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Major conclusions from the macroeconomic risk analysis of the 2009 budget bill

Every year, the State Audit Office (SAO) gives an opinion on the budget bill, examining if the planning methods applied and the amendments proposed by the regulators back up the implementation of the main appropriations of the budget bill.

THE ANTECEDENTS OF THE RISK ANALYSIS STUDY OF THE YEAR 2009

When working out its opinion on the 2008 budget, the State Audit Office Research and Development Institute (SAO-RDI) made an evaluative study on the macroeconomic foundations of the bill in October 2007, so as to point out to the National Assembly the risks involved in the bill. *The study put at the disposal of the National Assembly in October 2007 and utilised in the budget debate established the following risks of considerable significance:*

- in the year 2008, the economic growth rate will fall short of government predictions by a few tenths per cent and, from 2009 on, GDP growth will accelerate less dynamically;
- in 2008, inflation will significantly exceed the level predicted by the government;
- the growth of gross average earnings in the competition sphere will significantly exceed the level taken as a basis when making the predictions.

Considering these three factors, the study by SAO-RDI also formulated numerical values, which thus can be compared to those in the autumn 2007 and autumn 2008 predictions of the Ministry of Finance (MF). These data are summarised in *Table 1*. As the table reveals, *the risks disclosed by the SAO-RDI study were so real that they did in fact come true in 2008*. The direction of divergence from government predictions was established correctly in all the three cases.

Despite the fact that the risks indicated in the study actually became reality, it is important to underline that what *SAO-RDI prepares is not actual macroeconomic predictions but a budget risk analysis*. This takes government predictions as a basis and examines, compared to the former, changes of what size, in which direction and at what likelihood are probable to take place. The aim of the analysis is to reveal the dangers (chances) that are of high likelihood and which may cause considerable divergence from the government predictions, i.e. which involve risks in attaining some important budget objective. Accordingly, risks analyses, too, include predictions. These are, however, not individual predictions on respective macroeconomic parameters (e.g. inflation) but the values of estimated divergence from government predictions. The worked out methodology of

Table 1

THE RISKS PREDICTED BY SAO-RDI AND THEIR LIKELY REALISATION IN 2008

Description	MF, October 2007	SAO-RDI, October 2007	MF, September 2008
GDP volume index	2.8	2.4	2.4
Inflation rate	4.5	5.5	6.5
Gross average earnings	5.4	6.5 – 7.0	8.6

macroeconomic budget analysis has been published in various professional journals – including the *Public Finance Quarterly* – in 2008.

The experience of the debate on the first macro study shows that *macroeconomic risk analysis may be an important method of preparing an opinion on the budget bill*. It has also become clear, at the same time, that in this phase of budgeting, there is insufficient time already to look for less risky alternatives. Considering this, it was at the expected time of the publication of the government's budget principles, in May 2008, that the president of SAO presented the new evaluative study of SAO-RDI on a few correlations of the macroeconomic scope of budget planning for 2009 to the National Assembly.

STUDY ON THE MACROECONOMIC RISKS OF THE 2009 BUDGET

In October 2008, SAO-RDI made its third macroeconomic study, drawing the attention of the National Assembly to the macroeconomic risks related to the 2009 budget. *The evaluation of risks took place under extraordinary circumstances*. The government submitted the 2009 budget bill to the National Assembly by the deadline, at the end of September. In its study entitled *The analysis of the macroeconomic risks of the 2009 budget*, SAO-RDI prepared an evaluation of the government's macroeconomic predictions serving as the basis for the bill, revealing extremely serious risks. The study was sent by the president of SAO to the

National Assembly, the minister of finance as well as the government organs concerned on October 15. Prompted by the international financial crisis rapidly deepening from the end of September, the government withdrew the bill and, on October 18, submitted a revised (second) bill. The greatest changes in the latter were the reduction of the earlier predicted 3.0 per cent GDP growth rate to 1.2 per cent and, in relation to this, the reduction of the growth rates of both export and import. Within a few days it became clear that even these macroeconomic predictions were too optimistic. Realising this, the government was forced to work out new macroeconomic predictions, which expect 1 per cent fall in GDP already. The latter predictions were subjected to a risk analysis by SAO-RDI once again, which analysis – attached to the opinion of SAO – was sent by the president of SAO to the committee of the National Assembly in charge on November 2. Considering this situation, *in addition to presenting the main messages of the original SAO-RDI study, the main conclusions of the subsequent analysis are also to be outlined* in this article.

The October study of SAO-RDI examined, clustered in four topics:

- the risks in the budget processes (in the change in the structure of expenditure, in factors affecting the balance) as reflected in the Convergence Programme (CP);
- demand risks, including world economic processes, the role of state demand, the impact of EU subsidies, developments in household income and consumption;

- risks originating from the improper operation of certain fields of the economy, including factors affecting competitiveness, employment processes, the system of taxation, the implementation of health policies, the operation of the local government system;
- some important correlations of sustaining balance targets and the scope of economic growth.

In this article, we shall first present the most important results of the analysis of the budget processes of 2006–2008, to be followed by a short summary of the risks related to the development of demand and originating in the improper operation of certain fields of the economy, and finally by a detailed description of the conclusions to be made from the analyses and model calculations related to balance targets and economic growth correlations.

THE (BUDGETARY) IMPACTS OF THE CONVERGENCE PROGRAMME

Macroeconomic impacts

The macroeconomic indicators included in the CP passed in December 2006 and amended in December 2007 and the most important macroeconomic indicators currently known are summarised in *Table 2*.

The table clearly reveals the growth indicators less favourable compared to the original plans of *the year 2007*: the direct and indirect – implemented through inflation – impacts of fiscal correction are to be felt not only in communal but also in household consumption. The little rise in purchased consumption was finally made possible by an increase in household loans. It can be established furthermore that the scarce economic growth of the year 2007 was due to the dynamic growth of foreign trade

Table 2

THE DEVELOPMENT OF THE MAJOR MACROECONOMIC INDICATORS

Description	plan, 2007	plan, 2008	fact 2007 MF-predictions, October 2008	2008
Macroeconomic indicators in percentage of the previous year				
GDP-volume change	2.2	2.8	1.1	1.8
GDP domestic use	0.5	0.9	-1.0	2.1
Household consumption	-0.8	0.5	-1.8	0.9
including: household consumption expenditure	-0.3	1.2	0.7	1.1
Communal consumption	-1.6	-3.5	-2.2	-2.0
Gross fixed asset accumulation	2.4	4.2	1.5	1.0
Export volume change	10.6	12.9	15.9	7.6
Import volume change	8.2	11.1	13.1	8.1
Living standard indicators				
Real salary per earner	-4.2	0.4	-4.8	-
Number of employees	-0.5	0.2	-1.1	-1.0
Inflation (annual average)	6.2	4.8	8.0	6.4
Financial balance indicators				
General government balance (cash flow)	-6.9	-4.5	-5.4	-3.4*
Government sector balance (EASA)	-6.8	-4.0	-5.0	-3.4
Public debt (ESA)	71.3	65.8	65.8	65.6

* not including local governments ESA

turnover and especially the improvement of net exports within the latter, which, again, was fostered by the decrease in import demand as a consequence of the fall in domestic demand.

