Árpád Kovács*

Observations about the convergence programme

The activity of supreme audit institutions is no longer limited to the preparation of reports on audits – conducted in accordance with international standards – but supports the work of legislators and the (financial) government in (national) economic issues with advice based on the synthesis of audit experiences. The evaluation of the economic or fiscal policies, or the professional correlations thereof is beyond the competence and authorisation of such institutions. Advice is given and opinion is formed usually via the publication of audit experience analyses and recommendations that can be utilised in the implementation of a certain task or programme.

The provision of advice may thus extend to the assessment and evaluation of the well-foundedness of certain economic policy objectives and measures, the preparation fostering the sustainability of processes leading to the realisation of such objectives and measures, the quality of preliminary analyses, as well as the implied risks, and as such it is in full accordance with the legal requirements and authorisations pertaining to the supreme audit institution of the state. The State Audit Office of Hungary (SAO) feels and assumes responsibility to publish on the basis of its audit experience – and even beyond – the conclusions it has reached, the risks it has revealed and the corrective measures it finds necessary. This is also the main strategic objective of the SAO.

Upon the Prime Minister's request, the State Audit Office evaluated the convergence programme especially with this goal in mind.[1]

When compiling the opinion, instead of the stabilisation measures we focused our attention on the evaluation of the well-foundedness of institutional reorganisation and structural reforms accepting the stabilisation measures as facts, as a realistic foundation of programme launching. In addition, we focused on aspects on the basis of which we can contribute to the better transparency of the utilisation of public funds, the improvement of the operational efficiency of the state and public finances through evaluating (the working material of) the convergence programme, too.[2]

THE MAIN DIRECTION OF THE PROGRAMME – GENERAL OBSERVATIONS

Similarly to the written opinion of the National Bank of Hungary (NBH) and the Convergence

* The author thanks his colleagues *Gusztáv Báger, Erika Horváth Menyhárt* and *László Kékesi* for their involvement in compiling the SAO opinion on the convergence programme of Hungary. Their and other colleagues' work, too, contributed to the publication of these observations.

Council about the convergence programme, we also found that the series of measures presented in the programme can be regarded professionally well-elaborated along a definite concept and strategy. We found it positive that both the approach and the concrete measures explicitly talk about the roles and responsibilities of the individuals and the state in burden sharing. Professional well-foundedness and elaborateness is maintained basically until the end of the programme, i.e. 2009. However, in the subsequent period the contours of the programme become vaguer due to natural uncertainties arising from the long time horizon, and also to a great extent from the lack of elaborateness of further measures required for sustainability.

The programme makes it clear that it intends to promote the creation of an economy that strives and is able to continuously renew in terms of structure, technology, level of organisation and quality of management.

Having compared the figures of the document with the available information, including direct audit figures, we concluded that *the initial parameters and forecasts of the macroeconomic path are realistic,* or rather somewhat pessimistic and prudent. Therefore, in this aspect the programme carries no risks, on the contrary, it has some reserves. The chances of implementing the path outlined in the programme are also specifically improved by the fact that the Government reports to Ecofin (Economic and Financial Council) semi-annually, and it must also ensure the implementation of corrective measures should such become necessary.

We find it important that the programme describes alternative paths, too. However, we believe that it would have been (it would be) necessary to develop and analyse a version for the undesirable case when all conditions and influencing factors considered during the development of the balance path are less favourable than expected and calculated. This worst case scenario must not be ignored either. It would be reasonable to figure out how a situation like this would influence the Government's room for manoeuvre, or the main direction of the programme, the chances of implementation of the underlying sub-measures, as well as compliance with the original deadlines. It can and must be analysed especially in this correlation how the possible return to the old regime could be prevented in the worst case scenario.

The annex to the document contains the most important measures. This helps in following and controlling the events.

The authors of the programme believe that the tensions in balance can be relieved and the economy can be put on a sustainable growth path via comprehensive reforms.[3]

In professional circles there has been full agreement about the fact that the prerequisite of the progression of the reforms is immediate consolidation, the stalling of processes unfavourable for the balance, and the consistent implementation of the underlying fiscal measures.

Central bank analysts and others, too, have drawn attention to the vulnerability and fragility of the Hungarian economy, and the need for fiscal consolidation. According to the central bank, due to the balance problems, the Hungarian economy is very vulnerable to capital-market shocks. If the funding needs of public finances do decrease in the wake of consolidation, this process will automatically entail the improvement of the external balance according to NBH.[4]

In other words: the vulnerability of a country may be caused by the impacts of several factors of capital movements. A balanced budget policy and a sustainable stock of debts are fundamental requirements to offset such impacts.[5]

Another study argues for the need for turnaround from the aspect of macroeconomic balance and economic growth. According to the authors of the programme, the two major steps promoting the aforesaid are the definite, expenditure-based reduction of the budget deficit and the growth in employment. They also cite international experience, according to which deficit cuts "pay off" anyway. They confirm that countries with nearly balanced budgets managed to catch up to a greater extent in the past decade, and could better retain their edge in terms of income. They point out that economic growth and deficit cuts are factors that mutually strengthen each other. Not only deficit cuts could influence economic growth, but equally, the latter can contribute to the reduction of deficit.[6]

For the achievement of goals specified in the programme, and the enforcement of the main direction it is positive that *the medium term objectives and measures aiming at the reduction of public sector expenditures could be formulated with uniform logic.* Real progress, catching up and a sustainable growth path *inevitably require that the structural reforms be completed as soon as possible,* i.e. there is work to be done to develop the contents and schedules of steps and measures coordinated with one another that lead to reform-scale changes, as well as to develop the guarantees underlying implementation. This is equally true for public finance reform in the narrower sense, the modernisation of public administration, the careful definition of the group and content of public services, and the solutions of related funding. This is all the more important since full agreement has not been reached in the case of short-term, "industry level" expenditure cutting measures built on mature decisions either.

