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Application of the ESA 95 methodology in the budget

Today's discussion papers continuously debate the new issues related to regionalism, globalisation and economic integration; the term 'national sovereignty' seems to have lost its original meaning. International organisations issue recommendations and proposals to the member states' decision-makers, and the membership often requires the irreversible conversion of the entire legal system. By signing the Treaty of Accession, Hungary undertook to align its economic policy to the requirements of the Economic and Monetary Union and prepare for the requirements arising from the membership. Its commitments have affected the country's accounting and statistical system; preparatory work has started with great swing since Brussels seriously scrutinises the reports on convergence, criticises the implementation of the economic policy and records presenting the economic performance.

The member states and the candidate countries are required to prepare a report in accordance with the *ESA 95 methodology* based on which the data relating to the budgetary deficit listed among the convergence criteria for GMU member states and candidate countries may be compared among others. The introduction of the international and European requirements for accounting and statistical records is a great burden on the authorities of the member states. This paper – after introducing the international accounting and statistical systems – aims at revealing the difficulties occurring in connection with the convergence process and in the course of preparing an inventory of the data of the general government sector, which are expected to exist for a longer period and the routine like management of which will probably be possible only after a longer adjustment period.

INTERNATIONAL ACCOUNTING AND STATISTICAL REPORTS

The aim of the so-called general financial reporting is not to serve individual needs, but rather to disseminate information to a wider audience including taxpayers, the institutions of legislation and law enforcement, creditors, business partners, the media and a great number of employees. In the public sector the particular goal is that the financial statements could provide appropriate information to the decision makers and organisations could prove that they manage their resources appropriately. The underlying statistical and accounting models provide help in describing and interpreting the activities and financial processes of the operators and comparing these on an international level.

■ The need for standardising the *financial statements* first arose in the business sector especially among companies registered on the stock exchange. For this purpose IFRS (International Financial Reporting Standards) were created, which are continuously reviewed, extended and clarified by the IASB (International Accounting Standards Board). The IPSAS (International Public Sector Accounting Standards), which help the recording of the public bodies' accounts, are developed by the International Federation of Accountants Public Sector Committee (IFAC/PSC) in order to support their use by governments and other public sector entities. In fact, IPSAS are based on IFRS and are adapted for the use by public sector entities; the public sector accounting standards are updated in line with the development of the IFRS. (Since 2000 twenty standards have been developed and used in general government accounting.) In certain fields, if there are deficiencies in the state accounting standards, the rules laid down in the IFRS should be used; as far as the IPSAS are concerned, deviations from the guidelines contained therein may be made only in justified cases. The standards equally apply to the financial statements of individual organisations, the consolidated financial statements of a business organisation, group, such as the government level statements. The European Commission itself has switched to an accrual basis of accounting as of 1 January 2005 introducing accrual basis accounting in the EU budget and thus setting an example for the member states' government bodies, which apply significantly different accounting policies.

■ There have been great achievements in the field of *statistical models* in order to align the information content of the international statistical data. The UN, the IMF, the Commission of the European Communities, the OECD and the World Bank jointly undertook to develop the System of National Accounts (SNA 1993), which is a well-known model of international statistics covering micro- and macroeconomics. There is an ongoing comprehensive update of the system to be reviewed completely by 2008. In order to standardise the financial statistical accounting of the government sector, the International Monetary Fund published a manual (Government Finance Statistics Manual, 2001); the economic and statistical concepts, accounting rules, guidelines for systematising the operational data of the public sector included in its system of controls (hereinafter: GFS) incorporate the entire government sector including the public corporations.

Serious efforts have been made in the European Union in order to standardise the varied data supply practices of the national statistical offices, as a result of which the ESA 95 methodology – which is also currently under review[1] – was developed for the management of the budgetary deficit and public debt. Both the GFS and the ESA 95 are in line with the system of national accounts (SNA).