Considering world economic processes, in September 2008 the Ministry of Finance amended the spring predictions *for the year 2008* and, instead of the earlier planned growth of 2.8 per cent, it held only 2.4 per cent growth for possible, primarily due to the significantly decreasing foreign trade dynamics.¹ According to the amended predictions, both inflation and gross salary rise would significantly exceed the planned values, rising by 6.5 per cent and 8.6 per cent respectively on an annual average.

Summarising the macroeconomic impacts of the CP measures experienced so far, it can be established that they have slowed down economic growth and increased the inflation pressure to a greater extent than expected, and the number of the employed has fallen as well.

Budgetary impacts

In the financial-budgetary balance, there has been a spectacular improvement. It can be established from the factual data of the final accounts that, *in 2007*, the higher than planned improvement in the balance (compared to 2006, there was a fall of 3.8 percentage points in the cash flow deficit and a fall of 4.3 percentage points in the ESA-balance) was, in addition to the omission of one-time items, primarily fostered by the higher than planned tax revenues attained as a consequence of the tax increases and the measures implemented for whitening the economy. Compared to the factual number of 2006, tax and contribution revenues rose by GDP 2.5 per cent on the whole while, in the balance of expenditure, they fell by 2.0 percentage points.

In 2008, the budget balance, considering the data so far – the data of the first half of the year

or of January to July – has been more favourable than planned, in which the lower base of the year 2007 has a significant role. After the favourable, 5.4 per cent base in the year 2007, an improvement of “only” 1 percentage point is necessary in order to meet the commitment of 4.4 per cent cash flow deficit.² According to the analyses and government predictions made so far, the most important tax and contribution revenues are to be met; what is more, they, expressed in GDP percentage, are to be some 0.5 percentage points higher than planned. According to the Ministry of Finance, the majority of expenditure predictions were met time-proportionately in the first half of the year or, what is more, even underperforming the predicted figures, while in the case of some appropriations, extra expenditure can be expected.

Analysing the correlations between the cash flow data of the budget and the tax burden, we have estimated the main figures of the 2008 budget (revenues and expenditure) and the likely divergence from the plans in the development of the structure of expenditure. According to the September estimation by the Ministry of Finance, income centralisation in 2008 – including the surplus of other revenues – may be by 0.5–0.6 percentage points higher than the factual level in 2007. The changes in the corner figures of the CP are summarised in *Table 3*.

As can be seen, the fiscal correction in 2007 was implemented alongside a centralisation 2.2 percentage points higher compared to 2006 and 0.7 percentage points higher than the target value set for 2007 in the CP, which will affect this year's level as well. The development of the indicator is partly due to the lower nominal GDP prompted by the lower than expected growth rate and the stronger than estimated effect of economic whitening. The ambitious income centralisation target set in the CP for 2009 originally, which is some 2 percentage

Table 3

**THE IMPLEMENTATION OF THE CP BUDGETARY CORNER FIGURES*
SO FAR**

In GDP percentage	fact, 2006	CP, 2007	fact, 2007	CP, 2008	expectation, 2008**	CP, 2009
Revenues of the government sector	42.6	44.1	44.8	44.2	45.4	43.3
including: tax burden	37.0	39.1	39.5	39.0	39.6	38.3
Government sector expenditure	51.9	50.3	49.8	48.2	49.2	46.5
<i>Government sector balance</i>	-9.3	-6.2	-5.0	-4.0	-3.8	-3.2

* Under ESA, 95 methodology

** September estimations by the MF

Table 4

**THE FUNCTIONAL STRUCTURE OF STATE EXPENDITURE IN HUNGARY
AND THE EU AVERAGE**

Key functions	EU-15	Hungary		Hungary		
	2005	2005	2005	2006	2007	2008 expectation*
	<i>in GDP percentage</i>					
Operation of the state	7.1	8.8	8.6	8.4	8.2	7.5
Welfare functions	32.8	30.7	31.7	32.1	30.9	30.6
including: Education	5.2	5.8	6.4	6.2	6.1	5.6
Health care	6.6	5.5	5.3	5.2	4.6	4.4
Social protection	18.8	16.9	16.2	17.0	16.8	17.2
Economic functions	4.5	6.2	6.9	8.4	7.7	7.2
Expenditure on interests	2.8	4.1	4.2	4.1	4.0	4.2
Total	47.2	49.9	51.6	53.3	51.1	50.2

**Own estimations using the interim data and predictions of the MF

Note: The first two columns present data according to ESA95 methodology; the source is the EUROSTAT data base. The other four columns are data from Hungary; the source is the cash flow-oriented final accounts.

points lower than the current level, could only be implemented by significant tax reduction, the conditions for which are not available, however.

The answer to the question to what extent various fields of expenditure (operation of the state, education or health care, etc.) have been affected by the balance improvement measures of 2007 or, to be more precise, relative savings in which state function categories have contributed to the improvement of the balance to what extent, can be found by the comparison of functionally distributed data. The relevant main figures are summarised in *Table 4*.

The first two columns of the table demonstrate the differences in the structure of state functions in Hungary and in the EU-15. Considering this, we have tried to “criticise” the original target figures of the CP, too, examining to what extent the planned structure of state expenditures was likely to serve real convergence, i.e. to what extent it would approach the structure in the EU-15. The table reveals that, while the size of redistribution in Hungary is just a little above the average of the EU-15, there are quite significant differences in the structure of expenditures.

▶ The average of the EU-15 is exceeded by 1.7 percentage points regarding the expenditure on the operation of the state, by almost 2 percentage points in economic functions, by 0.5 percentage points in GDP proportionate expenditure on education and by 1.3 percentage points in the expenditure on interests, while the expenditure on welfare function outside education is 2.5 percentage points lower on the whole.

▶ Within the latter, the rate of state expenditure on health care was over 1 percentage point lower and that on social protection (social security and social expenditure, the greater half of which is pensions) was almost 2 percentage points lower than the average of more developed countries already in the year 2005.

Let us now examine how the structure changed in the year of state overexpenditure in 2006 and the two years of fiscal restrictions following!

▶ There has been only a slow decrease in the size of the function of state operation, while, after the rise in 2006, the GDP-proportionate value of welfare functions has been gradually falling, i.e. getting further from the average of the EU-15.

▶ Within welfare expenditure, the share of state participation in health care has drastically fallen; by the end of the year 2008, the lag behind the average of the EU-15 is to be 2 percentage points already.

▶ In 2005, the rate of expenditure on education was still higher in Hungary than the average of the EU-15, but it has gradually decreased since then and, if appropriations are met in 2008, it will drop to under the EU average.

▶ The GDP-proportionate value of social and pension expenditure has not fallen to under the peak in 2006 despite the measures taken so far, as a consequence of which its share in total expenditure has been rising continuously, while we are still far from the ratio characteristic for EU countries.

▶ After the peak in 2006, the rate of economic functions has been falling slowly and gradually, but is still much higher than the average of the old EU countries.