The (working material of the) convergence programme stays within the frameworks of public finances. It tries to outline a realistic economic growth path, however it fails to sufficiently count with how the measures may hamper economic growth or what social impacts they may induce. Therefore, during the practical implementation of the programme the line that shows how the measures will lead to real reforms would definitely have to be made more marked. One of the basic preconditions for laying the foundations for and successfully implementing this objective is – what the SAO emphasises at every possible forum – the full-scale reconsideration of the role of the state, and on this basis the clarification of the contents of state liabilities and tasks, which also requires new compromises, and then the regulation thereof in a manner that allows monitoring in practice, and the distribution of the workload among the various actors involved in implementation that are not necessarily and exclusively state players.

On the basis of the audits, our reports have repeatedly emphasised the lack of harmony between state tasks, organisational frameworks and budgetary resources, and focused in particular on the evaluation of the operation of the large provision systems from the critical perspective. Our recommendations for the elimination of contradictions have been only partially utilised.

The audit findings warn that the social and economic processes, tasks and determining conditions are too complicated for us to claim that the central aim and objective of the state reform should be clearly the creation of "a smaller and less expensive state". *It is advisable to consider gradually "building" a modern state that provides for closing the gap, development and services in line with the requirements of our age.*[7]

This state (concept) is forward-looking, and is very much different from the existing one in terms of basic features. It is worth highlighting in this context (too) that the interpretation and reconsideration of the tasks of the state – which recur in this writing of mine, too – i.e. one of the key issues of the public finance reform is inevitable, since the task structure of the modernised and europenised state of the future will definitely differ from the currently funded “task package”.

The public finance reform is indispensable for state reform, and in fact, public administration can and must be restructured, europenised and modernised on the same basis, simultaneously. The warnings that come from several sides (Hungarian expert writers, international financial institutions and several SAO reports) that find it urgent and important that the reliability of budget planning be enhanced by the methodological development of macroeconomic forecasts, by strengthening the forward-looking nature of finance policy, and that fiscal and development policies be consistently coordinated, practically recommend and require the revival of the (system of) institutionalised national economy planning and the operation thereof in accordance with the requirements of our age. However, all this (reforms and modern planning) can be implemented only in line with strategic principles based on professional consensus and supported with in-depth impact assessment studies. Implementation is paramount, since we definitely need to find a way out of the situation, according to which today the need for the development and reinforcement of the (aspect and practice of the) individual's responsibility for burden-sharing and self-support exists side by side with the need for the introduction of strong austerity measures serving consolidation.

This is one of the fundamental contradictions of progression, especially for the day-to-day life and short-term perspective of the population, the citizens. The contradiction requires control and solution at such level of development in Hungary – medium-level by international comparison – which represents a specific “danger zone” in the world economy. The population's needs have almost reached the level of developed countries, which is also fostered by the demonstrative effects of those countries. However, the performance and competitiveness of the Hungarian national economy is not yet sufficient to allow most citizens to satisfy these needs from labour income.[8]

Catching up and a sustainable balance path would be fostered if analyses quantifying the expected impacts of the measures outlined in the convergence programme were disclosed and were publicly available. Such analyses would not only support economic assessment and the better understanding of the programme, but would surely help develop expedient governmental behaviour and action as per how the society could be prepared to adopt the impacts of the measures underlying the realisation of the programme, with regard to the fact that initially these impacts will be detrimental for most income earners, i.e. a large part of the population. I am deeply convinced that this is a task of invaluable importance that cannot be put off. *The society* (which is of course far from being homogeneous and uniform, and is characterised by many layer-specific features) *must be regarded as a partner, and it must be won over to the cause of reforms* that go with difficulties due to the austerity measures, but *serve future generations, too!*

One of the most important manifestations of our activities serving the National Assembly, which facilitates the work of the members of Parliament is that – in line with the legal requirements – each year we audit the budget bill for well-foundedness, feasibility and internal consistence. We submit an audit report, which is officially called opinion, to the National Assembly, which is also a precondition for parliamentary debate. We first of all draw attention to the major risks implied in the budget bill, as well as its positive features that foster progress.[9]

The approval of the convergence programme by the EU has practically set off the development of the necessary turnaround. The budget for 2007 must be also determined so that the process could continue. The budget basically relies on, or adjusts to the convergence programme. This partly explains why it contains lower level and smaller risks than the budgets of the previous years.

It is beneficial that in general, the expected tax revenues also carry lower risks than before. It is positive that most of the revenues planned to be realised from state property is well-founded. It affects the expenditure side that by observing the convergence criteria, appropriations that can be exceeded without the need for budget modification could be realistically planned, and their ratio has not increased compared to the 2006 level. Within this the most significant family, social, normative and housing subsidies can be regarded well-founded, which is very important for social justice and cohesion. The revenues of the social security funds are also well-founded. The benefit budget of the Pension Insurance Fund is realistic. It is uncertain whether the Health Insurance Fund appropriation can be realised. The risks can be reduced by the enforcement of measures and regulations adjusted to the convergence programme, which reduce expenditures, make the distribution of the contribution burden more equitable, and create long-term sustainability.