In order to eliminate the still existing differences in national and international regulations in effect, an international task force *(Task Force on Harmonization of Public Sector Accounting, TFHPSA)* was set up with the aim of reviewing the differences in the accounting and statistical models required for preparing financial statements and eliminating such discrepancies, if possible. The standardisation of the various systems of account also contributes to that the budgetary status and the debt of the individual states could be compared, which is an indispensable prerequisite of the economic convergence examination, since in a number of countries the public sector is liable for using more than 50 per cent of the GDP.

THE EURO AREA IN VIEW OF STATISTICAL ACCOUNTING

The convergence process of the new members of the EU is monitored not only by the central banks of the member states and the EMU. This is, at the same time, one of the most debated issues in the economic literature of the Central-European countries. The statistical inventory of convergence indicators is less often mentioned than the analysis of economic trends and the various economic policy measures.

The European Commission has set strong expectations for the national statistical offices with respect to the institution and the methodology, the latter being applied to the examination of the changes in harmonised index of consumer prices (HICP), exchange rates, long-term interest rates and the field affected by the regulations of the European system of the national and regional accounts within the Community (ESA 95), i.e. the finances of the government sector. The key information on measuring fiscal processes is described in detail in the Council Regulation (EC) No 3605/93 of 22 November 1993 on ESA 95 and debt and the regulations[2] related to the Stability and Growth Pact. ESA 95 provides an accurate description of the terminology used in general government statistics, and prescribes the harmonious treatment of the transactions particular to the government sector (such as capital transactions, securities transactions). The entries and rules used in accounting are in line with the system of national accounts of 1993 (SNA). From an accounting point of view, it converges towards accrual-basis accounting.

The 'public sector' described in ESA 95 includes the central government, the regional and the local governments and the social security funds. While most transactions within the general government subsectors are not consolidated, certain transactions, such as capital transfers are consolidated. The terms '*government deficit*' and '*surplus*' used in this system equal to "net lending (+)/net borrowing (–)" plus the aggregates "net settlements under swaps and forward rate agreements". The primary balance calculated this way excludes interest expenditure in the usual way of the GFS. In the excessive deficit procedure (EDP), the general government debt at nominal value equals the amount of the pre-defined ESA 95 category; however, it does not equal the data at market value in the ESA 95 balance sheets. The ESA 95 manual also touches upon the classification of funded pension schemes in case of government responsibility or guarantee, and the recording of military expenditure.

GENERAL BUDGET ACCOUNTS IN THE EURO AREA

If you look at the annual and quarterly budgetary data of the European Union, which together with the EU budget includes the national accounts and transactions of the government sector both for a national level and the EU, you will get a good example of the implementation of the principles and methodology of the ESA 95. The data prepared by the national statistical offices, supplemented by the estimates of ministries of finance and banks of issue, are collected by the EUROSTAT (quarterly data) in the framework of the ESA 95 data transmission program and the notification relating to the excessive deficit procedure performed twice a year. In addition, the European Commission and the central banks of the euro system supply statistical data in accordance with the GFS to the ECB based on the GFS guidelines of the ECB. The data transmitted this way are reviewed twice a year and depending on whether they apply to an annual or quarterly period, these are published in the relevant monthly report of the ECB.

Budgetary deficit

The data determined under ESA 95 for the total general government deficit is calculated based on the net lending (+) and net borrowing (–) positions which equal the difference between the general budgetary revenues and expenditures, or in other words, the difference between the net increase in financial assets and the net increase in liabilities. Revenue and expenditure items are further detailed by separating the current and the capital components. The calculation of deficit and surplus data recorded for the individual member states includes the revenues and expenditures related to the EU budget, which are then counterbalanced by the net transfer between the national and the EU budget.

Other current transfers, interests and capital transfers within the entire public sector are consolidated in the statements; however, data relating to expenditure, taxes and subsidies in connection with the purchase of goods and services are not consolidated.

