The Factors Determining the Macroeconomic Environment of the 2012 Budget

Academic Conference of the Research Institute of the State Audit Office of Hungary

On May 26, 2011, the Research Institute of the State Audit Office of Hungary (RIHSAO) held an academic conference titled *The Factors Determining the Macroeconomic Environment of the 2012 Budget*. The objective of the conference was to prepare the decision of the Fiscal Council due in the fall of 2011 impacting the 2012 draft budget. Nine lectures were given at the conference, where domestically and internationally recognized researchers presented their views. All three members of the Fiscal Council attended the conference. Two of them – *Zsigmond Járai* and *András Simor* – gave presentations and presiding chair of the conference was *László Domokos*, President of the State Audit Office.

Zsigmond Járai, President of the Fiscal Council gave a lecture on the state of Hungarian economy and economic policy, as well as the responsibilities, tasks and situation of the reformed Fiscal Council. In his view, putting the budget in order is underway; one-off and long-term steps have been taken, the simplification of the taxation system, the reduction of public debt and the cutting back of red tape has begun. The work, however, is far from over: education should be made more efficient, corruption must be clamped down, the domestic small and medium enterprises (SME) sector must be stimulated, the Hungarian banking sector must be developed and the structural transformation of the budget should also be performed. In his view, one of the most important tasks is to strengthen confidence and capital attraction, as the only way to create jobs is through investment which in turn requires capital. As he said in his presentation: strict fiscal regulations are required and the fact that such regulations are now in the Constitution is a development to welcome. At the same time, he also said that in his opinion it is a misconception that the Fiscal Council 'makes' the budget as it is not the Council's responsibility to decide what the budget will be like. A good budget first and foremost requires good governance – the president of the Fiscal Council emphasized.

In his presentation, András Simor, President of the Hungarian National Bank and member of the Fiscal Council gave an overview of the Hungarian macroeconomic situation and presented the estimates of the central bank. He elaborated on the fact that the Fiscal Council has particularly strong mandates which the Council must live up to, namely through independent, transparent and expedient operation as well as the provision of professionally sound opinions. He said that independence must not only mean independence from other government bodies, but also independence among

Council members which for the moment does not exist. Given the fact that the SAO audits the MNB and the president of the Council is the president of the Supervisory Board of the central bank, who thus also audits the central bank, while the SAO also has the right to audit the Supervisory Board of the MNB. The central bank will prepare several analyses which Fiscal Council members will be able to use. These will include a mid-term outlook which will contribute to the planning of the next budgetary strategy by examining the fiscal effects of relevant legislation. *(The study dealing with the lecture is found on page 307)*

István György Tóth, Director of Tárki gave a lecture titled *Income Distribution, Social Cohesion and Value Structure: The Framework Conditions of Economic Prosperity*. The researcher underlined the fact that Hungary needs active social policy, expanding employment, a balanced budget as well as an open and experimenting social policy. He emphasized that the expansion of employment has outstanding significance, particularly among those with low educational levels and those who are inactive. A basic improvement is required in terms of schooling, selectivity must be decreased, which in turn means that the amount of educational expenditure is not the most important policy issue at the moment. In his opinion, the national administration requires feedback during measurement and the planning of socio-political measures. He said: The distribution of incomes was mostly determined by the structural reforms and decreasing employment levels between 1987 and 1992, by the expansion of qualified people within society and technological change between 1992 and 2001, and finally by economic and social policy between 2001 and 2009. The welfare regime change benefited the lower middle classes and public servants, whereas the consolidation that took place between 2006 and 2008 caused great losses for the upper middle classes. In addition, the 2008–2009 crisis management had a detrimental effect on the lowest classes and the wealthiest 10% of the population, although to a lesser extent in the latter case. In his view, the most important trend during the crisis was the growth of poverty and inequality, and that 'labour market sclerosis' still exists. *(The study dealing with the lecture is found on page 379)*

In his lecture titled *Preparation by the SAO for the Analysis of the Macroeconomic Risks of the Budget*, Gyula Pulay, Director General of the RIHSAO emphasised that due to the transformation of the Fiscal Council the knowledge of the SAO and the knowledge acquired in the course of audits must be included in the decision-making process. The researcher also presented the methodology of the budgetary risk analysis prepared by the RIHSAO. The essence of budgetary risk analysis is the analysis of the government's macroeconomic projection, where the objective is to filter out points of risk and to examine consistency. Its starting point is the determination of trends for processes that determine budget revenues, followed by the identification of exogenous and endogenous (government) factors that impact this. According to the analysis, risk exists if deviation from the trend is not explained by external or internal factors. The study presenting budgetary risk analysis is a general overview which determines and quantifies risks. For this reason, adherence to the current budget and the reliability of the basis data must be assessed. *(The study dealing with the lecture is found on page 331)*

In his lecture, academician Attila Chikán presented the development of competitiveness and came to the conclusion that Hungary's competitiveness is insufficient and comprehensive changes are needed. The government has recognized the need for such changes and is moving in a positive direction, however, there are significant risks and measures taken until now have been contradicting. He pointed out that the role of small and medium-sized enterprises (SMEs) is increasing in national competition, and that while measures taken in connection with small-size companies are pointing in the right direction, their impact has yet to be really felt. The professor of the Corvinus University of Budapest called attention to the fact that according to 2011 data, Hungary has dropped five places on IMD's World Competitiveness Scoreboard. Hungarian competitiveness has deteriorated on all fronts, the worst performers being business and government efficiency. In his opinion, competitiveness is a complex issue and economic policy does not give it the attention it deserves: being competitive means more than what the governments are able to put into words; traditions, history and international habits and practices are also significant in this respect. The professor underlined that in order to improve competitiveness, the scale of values and culture must also change, but the appropriate management of the problem of the budget and public debt as well as the ensuring of stability and the transformation of the economic structure is also important. In his view, Hungary does not have an employment problem, but rather a problem of employability.