I must add that *the budget bill fails to present* (is unable to present) *the quantified impacts of the planned* or already realised measures *to the same extent as we missed the presentation of the quantified impacts of the reform measures from the convergence programme.*

How can we evaluate the relationship or harmony of the budget bill with the convergence programme? The public finance deficit figures contained in the bill correspond to the deficit appropriations set in the programme. The inflation path outlined in the programme and the forecast thereof for 2007 are in line with the macro-path indicators of the utilisation of the GDP.

The main uncertainty factor is the expected behaviour of the various income owners. It is difficult to assess in advance how investments will change in the competitive sector, and what impacts expenditure cutting and tax avoiding efforts will have. Furthermore, another major risk factor in the budget calculations, which greatly rely on private consumption, is how the population will react to the fiscal measures? The impacts of increasing living costs, job uncertainties, changes in private consumption and the presumably more prudent saving and borrowing attitudes can only be estimated and assumed. At any rate, the population's reactions deserve special attention even in relation to the social acceptance of changes.

Naturally, it must be acknowledged that in the case of such a broad economic and budget policy turnaround as we currently witness, the quantification and analysis of multi-year budgetary impacts is an especially demanding and complex task. However, it is undoubtedly important that the documents that shape and determine the vision of the society and the economy should contain as much relevant information as possible. In addition to the enhancement of the performance of the national economy, the improvement of competitiveness and the restoration of the balance, the availability of the most complete and substantive financial information ensuring transparency and accountability is extremely important, because as a specific reflection of the credibility of public finance management they themselves are eminent factors in the restoration of the confidence of the money markets and investors, which is indispensable for the success of the convergence programme.

On the road leading to the closure of the gap and the creation of the new balance it is a crucial step to eliminate the not sufficiently well-thought after, often squandering utilisation of public funds and the underlying causes. *However, the curtailment of expenditures is not an end, but a means.* The reduction of expenditures is one of the *preconditions for the recon-*

sideration of the contents, extent, arrangement and organisational frameworks of state tasks, and equally the determination of the requirements of task performance, as well as that of the renewable conditions for access to services provided within this framework.

We can only agree with the Speaker of the National Assembly, who formulated the following clear requirement, which has been several times published in the written and electronic media: it is inevitable for any progression to determine those minimum tasks that the state should undertake constitutionally in the interests of its citizens.

The success of the convergence programme also requires that we should focus more than before on the requirements, and equally on the favourable opportunities arising from our EU membership. Apart from anything else, Hungary's active participation in the European Union requires the immediate reconsideration of the roles of the central government and the local governments, and the development of a state that provides for catching up, development and services.

All this falls together with the economic policy message of the latest, 44th Economic Convention, which was submitted to the Government by the chairman of the Hungarian Society of Economics. Apart from other things the document says that: "Increased tax rates, reduced expenditure, or structural transformation remaining in the scope of business administration are not sufficient for the implementation of the Convergence Programme and for stepping on the course of modernisation. Social spending and social transfers should be transformed to such an extent which are inconceivable without the reconsideration of the basic constitutional rights (pension, healthcare, education and other tasks undertaken by the state), and the agreement on new social-political compromises (regional administration, the issue of municipalities, the redefinition of the state's role, the rebuilding of the state). It is the lack of public agreement that prevents the creation of stable and long-term programmes today. Wide professional and social partnership is needed for the reaching of public agreement, i.e. the reforms should not be implemented by way of stealthy legislation."[10]

QUESTIONS AND COMMENTS – COMMENTS ON THE DETAILS OF THE PROGRAMME

Reduction of public sector expenditures

The restraint, curtailment of expenditures is based on three pillars: headcount reduction, wage management and real expenditure cuts. As an aggregate impact, the public sector's GDP relative operational expenditures will drop from the current 18.4% to 15.2% by 2009. Therefore, this part of the programme contains the probable quantified impact or yield of the planned measures. On the other hand, the headcount reduction idea relies neither on performance requirements (the convergence programme only promises the elaboration of such requirements), nor on more extensive function and task analyses, as well as the concrete harmonisation of tasks and resources.

Our audit experience shows that recent restructuring projects – carried out mostly within the ministries – were not preceded by similar analyses and calculations either. However, the reduction of government staff without the expedient reorganisation of tasks cannot be regarded as an assuring solution. We drew the National Assembly's attention to this problem in our opinion on the 2007 budget, too.

I believe that for the time being we cannot determine for sure whether the cost cuts arising from the reduction of headcount (also because its implementation will temporarily entail additional costs in 2007) can be sufficient by itself to achieve the expected result in relation to the modernisation of the public sector, or further measures may become necessary, which may force the comprehensive review of the set of rules that determine the entire social and financial prestige of the public sector.

To the best of our knowledge no feasibility study has been prepared about that and the possible consequences thereof. The convergence programme does not deal with this side of the problem. However, this would also be necessary, since public administration should not be made uncertain when the public finance and public administration reform itself should be assigned to the experts working especially in public finances and public administration. In the absence of the preliminary assessment and evaluation of behavioural motivations and the various impacts, as job and work security diminishes, when life becomes unpredictable, we can count with an uncertain and bad-tempered staff of administrators and public service providers, although they have done nothing to deserve such a change in their situation and perspective. This increases the risks of the implementation and social acceptance of the reforms.

Sustainability of public finances

The programme devotes a separate section to the problem of sustainability of public finances. Within this section it deals with the pension and healthcare systems, and although it looks beyond the time horizon of the programme, it does not describe longer-term solutions.