In the course of this procedure the data content as well as accounting principles related to the valuation and accrual basis accounting reflect the ESA 95.

National debt

As mentioned before, a methodology somewhat different from that of the ESA 95 is applied for the calculation of the national debt in the euro area. Individual financial accounts are recorded at nominal value, and the gross debt calculated this way covers only a part of the categories defined in ESA 95. Based on liquidity and legal characteristics, ESA 95 distinguishes seven categories of financial assets:

- monetary gold and special drawing rights,
- currency and deposits,
- securities other than shares, excluding financial derivatives,
- loans,
- shares and other equity,
- insurance technical reserves,
- other accounts receivable/payable.

In order to calculate the debt used in the excessive deficit procedure (EDP), only the following categories are considered: “currency and deposits”, “securities other than shares, excluding financial derivatives” (such as government bills of exchange, government debentures and government bonds), and “loans”. The general ESA 95 accounting data used within EDP are further broken down by expiration, currency and headquarters of the originator.

The debt cancellation as an economic transaction is recorded as changes in loans, which are usually set off by a government capital transfer, except when the debt is to be reduced by revenues from privatisation: in such cases the counter item is an economic transaction.

The general government deficit ratio and the general government debt ratio are defined as a percentage of GDP as calculated under ESA 95. The difference of the changes of these two factors should be supported in the framework of the deficit-debt adjustment by the fully fledged system of ESA 95 financial accounts (the components of this difference are *inter alia* net acquisition of financial assets, valuation changes of general government debt, revenues from the privatisation of public corporations).

PRACTICAL EXAMPLES

We are going to present the records related to the privatisation and the implementation and operation of public utility companies with the involvement of the corporate sector, and their impact on the net borrowing/net lending of the government.[3] In accordance with the ESA 95 manual, the analysis of such cases is highly justified in economies in transition.

The cases under review are good examples of the asymmetry existing between the financial and non-financial assets in the statistical procedure. The changes in non-financial assets arising from economic operations are recorded on the capital account, and this way they may affect the balance of the net lending/net borrowing. However, the changes in financial assets do not affect the aforementioned balance.

Example I
Recording privatisation-related transactions

Direct sale of financial assets

The government holds a parcel of shares in a public utility company in the value of z, which appears in the balance sheet. In accordance with the decision related to the privatisation, a part (x) of the parcel of shares (ESA code F.5 on the financial account) is sold. The price of the sold shares increases the financial assets by x (ESA code F.2). After the direct sale the government's net lending/net borrowing position (ESA code B.9) is not affected by the transaction. *(See Chart 1)*

Indirect sale of financial assets

In the case of indirect sale of financial assets, the government does not sell its share, but the privatisation procedure is implemented through the sale of the financial assets of a public utility company (for example, the principal of the government in the public utility company is established by the transfer of other securities, and a later date the principal is sold and the equity of the public utility company is reduced). The price of the sold financial assets is recorded on the government's financial account, which reduces the equity of the public utility company with the same value. After the indirect sale the government's net lending/net borrowing position (ESA code B.9) is not affected by the transaction. *(See Chart 2)*

Direct sale of non-financial assets

In the case of selling non-financial assets directly, the financial assets received for the sold non-financial assets (x) (ESA code F.2 on the financial account) increase the value of the capital account, therefore the net lending/net borrowing position (ESA code B.9) is affected positively. *(See Chart 3)*

Indirect sale of non-financial assets

In the case of selling non-financial assets indirectly, the price of the sold non-financial assets is recorded on the government's financial account, which reduces the equity of the public utility company with the same value. After the indirect sale the government's net lending/net

Chart 1

GOVERNMENT				PUBLIC UTILITY COMPANY			
Opening balance sheet							
A			L	A			L
EL.5	z					EL.5	z
Financial account							
ΔA			ΔL	ΔA			ΔL
L.5	–x						
L.2	+x	B.9	0				
Closing balance sheet							
A			L	A			L
EL.5	z–x					EL.5	z
EL.2	+x	ΔB.90	0			ΔB.90	0