The question furthermore is to establish to what extent the structure of state expenditure thus developed follows the original target figures of the CP for 2009, and to what extent the divergences hinder or serve the long-term implementation of the CP. Considering the latter, we have compared what the appropriations of the CP were in the field of expenditure reduction for the extent of state functions and what of these has been realised in what ways so far (*see Table 5*).

Columns 1-4 of the table present the size of the state's role in the respective function clusters, expressed in GDP percentage: the average rates of the years 2004–2005 before the CP, the current rates (expected in the year 2008), the target set for 2009 in the CP and the appropriations in the bill. The last column, in turn, shows the changes in real value in the state expenditure on the fields concerned, compared to 2005, as a result of the measures achieved so far. On the basis of the data it can be established that, on the whole, the real value of state expenditure is hardly higher than the 2005 level, but there are significant structural differences within that.

On the basis of the data presented in the table, the following conclusions can be made.

▶ It can be established that, with the exception of social security, social expenditure and transport expenditure, the rates of individual expenditure categories have changed in the direction set by the CP.

▶ Albeit slower than set out in the CP, the rate of expenditure on the operation of the state has fallen by 2008, which means a fall of 8.4 per cent in real value compared to 2005. (Under the CP, further reduction should take place in this field by 2009, which is only partly targeted by the appropriations for 2009 and its

Table 5

CHANGES IN THE STRUCTURE OF EXPENDITURE AND THE TARGETS OF THE CONVERGENCE PROGRAMME FOR THE YEAR 2009

Key state functions	average, 2004–2005	fact, 2007	expectation*, 2008	CP, 2009	expectation**, 2009	2008 expectation/2005 volume index
	in GDP percentage, current prices					
<i>F1+F2+F3 Operation of the state</i>	8.5	8.2	7.5	6.1	6.9	91.6
F4 Education	6.4	6.1	5.6	5.2	5.6	91.1
F5 Health care	5.2	4.6	4.5	4.2	4.3	88.2
F6 Social security and welfare expenditure	15.9	16.8	17.1	16.5	17.0	110.9
including: pensions	9.0	9.7	10.0	9.7	10.1	114.1
family subsidies	1.5	2.0	1.9	1.9	1.9	138.5
<i>F9-F14 Economic</i>	6.5	7.7	7.1	6.4	6.9	108.8
including: F12 Transport	2.6	4.0	3.1	2.5	3.2	115.1
including: F14 Environment protection	0.7	0.9	1.0	1.1	1.0	150.5
F1. State debt management	4.3	4.0	4.2	3.7	4.0	105.1
Total expenditure	50.7	51.1	50.2	47.6	49.1	101.8

* Own estimation

** Under the second budget bill submitted. i.e. data do not yet reflect the reduction of expenditure decided by the government after submitting the bill.

Source: Ministry of finance. cash flow-oriented data

implementation depends also on the final realisation of this year's target.)

► Expenditure on education will also change in the direction set by the CP if this year's appropriations are met, whereby the real value will be 9 per cent lower than the 2005 level of expenditure. And, although we are approaching the international average this way, from the point of view of human resource development, on the other hand, the further reduction targeted in the CP is to worsen Hungary's chances of catching up. The appropriation for 2009 is to keep this year's expected rate at level.

► It is the rate of health care expenditure that has fallen to the greatest extent, meeting the targets of the CP, but increasing Hungary's lag behind the average of the EU 15. It is highly likely to lead to tensions that the appropriations for 2009 further reduce state expenditure in this field, where there has been a loss of 12 per cent in real value compared to 2005 already, by another 0.2 percentage points.

► The function clusters of social security and social expenditure as well as transport expenditure have developed contrary to the direction set in the CP. As regards social expenditure, 60 per cent of which are constituted by pension expenditure, it can be established that, by the end of this year, its real value is to be over 10 per cent higher than the 2005 level.

- ◆ Within the latter, the GDP proportionate value of pension expenditure has risen by 1 percentage point and its real value is 14 per cent higher than in 2005. There are several reasons for the latter: in addition to demographic reasons, more people have opted for retirement due to the restrictive measures and the employment problems, whereby the number of new pensioners has sky-rocketed. Consequently, the rate of pensions established under the new methodology has increased.
- ◆ The level of family subsidies, transformed in 2006 – by raising family allowances and

partly replacing tax allowances thereby – was to be sustained even under the CP, which is what is expressed by the growth in real value.

The appropriations for 2009 do not include a reduction; moreover, a further increase of 0.1 percentage point was to be implemented. Taking the measures announced would result in a reduction corresponding to GDP 0.5 per cent in pension expenditure.

► Through the realisation of unimplemented projects, the weight of environment protection is intended to grow: thus, if this year's appropriations were met according to estimations, there would be an increase of over 50 per cent in this field in real value, compared to the level in 2005. The appropriations for 2009 in GDP percentage keep this direction at level, without increasing it as intended by the CP.

► Finally it can be established that the rate of expenditure on transport boosted by the motorway construction in 2006, has been decreasing much slower than targeted by the CP. Contrary to the CP targets, the appropriations for 2009 still expect further increase.

THE MOST SERIOUS RISKS IN THE SYSTEM OF CONDITIONS OF THE 2009 BUDGET

Demand risks

Under the predictions for 2009, the world economy is to be characterised by a slowdown in the growth rate. Foreign demand for Hungarian products has shown considerable weakening, which means a much more restricted contribution to economic growth than before. It poses special danger that, in the Hungarian export structure, the rate of products that consumers typically purchase on loans is very high.

From the point of view of fostering growth,

the role of state orders in Hungary is important. In a European comparison, the volume of state demand in Hungary can be considered high. In 2009, the intended amendment of general government expenditure is to reduce the size of the 'state market' and is to change the structure thereof in the direction of a decreasing rate of capital expenditure. While the intention to shrink the state market can be considered justified on the basis of international comparison, regarding its direct impact on economic growth, however, both changes can be viewed as unfavourable. From the sources of development, the amount of subsidies from the EU has been rising dynamically, while the rate of domestic subsidies has been significantly falling. By today, it is the efficient and time proportionate use of EU sources that has become the most important growth factor of the Hungarian economy. The model calculations made during the preparation of this study justify that the failure to use these subsidies or their less efficient utilisation may retard Hungary's economic development to a sensible extent.

Analysing the factors affecting household consumption expenditure, the study establishes that the 4.3 per cent inflation prediction looks realistic, although there is a risk that actual inflation will exceed this extent by some 0.5 percentage points. At the same time, there is also a chance for a divergence in the other direction since foreign inflation pressure is to ease as a consequence of the world economic recession. In the competition sphere, the growth dynamic of average earnings is likely to exceed the inflation rate, while the volume of earnings is to shrink as a consequence of a fall in employment. This, as well as a shrink in household loans is to reduce household expenditure on consumption. As a consequence of the recession, it is only in the case of investment financed from EU subsidies where growth can be expected. Domestic use is thus

not expected to rise considerably, i.e. will be unable to contribute to the growth of the Hungarian economy at a significant extent.