Healthcare

One of the specifically sensitive areas of the convergence programme is healthcare, and the presentation of the reform ideas aiming to restructure healthcare. The restructuring that affects both institutional funding and responsibility relations promises “better care and more health”. However, its pillars cannot be clearly judged since the presentation and evaluation of the impact mechanism of the listed measures are completely missing from the programme. For the lack of a published computational background no opinion can be formed about the well-foundedness of “resource strengthening”.

The programme does not highlight the model of enforcement of the accessible for all principle. The enforcement of a constitutional right does not only assume public power will (guarantees, including financial guarantees), but also the involvement (responsibility) of the individual, which is clearly expressed by the document. This is why it is completely justified that apart from the state the individual should also be given a role (proper encouragement) in ensuring access to healthcare services. With the regulation currently in force, coverage for services is provided by the state budget – by the taxpayers – for several groups of significant size. The current solution – which, by the way, draws resources away from other, equally important tasks – cannot be undertaken in the long run. If the material does not outline concepts for the reduction of such state responsibilities, then the system continues to be burdened by an unsolved matter, which will continue to curb community expenditures (reduce development funds) as a rule.

Let me cite a few SAO audit experiences from the healthcare system to illustrate the typical problems.

No fundamental changes have been carried out in the field of healthcare. The preparation of the National Health Development Programme was several years behind schedule. The National Assembly decided about launching the Decade of Health Béla Johan National Health Program in 2003. Only part of the resources required for the completion of the sectoral tasks was available. The consistent realisation of long-term programmes was hindered by the fact that the Government had no approved concept. The long-term programme launched for the renewal of the stock of instruments/equipment of institutions was shortened to one year. Deficit became permanent, which was caused by the changing social and economic environment, the professionally weak planning and the growth of contribution debts.

The financial standing and operational conditions of local government owned hospitals were improved by the recent central measures (raising the basic fees, 50% wage hike, consolidation programme), but the systemic and complex review of tension inducing factors, the comprehensive handling and resolution of problems have not taken place. Shortage and wastefulness still exist side by side in the healthcare system. Shortage is characterised by the bad state of repair of the buildings, the obsolete instruments, the employees' income level and the inadequate level of hotel services, while wastefulness is triggered by maintaining an inefficient structure and the shift in the provision of care towards the more expensive in-patient care. Healthcare in Hungary is still hospital-centred. The continuous growth of performances in out-patient and active in-patient specialised care is induced not by changes in the population's needs, but rather by the need of the institutions to increase revenues. The funding entity could not provide comprehensive and continuous professional control for the actual content of performance settlements, the institutions tried to increase their revenues by enhancing their performances at any price.

We must agree with the effort to increase resources for public financing, since there is no other possibility. In the case of in kind benefits the key to changes is the development of an insurance system/insurance systems, of a funding solution/funding solutions for the use of services, and the changes of the systems of subsidies (primarily that of pharmaceutical subsidies). It must also be considered how the institution of disability pension could be realistically handled – by eliminating the potential risks of corruption – and how the practice, according to which there are currently nearly 800,000 people who do not pay contribution, could be ended.

Education

The reform objectives defined in this circle give priority to the promotion of the enhancement of competitiveness, and the utilisation of the opportunities inherent in innovation for growth, which is appropriate. However, it can be criticised that the measures first of all focus on secondary and higher education and neglect primary education, where the economy-of-scale problems are well known according to the convergence programme, too. For the lack of a forward-looking educational policy, and partially due to a shortage of funds, in the past fifteen years the higher education institutions turned out more graduates than needed and not in line with the necessary employment structure. The programme does not sufficiently deal with this problem. Therefore, it does not (cannot) tell what to do with young professionals that can no longer or not yet be employed in the economy.

Another tension is caused by the drop in the turnout of secondary level vocational training, which will gradually form an obstacle to competition, since soon we will witness a "shortage" of well-trained skilled workers. Therefore, it is not enough to merely speak about the need for a vocational training system that is more adjusted to the market requirements. A new secondary level vocational training strategy must be developed that corresponds to the current conditions and the needs of the foreseeable future alike. It can and must be achieved with the necessary changes to curb significant unemployment among college graduates and prevent Hungary from becoming a pool of disadvantaged unskilled workers on the labour market of the EU in a few years' time.

The SAO audits have also revealed that the integration of higher education institutions did not yield the expected cost reduction, it did not have a synergic effect, and the training structure of integrated institutions did not show any significant change or development. Research resources have not been concentrated in an expedient way, management and organisational fragmentation, and consequently, inadequate efficiency still prevails. Research and development subsidies allocated from the central budget are not adjusted to the importance of the task, and the award of state subsidies is not linked to a modern, performance oriented set of requirements. Normative funding developed in higher education could not be made an efficient budgetary tool. The institutions have not become interested in optimising the training costs.

The pension system

The convergence programme makes it clear that one of the main reasons of the existing imbalance, which will soon assume menacing proportions, is the pension system. Yet, it does not pay sufficient attention to the more comprehensive, long-term reforming of the pension system, which could also guarantee sustainability. Whereas the system, which is inequitable already in its elements from several aspects, and cannot be sustained in the long run, has been ripe for such a change for a long time.

The current problems include that the regulatory system contains a lot of disproportions and contradictions, and long-established privileges that can hardly be justified today, while the relatively low retirement "age centre" can only be partially supported with the population's state of health. The programme defines contradictory objectives. While it shows strong social policy commitment to the increase of pensions and pension-like benefits, it also promises the completion of the corrective programme undertaken last year. However, the series of recommendations hardly moves towards the creation of real fundability. The increased retirement age, and the more stringent conditions for retiring do not yield assessable impacts in the short run. In fact, they hardly do more than "heat" the social policy surface of the issue.