György Localiszky, Dean of the Faculty of Economics of the University of Miskolc and member of the Monetary Council of the Hungarian National Bank held a presentation titled "*Is it Possible to Curb the Expansion of Regional Disparity? – Results of the Transition, Conditions of Convergence*". According to the professor, regional differences in Hungary are continuously increasing, which shows that regional policy could not fulfil its function and that by now, the breaking away of peripheral regions has become an unstoppable process. Regional policy was unsuccessful and was unable to achieve even as little as relative convergence, meaning that it was unable to put the given region, county on their own distinctive development path. The presented data to support his thesis that regional differences have become more marked in Hungary between 1995 and 2009, the gap between the centre and the periphery has become wider in terms of almost all of the relevant indicators. Regional disparities have doubled in Hungary over the last 15 years. This meant that while development was practically uninterrupted in Budapest, the situation of counties on the periphery did not change substantially in terms of per capita GDP at purchasing power parity. The monthly income of more than 700 thousand people does not reach HUF five thousand. The Human Development Index of one tenth of the population in Hungary's microregions was reminiscent of the "third world". *(The study dealing with the lecture is found on page 320)*

András Inotai, Director of the Institute for World Economics of the Hungarian Academy of Sciences, in his lecture presented the changes of the international environment. He felt the world had only managed to weather the financial storm of the economic crisis, and that it was already apparent that the developing, emerging countries were the clear winners of the crisis. The Hungarian economy is an open economy, and the issue of openness must be treated by securing new markets: there is potential in the Chinese, Russian markets as well as the markets of the developing countries. However, Hungarian economic policy must also bear in mind that 70 percent of Hungarian exports are geared towards the European Union. According to Inotai, much greater emphasis should be placed on cooperation with multinationals and it is also important to determine how to increase added value and how to eliminate the duality of the Hungarian economy. EU funds should be used to develop exports, join multinational networks, offset imports and improve competitiveness – underscored the researcher. He emphasised that even the best economic policies run aground if society refuses to take an active part in the processes. *(The study dealing with the lecture is found on page 360)*

KÁROLY FAZEKAS, Director of the Institute of Economics of the Hungarian Academy of Sciences, in his lecture titled *On the Development of Factors Determining the Expansion of Employment* gave an overview of the current situation of the Hungarian labour market. He emphasised that extraordinarily low employment levels, polarised society, cumulative disadvantages and uncertainty are equally and simultaneously typical of Hungary. As he pointed out, employment level of people without school leaving examinations in Hungary is the fifth lowest in the European Union and it says a lot that there are former Socialist countries at the bottom of this list. Regional polarisation has also increased significantly: only public works programs were able to reverse polarisation, but only for the term of these programs; in essence no lasting effect was achieved – he added. In his opinion, the long-term unemployed and people with limited education are continuously being squeezed out of the labour market, and it is still unclear what real effect the recent job retention programs have had. *(The study dealing with the lecture will be published in the next issue of the Public Finance Quarterly.)*

ERZSÉBET GÉM, Chief Economist of the Hungarian Development Bank (MFB) gave a lecture titled *The Development of Internal Demand and Bank Lending* and said: The lack of the acceleration of the Hungarian banking industry and lending slowed down the recovery of the Hungarian economy, while both credit demand and credit supply have been limited. In her opinion, the fact that banks are still tightening their lending conditions, while a widening range of companies are planning to apply for loans, is causing serious tension. Her lecture revealed that practically half of micro companies and three quarters of large corporations are planning to borrow over the course of the coming year. Although Hungary's growth rate puts the country in the mid-range in the European Union, in the region its lag is considerable – she added. The consumption rates of Hungarian households have been on the rise until the end of 2003, followed by a period of reduction, once again followed by repeated growth in the wake of the 2006 elections. "The consolidation of public finances pushed both consumption and investments down", said Erzsébet Gém, pointing out that in the 4th quarter of last year the reduction of investment projects accelerated to near 8 percent. She emphasised that the government must be successful in stimulating internal demand. Government measures in 2010 are considered significant steps from this aspect, however, it is yet unclear what the impact of these measures will be. *(The study dealing with the lecture is found on page 345)*

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The lectures and presentations given at the RIHSAO conference covered all important areas that determine 2012 budgetary processes: the lecturers presented the Hungarian macroeconomic situation and its outlooks, the changes of foreign markets, the development of broadly interpreted competitiveness, budgetary risks, and amidst what labour market and social processes the government must prepare a budget that meets the debt decreasing provisions of the Constitution. Several participants indicated that further analyses, research and preliminary work are needed in order to enable the Fiscal Council to make a responsible decision in the autumn of 2011 about the 2012 draft budget.

Pál Péter Kolozsi
Email address: kolozsipp@asz.hu