RISKS ORIGINATING IN THE OPERATION OF THE RESPECTIVE FIELDS OF ECONOMY

According to the contracted indicator of IMD World Competitiveness Yearbook, Hungary has fallen further in the competitiveness ranking. From the component indicators making up the contracted indicator, it was in the fields of government efficiency and business efficiency where the backlog was the greatest. For improving economic competitiveness and creating the conditions necessary for long-term growth, it is indispensable to establish an efficient government sector and modernise public finances.

Raising the standard of employment is a key issue of future economic growth. From the – structural and quality – side of labour supply, the conditions for fast economic growth are missing. Young people's labour supply is able to contribute to the dynamisation of the economy to a very small extent only. A significant part of the unemployed do not represent quality labour reserves for enhancing employment. As a phenomenon contrary to the tendencies of the past few years, the standard of economic activity has fallen again. For the short-term mitigation of unemployment-related problems, the Hungarian employment policy spends extremely high amounts, in an international comparison, on the subsidisation of various forms of temporary public employment. These are of extremely poor efficiency as regards the permanent employment of those concerned and, at the same time, withdraw sources from the financing of active employment political means of higher efficiency. The mitigation of the employment impacts of the developing recession makes it necessary to re-evaluate the priorities of the employment policy.

The withdrawal of the proposals amending taxation and contribution payment for the year 2009 is expected to boost general government revenues by HUF 140 bn compared to the original budget bill but, at the same time, it is to raise GDP-proportionate income centralisation by 0.6 per cent. The burden on labour is not to be eased and this will adversely affect the competitiveness of Hungarian enterprises.

Our survey conducted among local governments of settlements with a population of under 5,000 inhabitants in summer 2008 revealed that the scarcity of sources has been a “normal” characteristic feature of the system for almost one and a half decades now, yet, local governments are usually able to overcome liquidity problems. It is only a few per cent of local governments that are close to insolvency.

The fast increase in bond issuing by local governments poses a serious financial risk. Our surveys so far have indicated that this has no direct correlation with the local government projects approved and subsidised from EU sources. A significant part of the bonds issued has resulted in the boost of the deposit and state security stocks of local governments. Through this financial transaction, local governments wish to improve their financial liquidity, adding to future commitments. The absorption of EU sources by the local government sector poses significant planning risk. The reservation of the money assets coming from bond issuing may result in a “surprise” investment boom by local governments in the coming two years.

There are also significant reserves in the renewal of the local government system. Mitigating the maximalism of the professional or sectoral laws specifying the rules on how obligatory tasks should be met and working out a transparent, predictable and simple source regulation system along with it could significantly improve the operation of local governments.

The solution of the tasks revised in the study by itself demands the establishment of a national economic planning system. The latter is also made necessary by the general catch-up circumstances and requirements of the economy and the experience of the operation of economic political decision making. Considering all the above, the study advises to embark upon establishing a national economic planning system. The most important characteristic of the system to be established is that the institutional harmony of real development and financial planning should be guaranteed.

THE SCOPE OF PRESERVING BUDGET BALANCE AND FOSTERING ECONOMIC GROWTH

Risks directly affecting the budget balance

On the basis of analyses, we established in September 2008 already that there was serious risk that, in 2009, economic growth in Hungary would fall significantly short of the 3 per cent of the government predictions serving as the basis for the original budget bill. Considering the factors presented, the global money market crisis first of all, the export dynamic is likely to fall short of even the rele-

vant government predictions. As a consequence of the slowdown in the growth of exports, the standard of employment is to fall, which, in turn, is to involve a shrink in the volume of earnings. The stricter conditions of loaning are to significantly reduce household consumption and entrepreneurial investment expenditure.

The 1 per cent lower than planned GDP growth – depending on the composition of the change – is to reduce general government revenues by some GDP 0.4 per cent. The nominal rate of this certainly depends on the development of prices and earnings. During our analyses, we have come to the conclusion that it was not realistic to expect that, due to the significantly higher than planned inflation, there would be significant extra revenues for the budget. The same holds for the revenue increasing role of earnings and entrepreneurial incomes also. Accordingly, the most significant macroeconomic risk for the budget balance is the lower than estimated economic growth. Therefore, we have asked the question to what extent the reserves appropriated in the original budget bill are able to counterbalance this risk. The actual budget reserves of 2007 and 2008 (not including special reserves) and the planned appropriations for 2009 are summarised in *Table 6*.

Table 6

BALANCE RESERVES* IN THE CENTRAL BUDGET			
(HUF billion)			
Description	2007	2008	2009
Chapter balance reserves	80.3	88.8	
Blocked under Art. 50 + Enc. 18			75.6
General reserves	42.2	46.7	56.5
Central balances reserves	50.0	20.0	78.0
Total	172.5	155.5	210.1
in GDP percentage	0.7	0.6	0.8
Total (without blocking)	172.5	155.5	134.5
in GDP percentage	0.7	0.6	0.5

* without special reserves

The table implies as if the reserves of the year 2009 would rise compared to the 2008 budget, their volume reaching GDP 0.7 per cent once again. In reality, however, the blocked chapter balance reserves of the year 2009 cannot be considered reserves in the traditional sense of the word since their subsidisation coverage is not provided by the bill. Accordingly, these cannot be considered as balance reserves, because of which the level of actual reserves is only GDP 0.5 per cent. These reserves – also considering that general reserves serve other goals as well – are insufficient for the compensation for the loss of revenues if GDP falls behind the planned 3 per cent rate by more than 1 per cent.

It was pointed out at the beginning of this study that SAO-RDI does not make predictions but prepares risk analyses. It was therefore not with the intention to forecast but for the presentation of the volume of risks that we made the following calculation: how high revenue deficiency was there, compared to the 3 per cent GDP growth, *in the case of a lack of GDP growth* (i.e. of 0–0.5 per cent growth), to be counterbalanced so that the budget deficit target could be met. In order to estimate this, we assumed a *scenario* in which

- there is a significant slowdown in export dynamics, which involves a slowdown also in the growth of imports. The growth of imports rises slightly higher than that of exports;
- inflation stays in the 4.0–4.6 band;
- there is hardly any rise in domestic use, since
 - ♦ average earnings (as a consequence of the base effect primarily) increase at a rate slightly above the inflation rate,
 - ♦ the rate of employment falls by 1.5–2.0 per cent,
 - ♦ in both consumption and investment expenditure, the rate of loans decreases significantly,

- ♦ pensions rise at the rate specified by the law, while other social allowances rise according to the planned inflation rate,
- ♦ there is a slight rise in communal consumption,
- ♦ the use of EU-sources reaches the planned level;
- as a consequence of the lower import demand of the slightly rising domestic use, we expect a decreasing foreign trade (export) surplus.

The results of the calculations made based on the assumptions are summarised in *Table 7*. It can be seen that, in the case of such development in the GDP, budget revenues would be HUF 350 bn lower than in the case of GDP 3 per cent growth. In addition, the rising costs of state debt financing should also be considered³ (some HUF 120 billion), as well as the extra expenditure due to the rise in unemployment (HUF 50–70 bn). Accordingly, as a consequence of the international money market crisis, the position of the state budget will deteriorate by HUF 500–550 billion in the case of a lack of GDP growth due to adverse processes in 2009.