In the period of consolidation, in the conditions compelling the restoration of the balance, the possibilities to relieve the tensions of the pension system are rather limited. On the revenue side, the increase in contributions is inseparable from the question of the distribution of public burdens, while on the expenditure side the determining factors are extremely strong, as it is well known. The possibility of measures planned to be taken in the next two to three years seems especially critical. It must also be considered whether in the transitional period of balance creation all commitments undertaken at the expense of the budget (including for instance pensions for the 13th month) can be fully met? It must not be ignored either that the immediate modification of the retirement conditions announced a decade ago (retirement age, incomes considered during the calculation of pension benefits, employment while receiving pension benefits, etc.) to the detriment of those affected will only entail relatively modest savings. In addition, these measures are expected to be unfavourably received by the non-affected age groups of the society, too.

In effect, it is indisputable that the convergence programme highlights the real problems of the pension system, and tries to prevent the aggravation of these problems with rapid and firm measures. The situation is made more complicated by the fact that the earlier fulfilment of the election promises of the successive governments created the social illusion that the satisfaction of most demands aimed to improve living standards is nothing but a question of determination and goodwill on the government's side.

Yet, the future and the renewal of the pension system that will become unsustainable in the foreseeable future is a key issue.

There is no doubt that the unfavourable demographic structure and grim forecast of demographic processes, as well as the characteristic features of employment, and first of all the problems of fundraising due to the strong budgetary constraints make it extremely difficult to explore possible solutions that would be accompanied by the least possible shocks, and adequate in terms of future impacts.[11] However, the programme fails to outline the measures that may serve progression in the period after the turn of the decade.

Local governmental system

Compared to the national and international expectations about the reform of the system, and especially to the required modernisation corresponding to the new European needs, the measures envisaged by the document are modest. As far as we know, there are much more concrete modernisation plans on the desks of the competent authorities both for the situation arising if the acts requiring affirmative votes from two thirds of the Parliament are amended, and for the manoeuvring room provided by acts that can be amended without such a majority. In the light of this, two scenarios should have been followed.

In the case of changes requiring support from two thirds of the Parliament, apart from regional restructuring and the related simultaneous task re-centralisation (from the settlements to the regions) and decentralisation (from the central level to the regions) new opportunities may open up through prescribing the fulfilment of certain tasks by mandatory associations, and through the "tightening" of the budgets of the local governments: liquidation of the standard local governmental monetary fund, requirement of a balanced current budget and surplus, reconsideration of the rule pertaining to the maximum credit line.

In the case of acts requiring support from half of the Parliament, significant results could be achieved by creating regulatory, framework-type acts, by simplifying the system of resource regulation (including the radical reduction of eligibilities for support and the confinement of such eligibilities to a certain period of time), as well as by transforming the system of local taxes. For example, completed preparatory steps and planned measures for property taxation should have been presented in a more pronounced manner. Local tax administration should be centralised and the number of local tax types should be reduced in order to streamline the system of local taxation and make it less expensive.

The success of the initial steps of the progression may be fostered by the fact that the budget bill for 2007 is based on priorities well chosen by the local governments. In line with the convergence programme and the macroeconomic requirements solutions that foster the utilisation of EU development funds in a practical manner, as well as developments boosting the reduction of regional disparities, and changes showing in the direction of the modernisation of financing and administration, have come to the foreground.

In the local governmental sector the Government promotes that development programmes should be increasingly implemented under the aegis of the EU. It raises the related budgetary appropriation, and rationalises the eligibility conditions. It is also in accordance with the convergence objectives that the role of the regions is strengthening in closing the gap between disadvantaged and more developed small regions. It is a forward-looking feature of next year's budget that task performance by multifunctional small regional associations, and regional cooperation will be intensely encouraged with fiscal means. However, these modifications cannot lead to the required turnaround in local governmental financial management. That requires system-scale changes that extend to – among other things – the definition of the content of public tasks, the rearrangement of the resource structure of supply, all the more since the debts of the local governments are growing.

Price subsidies

By curbing supplements provided through price subsidies the programme subordinates everything to the actual pressure of restoring the balance. It basically relies on transitional, temporary solutions. The causes that called for and maintained the extensive subsidies should also be considered systemically. The programme practically ignores such causes, and also whether the current system can be sustained in the longer run, or a real change will be put on the agenda in the near future. In case "purchase power with insufficient income" is required to be supported in the longer run, the reconsideration of income distribution (linked with the issues of employment and income policy) is inevitable. In addition, it must also be examined whether the expenditure envisaged for this purpose is commensurate with the expected outcome. It cannot be ignored that the volume of the corporate income tax has been practically constant for years. Meanwhile, a significant gap has occurred between the state subsidies and the tax paid on the basis of profits.

Revenue increasing measures

Within the programme these measures mostly contain changes that are indispensable for quick balance improvement. However, the statement, according to which apart from the property tax planned to be introduced in 2008, no other significant tax/contribution measures are needed, is considered to be risky. Apparently, this standpoint does not count with the fact that should the continuous expenditure cuts slow down or come to a halt, the resources that become available due to the measures earmarked so far are probably not able to fulfil the co-financing needs, especially if – which must also be taken into account – in contrast with the forecasts, the external market conditions may also change to the detriment of Hungary.

