exceed the value budgeted for 2008. For years 2010 and 2011, the Government had to submit a Budget Bill that assured that the budgeted value of the adjusted primary expenditure total of the central subsystem of the legal government, in real terms, increased over the value budgeted for the previous year and calculated in the same manner by no more than fifty percent of the expected growth rate of the gross domestic product in real terms.

¹⁵ The members of the Fiscal Council were elected by Parliament in February 2009, and the Council started its operation in June 2009.

¹⁶ For example one of the initiatives proposed that in case the budget of any given year should significantly differ from the figures adopted by Parliament, then – depending on the measure of the difference – the ministers should have financial liability. www.jogiforum.hu/hirek/19018

¹⁷ Act CLXIX of 2010

¹⁸ According to the new statutory conditions, the FC had an opportunity to express its opinion on the budget bill, as well as on the annual budget act adopted by Parliament, adopted by the President of the Republic, or waiting for the signature of the President of the Republic, or propose to the head of state to send it back to Parliament for consideration. On the basis of the transitional regulation, the newly formulated FC made two resolutions by the entry in force on 1 January 2012 of the Fundamental Law and the Act on the Economic Stability of Hungary. It provided its opinion – with a majority decision – on the budget bill of year 2012, then – unanimously – supported the final version of the annual budget developed at the closing vote of the budget. FC (2011a, 2011b)

¹⁹ Although he could have remained in office until the expiry of his mandate, the chairman of the Council resigned after the entry in force of the regulation.

²⁰ According to the Fundamental Law, as long as public debt exceeds half of the gross domestic product, the National Assembly may only adopt a central budget which provides for state debt reduction in proportion to the gross domestic product.

²¹ Some rules set out in the act were modernised in 2012 and in 2015; however, these did not affect the tasks and authorities or principles of operation arising from the Fundamental Law and set out in the Stability Act. These amendments were directed at the clear applicability of the public debt rule, the creation of a secretariat with an organisation function to assist the work of the Council, and the public law status of the chairman of the Council.

²² According to Art. 23 (1) of the Stability Act, the Council a) shall, in harmony with the provisions stipulated in Art. 44 (2) of the Fundamental Law, make comments on the draft of the Act on the Central Budget, and b) shall make decisions concerning the prior approval mentioned in Art. 44 (3) of the Fundamental Law.

²³ Article 36 of the Fundamental Law: “(4) The National Assembly may not adopt an Act on the central budget as a result of which state debt would exceed half of the Gross Domestic Product. (5) As long as state debt exceeds half of the Gross Domestic Product, the National Assembly may only adopt an Act on the central budget which provides for state debt reduction in proportion to the Gross Domestic Product.”

²⁴ Art. 23 (1) c) of the Stability Act

²⁵ The SAO and the MNB supports the FC not only by sharing their experiences, but also with special

analyses connected to FC decisions in accordance with the Stability Act. With the studies prepared by them, they have managed to make the commenting work of the Council supported from many sides. These special analyses are directed at checking the compliance of the drafts of the annual budget bills and the uniform budget bill with the public debt rule, as well as the evaluation of the semi-annual processes of the budgeting processes.

²⁶ Now consisting of 6 persons, and performing an organisational function, the FC Secretariat was created on the basis of Art. 18 (8) of the Stability Act (which paragraph was established with Act CCXLI of 2012). Starting from 2013, besides the various analyses of the SAO and the MNB, each year studies representing different approaches and examining macro-economic processes in different dimensions and with different time horizons are also prepared. In 2013 three, in 2014 six, in 2015 again six, and in 2016 seven such papers were (or are being) made. Considering the number of SAO and MNB researchers, together with the people carrying out analyses on a commission basis, a professional background of about 100 persons – adapting flexibly to current or medium-term perspectives – is available to the Council. Upon the request of the Budgeting and Audit Office Committee of the National Assembly, monthly and quarterly summaries are also prepared in FC competence.

²⁷ Criticism was primarily fuelled by the notion that the extremely strong public law position justifies the higher professional expectations. (European Commission SWD(2012) 317 final, SWD(2014) 418 final, SWD(2015) 36 final, 2013/C 217/10)

²⁸ Art. 23 (1) e) of the Stability Act

²⁹ The publicity of these documents is also ensured, they are available on the website of the SC.

³⁰ The original rule of the Stability Act provided that in case the real growth of inflation prognosticated

for the fiscal year and of the gross domestic product both exceed 3 percent, then the value of the debt of the state budget planned in the act on the central budget for the last day of the fiscal year should be determined so that the growth rate of public debt planned on this basis as compared with the previous year should not exceed half the difference between the real growth of inflation specified in the act on the central budget and expected for the fiscal year and the real growth of the gross domestic product.

³¹ The Council wrote several letters to the Government, and the SAO and the MNB also demonstrated in professional analyses that the regulation is unsustainable.

³² Valuable professional debate was also conducted on the applicability of the indicator. (Balatoni – Tóth, G., 2012)

³³ Enforcement of the rule would have made several, socio-politically unacceptable budget austerity measures necessary by 2016.

³⁴ The following alternative requirement was added to the rule: in case at least one of the real growth of inflation prognosticated for the fiscal year or the real growth of gross domestic product does not exceed 3 percent, then the value of the debt of the state budget planned in the act on the central budget for the last day of the fiscal year should be determined so that the decrease of the public debt ratio as compared with the base year should reach at least 0.1 percentage point.

³⁵ Art. 23–27 of the Stability Act, Decision No. 3/2012.06.08 of the FC (Bylaws), Sections 4–5

³⁶ As presidents of the MNB, until 3 March 2013 András Simor, and after that György Matolcsy, who are well-known to represent different economic and monetary policy concepts, were both members of the FC.

- ³⁷ According to information from conferences organised by ECFIN (Directorate General for Economic and Financial Affairs of the European Commission), it is a general endeavour of the institutions working with a large staff as their own background support (40 to 60 people) to cut back on the internal staff significantly (as much as to half or one-third) and solve a growing proportion of their tasks by involving external experts and analyst organisations.
- ³⁸ Art. 18 (8) of the Stability Act, Decision No. 3/2012.06.08 of the FC (Bylaws), Section 1.2

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