So as to retain confidence in the Hungarian economy it is essential that the deficit targets of next year's budget should correspond to those set in the CP for 2009 or, if possible, should be more favourable than those, and that these targets should be well grounded by budget correlations. In the current insecure economic situation, we have considered it especially important to *increase real balance reserves to an amount corresponding to at least GDP 1 per cent*. Reallocating some of the planned target reserves to the general budget reserves and creating subsidisation coverage for the blocked chapter balance reserves (along with the proportionate reduction of other subsidisation appropriations) would serve the above goal.

A few days after the publication of the SAO-RDI study, the government submitted to the

Table 7

THE MACROECONOMIC PARAMETERS OF A “0” ECONOMIC GROWTH ALTERNATIVE FOR 2009

Description	2008, * Budget submitted	2009, Budget submitted	2008, * “0” growth	2009, “0” growth
Consumer price-index, percentage	6.5	4.3	6.5	4.3 – 4.5
Change in number of employees, percentage	-0.7	0.4	-0.7	-1.5 – -2.0
Investment rate, in GDP percentage	20.6	21.1	20.6	20.9
The individual items of GDP-balance, change in percentage, unchanged prices				
GDP growth in previous year's price, percentage	2.4	3.0	1.9	0 – 0.5
Household consumption expenditure	1.2	2.2	1.0	0 – 1.0
Household consumption total	0.5	1.0	0.3	0.1 – 0.9
Communal consumption	-3.5	0.8	-3.5	0.5 – 0.7
Investment	2.0	6.0	1.5	2.0
Domestic use	1.7	2.6	1.4	0.4 – 0.9
Export of products and services	9.5	8.0	8.0	5.0
Import of products and services	8.9	7.6	7.5	5.5 – 6.0
GDP value in current prices, HUF bn	27 380	29 110	27 261	28 230
GDP-loss			119	880
Loss of general government revenue			approximately 40	approximately 350

* expected performance

National Assembly a new budget bill based on new macro economic predictions, shortly after which it was compelled to revise its macroeconomic predictions and work out an amendment package drastically reducing budget expenditure. The main indicator figures of the government's macroeconomic predictions attached to the second budget bill submitted as well as those of the predictions amended thereafter are summarised in *Table 8*, with the risk analysis alternatives of SAO-RDI added.

The comparison of the government's macroeconomic course serving as the basis for the second budget bill and the “0” growth risk analysis alternative of SAO-RDI highlights the inconsistency of the macroeconomic course relying on the government predictions. The “0” alternative of SAO-RDI namely indicates that a course like this involves a loss of general government revenues of over HUF 100 bn, which must be counterbalanced by reducing expenditures. This, in turn, results in constraining domestic use, i.e. it involves a further economic

slowdown. It seems that those working out the government predictions became aware of this only when the government actually decided on the greatest items of expenditure (suspending 13th month's salary in the public sector, setting a ceiling for the 13th month's pension). Thus, the government was forced to pass new macroeconomic predictions, based on the expectation of a 1 per cent fall in GDP. The comparison of the main indicator figures of the original and the amended government predictions clearly shows that the difference is not in the estimation of the expected export dynamics, since the difference here is only 0.2 per cent. What simply happened was that *the original predictions ignored the negative impact of the forced reduction of expenditures on domestic use and, through this, on economic growth.*

For the presentation of the size of risks, we have also examined the macroeconomic course based on the amended government predictions. This prediction scenario is based on the following main assumptions.

THE COMPARISON OF CALCULATED AND CALCULABLE MACROECONOMIC COURSES FOR THE YEAR 2009

Description	2008 No. 2 budget submitted	2009	2009 SAO- RDI "0"	2009 MF amended	2009 SAO- RDI
GDP growth in previous year's prices, percentage	1.8	1.2	0.2	-1.0	-1.0
GDP-deflator, percentage	5.2	3.5	3.3	2.75	2.75
Consumer price-index, percentage	6.4	3.9	4.3	4.5	4.5
Public sphere gross average earnings, percentage	7.1	5.0	n.a.	-7.0	-7.0
Change in number of employees, percentage	-1.0	-0.6	-2.0	-0.6	-2 -2.5
Investment rate, percentage	20.6	21.2	21.1	20.9	20.9
Individual items of the GDP-balance. change in percentage. unchanged prices					
Household consumption expenditure	1.1	0.2	0.0	-3.8	-4.3
Household consumption total	0.9	0.3	0.1	-3.1	-3.6
Communal consumption	-2.0	0.5	0.7	0.2	0.0
Investment	1.0	4.0	2.0	-0.9	-0.9
Domestic use	2.1	1.1	0.4	-2.2	-2.5
Export of products and services	7.6	4.1	5.0	3.9	3.9
Import of products and services	8.1	4.1	5.5	2.4	2.1
GDP value in current prices, HUF bn	27 220	28 490	28 200	27 690	27 690
GDP/loss compared to budget submitted			290	800	800
Loss of general government revenue			116	300-310	320-340

There will be a significant, 3.8 per cent fall in household consumption expenditure, caused by the drastic, 7 percentage point reduction of the average gross salary in the public sphere and the – presumed – slowdown in the so far dynamically increasing household loaning. The number of the employed will drop by 0.6 per cent.

Investments will fall by almost 1 per cent, as a consequence of development slowdown in the competition sector.

Export dynamics will fall significantly, to 3.9 per cent, which will, in turn, involve a slowdown in the growth of imports. Due to the fall in household consumption, known to be of high import content, however, the slowdown in imports will be higher than in exports, because of which export dynamics will exceed import dynamics by 1.5 percentage points.

In relation with the amended macroeconomic course of the government, we have formulated the following risks.

1 The amending proposal does not include new indicators for the expected performance of the year 2008. Therefore, the predictions for 2009 can be compared only to the values expected for 2008, included in the second budget bill, although some indicator figures (e.g. GDP growth, exports) are likely to be less favourable in 2008 already than the predicted figures attached to the budget bill. *Thus, there may be serious risks involved in the base figures already.*

2 From the macroeconomic indicators of the year 2009, the prediction of a 0.6 per cent fall in the number of the employed “stands out”. The chance of a fall in employment is indeed mitigated by the fact that, in the public

sphere, further downsizing is not on the agenda. *Due to the fact that the financial crisis has spread to the real economy at a significant extent and because of the fall in GDP, there is a great risk, nevertheless, that the number of the employed may fall at a much higher extent, by as much as 2–2.5 per cent.* This will clearly affect the volume of earnings and, through this, household consumption and budget revenues. (In the competition sphere, employment projects have been proposed, while the extra costs involved have not yet appeared in the budget amendments).

③ According to our calculations, the government predictions assign a demand reducing effect of only 1 percentage point – some HUF 150 bn – to the fall in household loaning, which seems insufficient, since, prior to the financial crisis, Hungarian households financed over 10 per cent of their consumption from loans already. The strictening of loaning may thus result in a much more significant dropback in household consumption than predicted. A higher than predicted fall in employment and the expected drastic fall in loan financing may result in a further fall in demand, i.e. a greater fall in consumption and GDP.