Since the programme is about a series of short-term and tense budgetary measures, the future of withdrawals requires a more prudent approach. This is all the more so because the listed modifications (or impacts thereof) are not quantified either. There are no planned revenue figures, or revenue sums expected to be collected with the given fluctuating rate of law-abidance in Hungary. This also increases the number of uncertainties that come to the surface in connection with the professional well-foundedness of the convergence programme.[12]

The convergence programme sheds a new light on more equitable public burden sharing. I would like to stress in this context (too) that tax policy is not and end, but a means of economic process regulation. Tax squeeze by itself cannot yield long-term and favourable results. It cannot replace a harmonised, more forward-looking tax reform adjusted to the macroeconomic processes, which assumes the development of a comprehensive economic strategy, which extends not only to the tax policy, but also to the entire income policy.

Within the list of urgently needed practical steps, the entire withdrawal structure should be stripped from the privileges, and the cost accounting rules that allow taxes to flow away must also be reviewed. Nearly two fifths of the taxpayers obtain supplementary income from the obsolete income tax exemption and accounting technique related rules. There have never existed so many companies that account all of their revenues as expenses. Similarly, the current practice of invoice issuance is a tacitly accepted social deviancy, which can only slightly be combated by audits, the number of which should definitely be increased. The document says nothing about such measures, and nor does it contain measures aimed at the modernisation and reinforcement of the technical and IT elements of the enforcing organisations, although these are also important conditions to enhance revenue discipline, and eventually to bring the Hungarian tax morale to the European level.

It goes without saying that next year's budget will definitely play an important part in the implementation of the convergence programme. Based on the SAO analysis of that budget we had to conclude that the significant changes in taxation specified both in the convergence programme and the 2007 budget do not show in the direction of tax reform. The system is too complex, its simplification is imperative. On the other hand, it is favourable that broadening of the tax basis will be started in accordance with the convergence programme. The chances of firmly containing tax avoidance may be enhanced by the strengthening of audits and the improvement of the underlying conditions. Tax and contribution hikes by themselves – and not as part of a comprehensive tax reform – in the short run will not foster efforts aimed at the reduction of the grey economy, and neither will they foster the fight against and reduction of corruption.[13]

Privatisation

The convergence programme mentions the role of privatisation in the modernisation of the economy in relation to productivity and employment. It lists a few major companies to be privatised. I believe that the main task is not the selection of companies to be sold. Rather, in the first step a comprehensive analysis should be drawn up about the existing state assets, and it should be assessed on this basis why and what percentage of those assets could be privatised. This percentage is very low, and selling those assets could mean no more than certain security reserves.

Partnership of the public and private sectors

The convergence document emphasises that this cooperation should be made more efficient, and that the private sector should be more involved in investment projects designed to develop public services. The need for "transition" between the two sectors, partnership based development projects and the supply of services are indisputable.[14]

However, not only the possibility of cooperation must be strongly emphasised, but also the need for applying schemes that provide institutional security for public money and public property, as well as the need for full-scale and realistic accountability. The relevant legal regulations must be worked out.[15]

In the past two years several decisions have been made about certain projects to be implemented in the PPP scheme (construction of student residence halls, prisons and motorways). In the light of the audits the experience is clearly unfavourable: private capital has practically not been involved at all, what's more, in certain cases the share undertaken by the private sector has been funded by the budget or the social security system. At this stage we finally got to the point that we cannot decide what the dominant objective is: sparing of budget resources, modernisation of services, or the creation of a new risk-free market – and a new type of subsidy in the special Hungarian form of the scheme – to private investors. Harmonisation of the objectives is a task to be solved. This scheme is rewarding for the public sector and the country only if it involves real capital investments, and is accompanied by quality performance guarantees.

The regulatory and institutional conditions of fiscal discipline

Although the convergence programme cannot endeavour to discuss in detail the professional questions and technical features, since this is not the objective of the document, it is striking how little the document deals with the various methodological, regulatory and institutional conditions of the enforcement of fiscal discipline.[16]

If said conditions were described in more detail, we would be more aware of what budget planning, institutional, regulatory and methodological solutions and changes may induce the attainment and preservation of the targeted results of the adjustments for a longer term, the restructuring of the expenditure side of the budget in greater harmony with the needs and the possibilities, i.e. the enhancement of the quality of the budget. In the current situation these are the tools and tokens of budgetary security, too, and shall be developed and strengthened as much as possible for economic and social considerations alike. In addition to the professional aspects, these are also important since they provide guarantees against any potential voluntarism of political character that may – intentionally or not – come to the surface.

The correlation is specific: said fiscal rules are necessary, but not sufficient conditions for structural reforms. These rules can fulfil their functions (and in this respect they belong to the tool portfolio of budgetary security – *inclusion by the author*) if there exists political willpower to enforce them and have them enforced.[17]

It is (also) emphasised in relation to reform-scale changes and the success of the convergence programme that "…budget planning that »thinks« over longer horizons must be provided …", which "…makes budget decisions and their effects transparent and easy to follow for Parliament, which exercises regulatory authority over the budget…", and "…creates an opportunity for increased security in planning long-term development concepts, and understanding the costs associated with their implementation."[18]

The OECD study analysing the Hungarian budgetary system argues similarly when it cites excess focus on the budget year and actual deficit, as well as the lack of clear rules of budgetary discipline as the main causes of the vulnerability of the Hungarian budget.[19]

EXPLANATIONS TO OUR PROBLEMS – A FEW CONCLUSIONS

The causes as well as the consequences of financial tensions, structural problems and usually economic difficulties are manifold and often interconnected. I believe that the common cause of the majority of these problems is ultimately rooted in the imbroglio of globalisation, the unsettled relationship between the global world economy and Hungary's national economy, and (also) in the lag of coordination and adjustment. No proper method and schedule have been worked out yet for the optimum adjustment of the national economy. The various balance and debt problems, as well as the difficulties in meeting the Maastricht convergence criteria mean and present only partially the problems of sustainable economic growth and balanced development.