Chart 2

GOVERNMENT | **PUBLIC UTILITY COMPANY 'A'**

Opening balance sheet

A			L	A			L
AF.5	z			AF.5	y	AF.5	z

Financial account

ΔA			ΔL	ΔA			ΔL
L.5	–x			L.5	–x	L.5	–x
L.2	+x	B.9	0			B.9	0

Closing balance sheet

A			F	A			L
AF.5	z–x			AF.5	y–x	AF.5	z–x
AF.2	+x	ΔB.90	0			ΔB.90	0

Chart 3

Opening balance sheet

A			L
AN	z		

Financial account

ΔA			ΔL
F.2	+x		
		B.9	+x

Capital account

ΔA			ΔL
AN selling	–x		
B.9	+x		

Closing balance sheet

L			L
AN	z–x		
ΔAF.2	+x	ΔB.90	0

Chart 4

GOVERNMENT | **PUBLIC UTILITY COMPANY 'A'**

Opening balance sheet

A			L	A			L
AF.5	z			AN	y	AF.5	z

Capital account

ΔA			ΔL	ΔA			ΔL
				AN	–x		
				B.9	+x		

Financial account

ΔA			ΔL	ΔA			ΔL
F.5	–x			F.2	+x–x	F.5	–x
F.2	+x	B.9	0			B.9	+x

Closing balance sheet

A			L	A			L
AF.5	z–x			AN	y–x	AF.5	z–x
ΔAF.2	+x	ΔB.90	0			ΔB.90	0

Chart 5

Opening balance

GOVERNMENT				HOLDING COMPANY				SUBSIDIARY 'B'			
A			L	E			L	E			L
AF.5	x			AF.5	z	AF.5	x			AF.5	z

Non-financial accounts

GOVERNMENT				HOLDING COMPANY				SUBSIDIARY 'B'			
Source			Expend.	Source			Expend.	Source			Expend.
		D.39	–20					D.39	–20		
B.9	–20							B.9	+20		

Financial accounts

GOVERNMENT				HOLDING COMPANY				SUBSIDIARY 'B'			
ΔA			ΔL	ΔA			ΔL	ΔA			ΔL
F.2	+20			F.2	+100	F.5	–20	F.2	+20		
F.2	–20			F.2	–20						
F.5	–20	B.9	–20	F.5	–100	B.9	0			B.9	+20

Closing balance sheet

GOVERNMENT				HOLDING COMPANY				SUBSIDIARY 'B'			
A			L	A			L	A			L
AF.5	x–20			AF.5	z–100	AF.5	x–20	AF.2	+20	AF.5	z
				AF.2	+80						
		ΔB.90	–20			ΔB.90	0			ΔB.90	+20

borrowing position (ESA code B.9) is not affected by the transaction. *(See Chart 4)*

Case of the collectively owned holding, which retains the privatisation revenues

The collectively owned holding sells 100 units of shares (ESA code AF.5) in subsidiary *A* in the course of a privatisation transaction. From the received revenues it transfers 20 units of financial assets (ESA code F.2) to subsidiary *B*. Since the holding keeps and manages the privatisation revenues in the course of its operation, the government cannot record the privatisation revenues directly. The government's net lending/net borrowing position (ESA code B.9) is not affected by the privatisation transaction. However, the transfer of the 20 units of financial assets without receiving any financial compensation is regarded a government payment; therefore the transaction has a negative impact on the government's net lending/net borrowing position (ESA code B.9). *(See Chart 5)*

Example II
Establishment and operation of public facilities with the involvement of the business sector

Case A)

In which

- the facility is built by the enterprise (in the value of 1,000 units);
- the government pays regularly in the utilisation period (100 units/year), and the facility is recorded in the company's balance sheet as operational lease;
- At the end of the utilisation period the enterprise sells the facility at residual value of 200 units. *(See Chart 6)*