④ *The development of foreign trade turnover is extremely uncertain.* The slowdown in the growth of exports may probably be higher than predicted by the MF. If domestic use drops at the rate forecast by the government predictions – in case there is no change in import demand – the 2.4 per cent growth rate predicted for imports seems an overestimation. What is more, as a consequence of the risks mentioned under 2 and 3 above, domestic use is likely to fall at even a greater extent, which will result in an even greater slowdown in the growth of imports. Under the amended government predictions, net exports are to rise considerably compared to last year, contributing to GDP growth by 1.2 percentage points. *In our opinion, if the 3.9 per cent growth of exports can be*

sustained, net exports may rise at an even higher rate as a consequence of a more significant fall in domestic use.

We have tried to numeralise the risks outlined. The results of this are presented in the last two columns of Table 8 (MF amended, SAO-RDI). The basis for reference of the calculations is the macroeconomic course in the second budget bill submitted. First we made a calculation on the extent of fall in the GDP and in general government revenues, in current prices, due to the latest macroeconomic course published by the government (MF amended). It can be seen from the table that, in this case, the fall in GDP would amount to HUF 800 bn, and this would reduce general government revenues in 2009 by some HUF 300–320 bn compared to the second budget bill submitted by the government.

We then numeralised the changes in GDP and general government revenues in the case of a macroeconomic course resulting in 1 per cent fall in GDP, with the risks listed under 1–4 also considered. The relevant figures are presented in the column SAO-RDI of the table. Data show that, also in the case of this macroeconomic course, the volume of GDP in 2009 would shrink by HUF 800 bn compared to the second budget bill submitted, since we have calculated with the same inflation rate⁴ and fall in GDP. This macro-course would, however, result in a somewhat greater fall in general government revenues (HUF 320–340 bn) since, due to the smaller volume of earnings, personal income tax and contribution revenues would be lower and lower domestic use would reduce consumption-related tax revenues.

As regards expenditures, the growing costs of public debt financing⁵ (some HUF 120 bn) as well as the extra costs involved in the rise of unemployment (HUF 70–90 bn) should also be considered. Accordingly, in case the amended macroeconomic predictions of the MF came true, the general government position would be

HUF 500–520 bn, and, with the risks above considered as well, HUF 520–540 bn lower than the values specified in the budget bill submitted.

Due to the great uncertainty related to the potential macroeconomic courses, the possibility of an even greater fall in export dynamics cannot be excluded, either. As a consequence, there may be an even greater fall – possibly 2 per cent – in economic growth. In the case of such a course, the volume of GDP in 2009 would shrink by some HUF 1,000, and that of general government revenues by HUF 400–420 bn. (A further fall of 1 per cent in GDP would deteriorate the balance, according to our calculations, by HUF 610–620 bn compared to what is included in the bill.) This danger to the budget balance should be paid due attention to especially considering that there are *several factors (the shrinking of export markets, major reduction in budget expenditure, the strictening of loaning, fall in employment) causing a major slowdown in economic growth*. If the accumulated effect of these is not sufficiently mitigated, the Hungarian economy may get into a recession spiral which, through the decrease of general government revenues, may even endanger budget balance. There are several signs suggesting that *these factors were not given their due weight when the government's macroeconomic predictions were worked out, because of which there is also a risk of curbing the economy*.

Summarising the conclusions made from the comparative analysis of the main parameters of the macroeconomic courses serving as the basis for budget planning, it can be established that the new, amended macroeconomic course of *the financial government counts with the world economic realities at a greater extent*, and – considering the expectations of IMF as well – it sets out a significant reduction in budget expenditure. Accordingly, the direct budget balance risks revealed in the SAO-RDI study have fallen significantly. *At the same time, the*

uncertainties prevailing in the real processes of the economy – economic growth primarily – have not yet been explored successfully and reassuringly, as regards their social-economic effects, and no measures have thus been outlined for their mitigation as yet.

The “independent” scope of development of the Hungarian economy

In the current situation of the world economy, the question to what extent the economic recession affecting the respective Hungarian export markets and the slowdown of economic growth in the European Union will limit the growth perspectives on the Hungarian economy, arises especially sharply. The survey of the development trends of EU member states reveals interesting correlations. Regarding the issue of catch-up, backlog or simultaneous development, it is worth considering the GDP growth average of the EU-27, the data of the countries with the fastest growth rates and the indicators of those with the slowest pace of development (*see Table 9*).

Examining the growth courses of the past half a decade, the following conclusions can be made from the point of view of the Hungarian macroeconomic scope.

► In the EU, the difference between the countries with the fastest and slowest paces of development has been permanently 8–10 percentage points.

► It is the biggest (and at the same time highly developed) countries that determine the average. The economic structure of these countries is stable. Even if there are phases of growth and recession, the extreme values of these are not to compare to those of the growth courses of countries in transition.

► In the period presented, the fastest growing countries are all accession countries in the

Table 9

THE GROWTH INDICATORS OF THE THREE EU COUNTRIES WITH THE HIGHEST AND LOWEST GROWTH RATES AND THE AVERAGE OF THE EU-27

(GDP growth in previous year's percentage)

Description	2003	2004	2005	2006	2007
The three highest growth rates	10.3	8.7	10.6	12.2	10.4
	7.2	8.5	10.2	11.2	10.3
	7.2	8.3	7.9	8.5	8.8
Average	1.3	2.5	1.9	3.1	2.8
The three lowest growth rates	-0.2	0.2	0.8	1.3	1.3
	-0.3	1.1	0.9	1.8	1.5
	-0.8	1.5	1.5	2.0	1.8

Source: Compiled based on the data of the Spring 2008, Economic Forecast of the European Commission

phase of catching up. Every year of the period examined, Baltic states produced above 7 per cent growth rate, and the annual levels of development of Slovakia and Romania were also high.

► The predictions for the years 2008–2009 reflect a slowdown in the growth rate of accession countries that have so far been characterised by a fast catch-up pace.

From the aspect of the Hungarian economic scope, the above means that the catch-up pace of new member states is significantly influenced by all-European growth but its framework is not limited by it: the fact that there is opportunity for “an upward break-out” is proven by the economic course of the countries mentioned. Consequently, for the countries in the catch-up process, the role of other factors in addition to the EU growth rate is also of primary importance. One of these factors, we believe, is the strength of the inner economy (especially that of domestic small and medium enterprises) and the other is the performance of the transnational companies present in the economy of the country concerned.

In the examination of the factors influencing the macroeconomic scope it is determinative whether it is short-term or long-term correlations that are examined. When determining the current scope, economic policy certainly considers

the most important components of the current state. The exclusiveness of short-term characteristics may, however, conceal factors that mean long-term trends characteristic not only for the past but important components of future development also. Keeping the requirements currently arising for the economic policy in mind, we shall now consider the longer-term correlations of the openness of the Hungarian economy.