There is currently fierce innovative competition and desperate fight in the world for new markets. At the same time, Hungary is retreating from the major markets. The world is currently dominated by a trend of accelerating buy-outs and mergers, while Hungary has been still excessively preoccupied with the distribution of resources (just think about the taxation rules of 2006). While the world is ridden by a more and more threatening "energy war", we are unable to decide about the energy supply strategy of the country (e.g. renewal of production capacities, clarification of the possible funding techniques of the rising energy prices, etc.).

There is no doubt that it is justified to agree with the conclusions – which has recently been more markedly present in the articles of *Zoltán Pitti*[20] from among the Hungarian opinion formers – that the biggest problem is not the budget deficit, but the lack of a theoretically mature economic strategy that relies on professional and political consensus, and can also be enforced in practice.

Therefore, it is wrong to follow the one-sided approach, according to which malfunctioning exists only in the state structure, because then we address the symptoms only. The competitive sector also plays a major role in strengthening the performance and competitiveness of Hungary's national economy, and in improving the balance. In agreement with Zoltán Pitti and others I believe that the closure of the existing gap, progression and evidently the realisation of the convergence programme require that *performance halting phenomena that can be revealed in the competitive sector, and the underlying causes should be offset.*

With certain simplifications these phenomena and causes can be summarised as follows.

- Structural changes in the economy, as a result of which nearly half of the GDP is now produced in the service sector due to the strong flow of resources (enterprise, capital, labour) from the productive sectors to the service sector; however, this sector has no export ability, wherefore it practically depends on the slowly growing domestic effective demand.
- The differentiation of the economic players represents a multidirectional problem, such as insufficient profitability and capital accumulation ability, and the negligence of economy-of-scale aspects.
- The domestic added value indicator relative to the gross output is continuously deteriorating, which can first of all be attributed to the shift of resources to industries producing lower added value.
- The relatively low knowledge performance of Hungary is the consequence of the curtailment or at best stagnation of R&D and innovative activities, which is also due to the fact that the entrepreneurial willingness of the competitive sector is low in this area[21].
- In certain sectors of the national economy, business forms or regions investments are lower than the reduction in assets. In these places we witness the limitation of expanded reproduction.
- The invisible, hidden economy permanently booms, we cannot cut corruption and the avoidance of the payment of public dues, and for the time being we are also unable to eliminate the underlying causes and social embeddedness.
- The capital supply is insufficient, and loan capital required for continuous economic activities is unrealistically expensive.
- The disparities in and contradictions between the level of qualification of the work-

force and the trade structure and employers' needs, as well as the "incapacity" of the vocational training system are gaining ground. Furthermore, the quality of public education is also deteriorating.

The operational and development possibilities of our national economy, the implementation of the convergence programme are influenced by many macro- and microeconomic correlations, the domestic and external markets, as well as social and human policy factors. This is why the questions of the future can be answered very diversely. And depending on the contents of such answers, we can presume several development paths.

It is true that without adequate motivation and encouragement even the best and more expedient programme may run into difficulties in the implementation phase, or may even go the way of incapacitation. Therefore, we must widen the horizon of our way of thinking and actions. Hungarian public administration and system of state institutions should not modernised in line with the current needs, i.e. in a static state. It would be more reasonable to create a vision and a state building concept that could adjust public administration to the functionality of Hungary in 15 to 20 years' time. We are talking about different things, yet the correlation is obvious: according to some opinions, the expenditure and revenue paths of the budgets of the next 10 to 20 years should be reviewed on a professional basis, and this should be the most important step in preparing the reforms.[22]

The models that so far have been mostly based on a static approach and restrictions should be replaced with dynamic models, since *we are facing a completely new challenge of adaptation.* We need to count with a range of specific factors of economic and social development (such as cooperation, new partnerships, the performance of the state organisational system, consistence in the application of law, the security of state task performance and the budget). These issues also affect social questions and correlations, and cannot, or can only hardly be expressed with the help of parameters. However, as a general effect they will settle into shape and may represent either a marked, boosting force that foster progress, or a counteracting, braking force.

Notes

[1] Opinion was formed about the draft, working material of the 2005–2009 convergence programme of the Republic of Hungary updated as of September 2006. The State Audit Office formulated its opinion on the working material received on 25 August 2006 by 28 August. This opinion was taken into account by the competent parties when compiling the final document, i.e. the *Convergence Programme of Hungary 2005–2009, Budapest, September 2006.*

[2] My study is also based on this approach. The gist of my opinion was outlined at the symposium of the Hungarian Society of Economics held in Kossuth Club, Budapest on 19 October 2006, where academician *Tibor Erdős* also gave a talk in the same subject.