According to the conditions of the operational lease, the owner's risks burden the company. The government's net lending/net borrowing position (ESA code B.9) is affected only by the annual fee. *(See Chart 7)*

At the end of the period the facility is trans-

Chart 6

BUILDING AND UTILISING THE FACILITY IN THE FIRST YEAR

GOVERNMENT				ENTERPRISE			
		Non-financial accounts					
Expend./ΔA		Source/ΔL		Expend./ΔA		Source/ΔL	
P.3	100			P.51	1 000	P.12	1 000
B.9	–1 000					P.11	100

Chart 7

HANDING OVER THE FACILITY TO THE GOVERNMENT AT THE END OF THE UTILISATION PERIOD

GOVERNMENT				ENTERPRISE			
		Capital account					
ΔA		ΔL		ΔA		ΔL	
P.51	200	D.99	+200				
B.9	0						
		Closing account					
A		L		A		L	
AN.11	200						

ferred to the government in the predefined value of 200 units.

Case B)

In which

- the facility is built by the enterprise (in the value of 1,000 units);
- the government makes regular payments to the enterprise in the utilisation period, and the facility is recorded in the government's balance sheet as financial lease. *(See Chart 8)*

According to the conditions of the financial lease, ownership rights are exercised by the government and the risks are borne by the government. The investment has a negative impact on the government's net lending/net borrowing position (ESA code B.9) in the total value of the investment.

Case C)

In which

- the government hands over the facility to the enterprise in exchange for ownership rights (in the value of 1,000 units);
- the enterprise pays participation to the government (100 units/year);
- at the end of the utilisation period the facility is transferred to the government at aresidual value of 200 units. *(See Chart 9)*

The government's net lending/net borrowing position (ESA code B.9) is not affected by the transaction. The government obtains ownership rights in the enterprise. *(See Chart 10)*

Nonetheless, the owner's revenue paid by the company is recorded in the government's accounts. The annual fees have a positive impact on the government's net lending/net borrowing position (ESA code B.9). *(See Chart 11)*

At the end of the period the facility is transferred to the government. This transfer does not affect the government's net lending/net borrowing position (ESA code B.9).

Chart 8

BUILDING FACILITIES AS GOVERNMENT INVESTMENTS

GOVERNMENT				ENTERPRISE			
Non-financial accounts							
Expend./ΔA		Source/ΔL		Expend./ΔA		Source/ΔL	
P.51	1 000					P.11	1 000
B.9	–1 000						
Financial account							
ΔA		ΔL		ΔA		ΔL	
		F.4	1 000				
		B.9	–1 000				
Closing balance sheet							
A		L		A		L	
AN.11	1 000	AF.4	1 000				

Cart 9

UTILISING AN EXISTING FACILITY

GOVERNMENT				ENTERPRISE			
Opening balance sheet							
A		L		A		L	
AN.11	1 000						
Other changes in the volume of assets account							
ΔA		ΔL		ΔA		ΔL	
AN.11(K.12.1)	–1 000			AN.11(K.12.1)	1 000	AF.5(K.12.1)	1 000
AF.5(K.12.1)	1 000						
Closing balance sheet							
A		L		A		L	
AN.11	0			AN.11	1 000	AF.5	1 000
AF.5	1 000						

Chart 10

GOVERNMENT				ENTERPRISE			
Non-financial accounts							
Expend./ΔA		Source/ΔL		Expend./ΔA		Source/ΔL	
		D.45/D.29	100				
B.9	+100						

Chart 11

HANDING OVER THE FACILITY TO THE GOVERNMENT AT THE END OF THE UTILISATION PERIOD

Capital account

GOVERNMENT ΔA		ΔL		ENTERPRISE ΔA		ΔL	
P.51	+200	D.99	+200	P.51	–200	D.99	–200
B.9	0						

Closing balance sheet

GOVERNMENT A		L		ENTERPRISE A		L	
AN.11	200						

Example III
Factors affecting the differentiation of operational and financial lease

The appendix of the ESA 95 manual provides a short summary of factors which determine whether an economic transaction is regarded as financial or operational lease. When making decisions, issues closely related to the asset and its financing during the lease period should be considered. Therefore the following issues are of key importance:

- who determines the building and the use of the asset,
- who is responsible for its maintenance and security,
- who repays the debt before the agreement expires,
- who bears the risk of the residual value etc.