The openness of the Hungarian economy has been in the centre of economic political thinking and of the Hungarian economic policy for decades. The export/GDP openness indicator⁶ of Hungary (taking forint data in current prices as a basis) was somewhat over 30 per cent at the time of the political change; until 1995, it rose only by a few percentage points, while in 1998, it reached 50 per cent. The forint-based openness indicator calculated for 2006 was 77 per cent already.⁷

In the years 2004, 2006 and 2007, the foreign trade growth rate exceeded the previous year's rate by 18, 18 and 16 per cent respectively. In 2007, its absolute value was Euro 68.6 bn. This did not only involve an increase in openness, but also a change in the rate of foreign trade and GDP growth; moreover, a change in the content of the correlation itself.

In the period of the transformation change

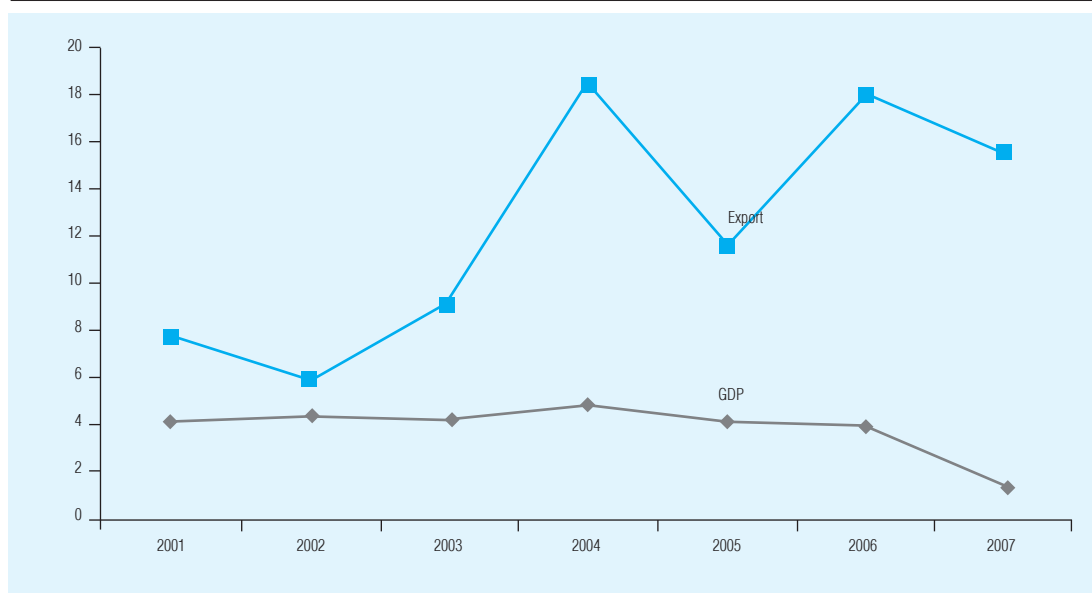
following the political change, the fall in or the disappearance of former COMECON-exports made production capacities superfluous and was one of the direct causes of the fall in production, while the outdated structure of production certainly limited the goods base of exports. In 1993, Hungarian export was exactly 20 per cent lower than the level of the year 1989 before the political change.

In 1993, the fall in GDP was practically the same as the fall in export: the GDP level was 82 per cent of that in 1989. At the time, considering the weakness of the Hungarian domestic market as well, it was formulated as a clear economic political goal that Hungarian economic growth should be based on the growth of export. The separation of the courses of GDP and foreign trade started in the years following the political change and got increasingly stronger by the continuously growing scope of multinational companies in Hungary (see Figure 1).⁸

The primary explanation for the divergence of the development courses of the two fields is that *a significant part of Hungarian export is in fact only very loosely related to the Hungarian economy*, to the inner production processes. The reason for this is not only the increasing role of foreign operating capital itself, but also the fact that, *in Hungary, a great proportion of the activities of foreign-owned multinational companies has not become an integral part of the inner economy. Consequently, in determining the macroeconomic scope of the 2009 budget, the development of export is important, but its role as regards its weight is different from what it was one or one and a half decades ago.* Some 80 per cent of Hungarian export is concentrated at foreign-owned multinational companies. *This export is based, to a significant extent, not on domestic production or the creation of Hungarian added value, but is ultimately based on import purchased for the sake of export.*

Chart 1

THE DIVERTING TREND LINES OF HUNGARIAN GDP AND EXPORT
(change to previous year, percentage)



Source: CSO Statistical Yearbook of Hungary 2006, pp. 199, 249, The CSO reports 2008/1, as well as CSO Foreign Trade Statistical Yearbook (various years)

The analysis of the statistical data presented is suitable for the formulation of a few remarks: the openness of Hungary, its dependence on the international economy has further increased in the almost two decades since the political change. *Today, this openness is, however, reflected not only or not primarily in the foreign trade turnover, but in the presence, production and trade of transnational companies.* The international connections between countries realised through foreign trade is complemented and made stronger by the direct influence of operating capital movements in a way that the role of transnational companies is increasingly significant in foreign trade itself. Thus, when estimating the macroeconomic scope of budget planning, in addition to processes in foreign trade, the changes, limitations and opportunities arising in the corporate sphere should also be considered.

Economic growth cannot be exclusively or decisively connected to export growth given the current structure thereof. The economic political goal may be to increase Hungarian added value within the import. This requires the closer integration of transnational companies into the Hungarian economy on the one hand and (parallel with the former and connected to it) the strengthening of the Hungarian small and medium enterprise sector and the increase of its export on the other hand. It provides significant growth reserves in general that the mass characteristics of production are increasingly less determinative for the rate of economic growth; instead, it is increasing the added value that is gaining a growing role. The added value, as a performance indicator, gets an increasing role also in the self-evaluation of companies. Actors of the competition sector have realised that, given rising raw material and energy costs, their market positions can be protected only by increasing the knowledge content incorporated in the product (production procedures), the almost exclusive

way of this is strengthening innovative attitude and behaviour.

The above presented fact according to which Hungarian export is, to a significant extent, based not on domestic production or Hungarian added value but ultimately on imports purchased for the sake of exports, throws different light on the growth effect of *the slowdown in the growth of export. It can be namely assumed that the slowdown in the exports of certain branches dominated by multinational companies will primarily result in a similar fall in the imports used for the exports but will only to a limited extent cause a reduction in GDP and unemployment.* Unfortunately, on the basis of our current knowledge, the indirect negative effects are not to be estimated at all.

The other conclusion to be made from the tendency presented is that, *due to the high import content of the export, a relatively high volume of exports is necessary to avoid that the import necessary for domestic use could result in a negative foreign trade balance.* There is thus a great risk that, if domestic use grows – even at a low rate – and export dynamics fall at the same time, the foreign trade balance will turn into the negative once again. It is this risk that we shall examine in the next chapter.

The risks of growth based on domestic consumption

Emphasising the change of content of export-oriented growth does not mean at all that the growth of the Hungarian economy should be unilaterally based on the growth of domestic consumption. The main reason against that is that the growth of *domestic purchase power does not necessarily lead to growing domestic consumption if the rate of import rises within consumption* and results in the deterioration of the balance of payment position. The import rate of products in retail trade has grown signifi-

cantly in the past decade. The growing openness of markets is a productivity increasing factor on the one hand while, on the other hand, the question arises when the replacement of Hungarian products with those of import origin reaches a level when it causes a reduction in the level of Hungarian production, potentially generating foreign balance problems. In order to numeralise this danger, we have commissioned ECOSTAT to perform model calculations.

We actually examined what macroeconomic effects it would generate if, in 2009, the import demand of consumption rose by 5 percentage points compared to the normal state and this rate continued in 2010–2011 as well. This required a new import demand function to be inserted into the ECOTREND-model as the function of the volume change of items of ultimate use. In this version, GDP is determined through the items of ultimate use and the development of imports.

The result of the model calculation was that a growth in the import demand of consumption directly increases import, while it has no direct impact on export. The consequence of this is the deterioration of the balance of payments as well as slower growth compared to the normal scenario. It has an indirect effect on the other indicators as well, which are of a lesser extent, however. The growth in import demand assumed for 2009 in this scenario raises the import volume level and, since these rates are to remain high later on, import will stabilise at a higher level. *According to the model calculations, the growth rate of import will be 2.7 percentage points higher in 2009, in 2010–2011, however, it will not be significantly different from the values calculated for the normal state.* The explanation for the latter is that, after 2009, there is no new “import shock”, i.e. the growth compared to the higher import level established by then will essentially be the same as the earlier – what is more, it was actually calcu-

lated to be a little lower than that. Although the difference is insignificant, it still requires an explanation: in 2009, the import surplus generates some slowdown in GDP growth and the slower growth, in turn, induces a lower import demand. What is more, the growth sacrifice is permanent- although its rate is 0.1–0.2 percentage points only – and because of this it has a reducing effect on import.

The growth in the import demand of consumption has a double effect on the foreign trade and current payment balances. On the one hand, the growth in import directly deteriorates both balances, while the above mentioned little slowdown somewhat improves the balances in 2010–2011.

The growth in demand has a clearly negative effect on the general government balance. The main reason for this is that the tax content of imports is lower than that of production of domestic origin. This effect is certainly made stronger by the loss of revenues due to the slower growth.

Thus, the basic conclusion of the model payments is that *economic growth based on domestic consumption may be successful only if the competitiveness of Hungarian enterprises improves at least at the domestic market.* In the contrary case, import demand and the import volume itself will rise, because of which GDP growth will slow down and both the foreign economic and the general government balances will deteriorate.

STATEMENTS OF SUMMARY

On the basis of the analysis of the study, we have drawn decision makers' attention to the following macroeconomic risks related to the 2009 budget bill.

► *The greatest risk is posed by the fact that, due to the significantly slower than predicted economic growth, budget revenues are to fall short of the*

planned level by several hundreds of billion forints while, due to the world economic changes, some items of expenditure (tax service, unemployment-related costs) are to rise. In order to sustain balance targets, it is necessary to adjust budget expenditure and revenues to the new situation and, *considering the high-level risk, it is advisable to raise actual budget balance reserves to a sum corresponding at least GDP 1 per cent.*

▶ As a consequence of *decreasing export dynamics, the coverage for the imports required by growing domestic consumption is not provided*, i.e. spurring domestic use by artificial means would lead to a negative foreign trade balance once again.

▶ There is *a realistic chance for an over 2 per cent fall in inflation*, so, if the rise of average earnings in the competition sphere (including the carry-over effects of this year's interim salary rises) is not adjusted to this, real earnings will rise at a rate unjustifiable by economic growth, which may, once again, lead to an imbalance of foreign trade. Here it should be considered also, however, that *the rate of loans in household purchase is expected to fall significantly next year*. This and the over-restriction of salary rises could lead to a considerable fall in household consumption expenditure, which will tone down economic growth and may generate a negative growth spiral.

▶ *Without increasing the competitiveness of Hungarian enterprises, export dynamics may fall very significantly and, due to the increasing import competition, the import demand of domestic use may also rise.* Both of the above would further reduce economic growth and general government revenues. Accordingly, *the aspects of the competitiveness of Hungarian enterprises must be maximally considered when taking measures to improve the general government balance* since, through this, the import

demand of domestic use could be mitigated. In our study, we pointed out that the balance targets set in the CP have been surpassed, but this could be achieved by increasing income centralisation only. The failure to implement the amendment of tax and contribution laws increases income centralisation by GDP 0.6 compared to the planned level. This worsens the competitiveness of Hungarian enterprises and, through this, the chances of sustaining economic growth.

▶ *The change in the structure of public expenditures does not strengthen economic growth, either*, since the rate of development-related expenditures has not grown; moreover, under the government's plans, despite the significant developments to be implemented through EU subsidies, it is not to rise in years to come, either. The situation is further shaded by the fact that, in 2007–2008, the implementation of EU-subsidised projects has progressed at a much lower pace than planned. *From the aspect of next year's economic growth, the possibly full utilisation of EU sources is a question of key importance.*

Considering the above, the conclusion arises that *the CP needs a thorough revision*. The balance targets of the CP must not be given up; moreover, on the basis of the tighter balance reached in 2007 and 2008, and with regard to the difficulties in public debt financing, it seems justifiable to set a tighter target for 2009. By today, it has become obvious that the economic course on which the CP was based is not realistic. The expected lower economic rate makes the revision of GDP-proportionate revenue and expenditure rates necessary. *When transforming the budget structure, priority must be given to measures fostering the competitiveness of enterprises, economic growth and the preservation of work places so that economic recession could be avoided.*

NOTES

- ¹ The government predictions serving as the basis for the second budget bill submitted expect only 1.8 per cent economic growth in 2008.
- ² The situation is similar as regards the result-oriented ESA-balance, in the case of which the factual numbers of 2007 reveal only 5 per cent deficit, compared to which, again, an improvement of 1 percentage point is necessary so as to attain the planned deficit of 4 per cent.
- ³ This is related directly to the international money market crisis rather than the slowdown in economic growth. Our calculations were based on the assumption that there would be approximately 10 per cent rise in state-debt related costs.
- ⁴ We do not consider it sufficiently well grounded that the government's inflation prediction has risen from 3.9 per cent to 4.5 per cent. At the same time, both these values are within the band of 3.8–4.8 per cent held for probable by the SAO-RDI study, because of which we have accepted the government prediction of 4.5 per cent as the basis for calculations.
- ⁵ This is not related to the slowdown of economic growth but is a direct consequence of the impact of the international money market crisis. We have assumed that the costs related to public debt would rise by 10 per cent approximately.
- ⁶ Despite the extremely different methods of calculating the indicator, the uncertainty of long-term time rows generated exactly by the changes in methods, the comparison limits of respective periods and the increasingly stronger distorting speculative effects on exchange rates it can be established clearly that the openness of Hungary measured through the volume of its foreign trade has increased continuously and extremely forcefully in the almost two decades since the political change.
- ⁷ Source: The values were calculated on the basis of: Central Statistical Office (KSH/CSO) The National Accounts of Hungary, 1996–1998, Budapest, 2000; The National Accounts of Hungary, 2005–2006, Budapest, 2008 The figure of exports includes product – and service exports.
- ⁸ The expansion of the production and the related foreign trade activity of companies operating in custom free trade zones, which began in 1993 already, was of special significance in this process.

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