In cases when both solutions are applicable, the case must be judged taking the relative importance of the issues into account.

ESA 95 AND THE BUDGETARY ACCOUNTING PRACTICE IN HUNGARY

In Hungary, reporting obligations are regulated not by standards but in legal regulations issued by authorisation conferred by legislation, by government decree 249/2000 on public accounting.[4] Under Article 176 of Act on Accounting[5] detailed regulations, methods and procedures implemented to supplement the legal provisions which are necessary for the principle of true and fair view should be prescribed in national accounting standards. These accounting standards can contradict neither the objectives and principles of this Act, nor the process of integration of the EU legislation. The reform of the budgetary accounting is inevitable in order to introduce accrual basis accounting.

In line with ESA 95 requirements, Hungary has been obliged to prepare fiscal policy statements in the framework of the Pre-Accession Economic Programs (PEP) since 2001. The Act amending the Act on Public Finance of 2002 stipulated that budget-related acts should take the rules of ESA 95 into account.[6] GFS32 type budgetary data have to be supplemented, corrected and ranked in order to get budgetary deficit and public data according to ESA 95. Significant methodology and information system development tasks have to be performed in the field of the financial-statistical systems of the government sector in order that in compliance with the EUROSTAT regulations the Ministry of Finance could prepare the notification report, the National Bank of Hungary could prepare the financial accounts and the Hungarian Statistical Office could prepare the government accounts.

As far as budgetary records are concerned, the Hungarian practice still follows the principles laid down in the GFS model, and in the case of data transferred to the European Commission it applies the settlement under ESA 95.

For cash-based data recorded in the GFS system financing items (amounts from national and foreign borrowings, amounts from the issue of securities, annual repayment of national and foreign loans, repurchase of securities in the given year, the part of deposits accumulated until the end of the previous year and the increase in deposits in the year under review) are not considered among revenues and expenditure.

In the past few years the balance sheet data[7] estimated and published by the Ministry of Finance based on the above (excluding local governments, for the entire public sector) are shown in *Table 1.*

The accrual basis ESA 95 data of the general government sector[8] are prepared using the cash-based revenues method, the purpose of which is to – irrespective of the date of cash payment – contain only items relating to the year concerned. The key difference of the two accounting approaches resulting from this, occurs in the field of taxes, social security contributions, corporate aid (for example state guarantee), and social benefits. Data may be adjusted on an accrual basis using three methodological procedures:

- investment-related statistical data are adjusted with the help of the so-called *full accrual* method (in the case of implemented investments transactions are recorded at the date of the commitment),
- the *time adjusted cash* method facilitates adjustments made to the operational budget (such as payroll),
- the *mixed accrual* method used jointly for operational and accumulation data is a mixture of the above.

The excessive deficit procedure

The statistical reports related to the excessive deficit procedure are reviewed on a regular basis; this is necessary due to overoptimistic forecasts and accounting techniques resulting in favourable data. To date the applied methods have been reviewed on a number of occasions upon the inventory of operational and accumulation expenditure. Data for 2003 and 2004 were significantly improved by the slowdown of VAT-refunds. In last year's second report, in the framework of the EDP notification of September 2005, in line with the opinion of the EUROSTAT, two substantive corrections were made: the uniform handling of the one-month additional salary of the public sector and the reclassification of motorway construction modified the 2004 and 2005 deficit figures upwards.

The extremely high ESA 95 deficit data presented in Table 1 equal the output data published this September (2006). With a view to the transitory period granted by EUROSTAT in their New Release nr. 117/2004 of 23 September 2004 up to 2007, mandatory, fully funded pension funds are classified inside the general government sector within the original

Table 1

GOVERNMENT DEFICIT DATA, 2002–2005

(in percentage of GDP)

	2002	2003	2004	2005
GFS (without local governments)	–9.28	–5.70	–6.29	–4.52
GFS (entire public finance)	–9.90	–5.87	–6.45	n. a.
ESA 95	–8.40	–6.40	–6.60	–7.50

program. However, in the EDP notification of September 2006, the mandatory, fully funded pillar of the pension system was recorded outside the general government sector, and based on the news release of the EUROSTAT of March 2006, the budgetary effect of the military acquisitions was re-valued. According to the government, the military expenditure (primarily related to the procurement of Gripen fighter planes) that has no structural effect, is not included in the earlier, December report. However, based on the EUROSTAT news release of March 2006, regarding the military procurements implemented in leasing or instalment payment arrangements, such transactions should be recorded as financial lease upon delivery. The revisions of the existing data are often related to the so-called "…creative accounting. Some are recorded with a retroactive manner, when costs should have been reflected in the deficit."[9]

The difference between the deficit data and forecasts contained in the two reports are well illustrated in *Table 2.*

Based on the reports of December 2005 and September 2006, one may find that serious measures should be taken in order to align the accounting-statistical methodologies.

Data and forecasts in the convergence report

The future measures of the fiscal policy and projected figures are included in the convergence report providing a macroeconomic analysis and the objectives of the medium-term economic policy, which intends to implement the general government sector adjustment required in order to reach the deficit calculated under ESA 95 by 2008. In addition to the required structural measures, the reform of the budget also means the introduction of more stringent accounting principles, which, in addition to the pension funds' issue already mentioned, have an effect on recording motorway developments implemented in PPP schemes and other debated issues as general government expenditure.

However, due to the higher starting level, the correction of the excessive deficit requires greater reduction of the general government deficit than projected in previous programmes, at 2–3 percentage points per annum, after 2006. The increase of the general government debt is primarily due to increasing interest burdens.

Factors influencing the general government debt beyond the primary balance and economic growth are recorded under other factors *(stock-flow adjustment)*. These may modify the balance by as much as 1–2 per cent annually – according to forecasts in a positive direction in the next few years (exchange rate effect, effect of revaluation, other statistical adjustments). *(See Table 3)*

The second (updated) convergence programme published in December, this year, which covers a period of five years, further refines the expected development of the general government's financial status. Compared to

Table 2

DIFFERENCES IN THE TWO REPORTS

(in percentage of GDP)

	2004	2005	2006	2007
ESA 95 (December 2005)	5.4	6.1	4.7	3.3
ESA 95 (September 2006)	6.6	7.5	10.1	6.8

Source: Ministry of Finance

Table 3

MAIN FIGURES OF THE GENERAL GOVERNMENT

(in percentage of GDP, September 2006)

	2004	2005	2006	2007	2008
Deficit	**6.6**	**7.5**	**10.1**	**6.8**	**4.3**
Primary balance	–2.2	–3.4	–6.3	–2.4	–0.2
Structural deficit	5.4	7.8	9.6	5.7	3.5
Gross debt	**60.2**	**62.3**	**68.5**	**71.3**	**72.3**

Source: Ministry of Finance

the converge programme published in September, indicators expressed in percentage of the GDP have changed significantly. This is primarily related to that the GDP figures at current prices are higher than before in the updated macroeconomic forecast – resulting primarily from methodology-related issues. Compared to the GDP at current price revised upwards, the proportion of revenues and expenditure is smaller, therefore the expenditure/GDP ratio is significantly reduced.[10]

Based on the above, it cannot be ensured that the well-known Maastricht convergence criteria (maximum budget deficit of 3 per cent of GDP and maximum total public sector debt of 60 per cent of GDP) will be met until 2011; however, according to government forecasts, these may be reduced to an acceptable level. *(See Table 4)*

In general, it is obvious that serious efforts should be made in the field of economic and accounting convergence in order to accelerate convergence, the most critical point of which is the control of the fiscal procedures, since this is the greatest challenge in the field of econo mic policy.

SUMMARY

The new member states of the European Union – including Hungary – were obliged to prepare Pre-Accession Economic Programs (PEP) since 2001. Statements included in the PEP had to be based on data set according to *ESA 95 methodology*, which – among others – forms the starting point of a comparative analysis of data relating to budgetary deficit, being one of the convergence criteria of EMU member states and applicants.

Budgetary data have to be supplemented, corrected, and ranked over in order to get budgetary deficit and public debt data according to ESA 95. The conversion techniques of the data expressed in flow of money terms is realised within the information system of the

Table 4

THE MAIN PROJECTIONS OF THE UPDATED CONVERGENCE PROGRAMME

(in percentage of GDP, December 2006)

	2007	2008	2009	2010	2011
Budgetary balance	**–6.8**	**–4.3**	**–3.2**	**–2.7**	**–2.2**
Primary balance	–2.4	0.0	0.9	1.1	ca. 1.5
Primary expenditures without EU transfer	43.7	40.5	39.7	38.5	ca. 38.0
Tax and contribution revenues	38.1	37.8	37.3	37.0	36.5–37.0
Gross debt	**70.1**	**71.3**	**69.3**	**67.5**	**65.0–66.0**

Source: Ministry of Finance

public sector through the data collection and estimating procedures organised for the management of emerging data (in balance of money terms).

For the replacement of the missing data in income-expenditure terms in the public sector information system EUROSTAT directives have to be applied, as data reflecting income-expenditure changes accounted in double-entry bookkeeping serve with more adequate information reflecting real processes from a methodological and reliability point of view.

After the alignment of different accounting and statistical systems in this paper we are introducing the most important characteristics of the ESA 95 methodology and the way it affects the public sector financial figures. The up-to-date and projected data on budgetary deficit and state debt level reflects the current state and the future path of the Hungarian fiscal convergence process.

Notes

1 Until about 2010

2 1997. Council Regulation (EC) No 1466/97 of July 7 1997, Council Regulation (EC) No 1467/97 of July 7 1997 the preceding Council regulations and those including the amendments were amended by Council Regulations No 1055/2005 and 1056/2005 of 27 June 2005.

3 Changes in the net borrowing/net lending position are always indicated by Code B.9 throughout the following examples in accordance with ESA 95.

4 Based on the acts on accounting and public finance; prescribes the so-called adjusted cash-basis accounting.

5 Act C of 2000 on Accounting

6 Article 8, Section 4 of Act on Public Financing: "The coherence and the relationship of the budgetary balance (surplus or deficit) of the general government subsectors shall be presented by the indicator required and reported under the excessive deficit procedure of the European Union: the deficit of the general government sector (Maastricht-definition deficit indicator)."
Article 112, Section 3: "The coherence and the relationship of the general government debt of the general government subsectors shall be presented by the indicator required and reported under the excessive deficit procedure of the European Union: the deficit of the general government sector (Maastricht-definition debt indicator)."

7 Based on the public sector and GDP data published by the Hungarian Central Statistical Office. Source: Hungarian Central Statistical Office

8 Source: Ministry of Finance

9 National Bank of Hungary (2005): Report on Convergence

10 The reason for these changes was that the Hungarian Central Statistical Office introduced methodological changes affecting a number of items in the statistics of national accounts in accordance with the requirements (recommendations) set by the EUROSTAT and the OECD. The methodological changes serve the purpose of aligning the Hungarian national accounts to the EU practice.

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