[3] According to the programme, the Government's most important objective is to create the prerequisites of growth based on long-term equilibrium, thereby facilitating the lasting and accelerating catching-up in economic output and living standards to the EU average. Real convergence requires a growth and development oriented economic policy relying on the long-term equilibrium of the general government. The achievement of the general government equilibrium requires not only adjustments with short-term effects but also substantive reforms of the operation of the state. *Convergence Programme of Hungary 2005–2009, Budapest, September 2006, page 3*

[4] Report on the convergence processes, *National Bank of Hungary, Budapest, 2005, page 6*

5 Dóra Győrffy: Eurócsatlakozás és fiskális konszolidáció Magyarországon, tanulságok a globális tőkepiacok történetéből, *Külgazdaság, 2005.3, pp. 79–80* (Adoption of the euro and fiscal consolidation in Hungary, lessons from the history of global capital markets)

6 Makro egyensúly és gazdasági növekedés, *Central European Management Intelligence, Budapest, April 2006, pp. 27–28* (Macro balance and economic growth)

7 The Hungary 2015 strategic research project integrates and summarises the work of the nearly 100 researchers. According to one of the summary studies of the research: "…we do not accept the neoliberal approach of a small and inexpensive state, but we rather start out from the concept of a strong and effective state that provides for development and services. Due to the permanent underperformance of the public sector, a *de facto* "state phobia" has emerged in Hungary, and demagogical statements about the drastic streamlining of the state are also often times heard of. Similarly, the institutions themselves have suffered an enormous loss of prestige in the past decade due to their low effectiveness, low efficiency and poor social impacts. Therefore such proposals have dominated the public opinion, according to which the radical downsizing of the institutions and the resulting savings will considerably improve competitiveness. In fact, the opposite is true, since the most important precondition and factor of international competitiveness is a high capacity state – or usually institutional – sector. The state shall not be downsized, but rather expanded – through radical reforms and its organic connection with the social capacity." *See: Attila Ágh: Az intézményi reformok – 2015, Az alapvető változások 2006 és 2015 között, White Paper, joint project of the Hungarian Academy of Sciences and the Prime Minister's Office, Hungarian Academy of Sciences, Sociology Research Institute, 2006, Budapest, pp. 242–243* (Institutional reforms – 2015, The basic changes between 2006 and 2015)

8 Attention to this specific correlation is drawn by academician *Mihály Simai* in his writing titled *The world economy and Europe in the early 21st century* (A világgazdaság és Európa a XXI. század elején). *See: Fejlesztés és Finanszírozás, 2006.1, pp. 7–8*

9 We have recently published our latest material: Opinion on the 2007 budget bill of the Republic of Hungary, *SAO report No. 0641, November 2006, National Assembly No.: T/1145/1.* In the following we will refer to this document several times without indicating the page numbers, since the findings are contained in different sections of the report.

10 Conclusions regarding economic policy made at the 44th Economic Convention – Information for the Government (Document), *Public Finance Quarterly, 2006.3, pp. 405–406*

11 The population of Hungary is continuously decreasing, and will drop to 9.85 million by 2021. Currently every fifth citizen is, and in 2021 every fourth citizen will be 60 years old or more. *See: Katalin Tausz: Társadalmi kohézió – 2015, White Paper, i.m. page 116* (Social Cohesion – 2015 White Paper) It must be mentioned here that "in 2005 there were 3,902,000 employed, and 304,000 unemployed people in Hungary. The economically inactive population totalled 3,517,000 people, 55% of whom were pensioners, 21% were full-time students, 17% were other dependents and 7% received childcare benefits. According to the analysis of the Hungarian Central Statistic Office (HCSO), the remaining 2.5 million people are not simply actively unconnected to the economy or the world of labour, but a significant portion of them is unable or unwilling to enter into employment." *See: Hungary 2005, HCSO, Budapest, 2006, page 19*

12 A prudent comment on the income policy: it would also be necessary to consider to what extent the limitation of effective demand will deteriorate the chances of survival of mostly service supply companies that almost exclusively rely on the internal market. It must also be considered that – due to the slow change in effective demand, and the restriction thereof – the freezing of incomes will at best slow down, or in a worse case scenario may even incapacitate the marketisation of the public service system.

13 After all this, it is just a supplementary note that the solidarity tax imposed on taxpayers over a specific amount (HUF 6.67 million per year) is more of a symbolic value than a measure designed to markedly increase revenues, while progress in the affected group is far from being uniform, and – from this aspect – this measure does not actually take income differences into account.

14 "…market mechanisms appear in various forms in the performance of public functions. … We can establish that the cooperation described

above (i.e. PPP schemes – *inclusion by the author*), its potential usefulness, or even necessity cannot be questioned." *Gusztáv Báger: Public-private partnerships and audits, Public Finance Quarterly 2006.1, page 76*

15 "Hungary has no legally distinct PPP category. Legislators only refer to it…" *Mihály Varga: PPPs in Hungary – Do They Hurt Us or Help Us? Public Finance Quarterly, 2005 Consolidated Issue, page 62.* Furthermore: "The World Bank's summary states that in 9 out of the 11 countries where PPP is being applied there is either established, properly formulated legislation, or a draft is under preparation …creating national regulation is a truly urgent task." *János Fónagy: PPP regulation is lacking, Public Finance Quarterly, 2006.3, page 367*

16 Functional and programme budgeting can also be mentioned here, since its specific disciplinary impact requires planning for a programme period usually spanning several years, which also counts with the influencing factors, and programme implementation also requires a specific impetus and compulsory path. The major characteristics, international and national experiences are well described by *Gusztáv Báger's* paper titled *Program budgeting-characteristic features and practical experiences, See: Public Finance Quarterly, 2006.3, pp. 284–305*

Among the guarantees, even more direct and targeted solution is provided by the tools of rule based fiscal policy interpreted in the narrower sense. The major elements of the relevant rule of law can be: budget policy rules (numerical limits on deficit, expenditure and debt), budget procedural rules (pertaining to medium-term budget planning or accrual accounting), transparency standards (reports on the financial standing of the state), and a monitoring and enforcing mechanism (possibly by an independent authority). *See: György Kopits: Conference on fiscal responsibility, Public Finance Quarterly, 2006.1, page 125*

Apart from the balanced budget and deficit requirements, the literature includes borrowing rules, reserve formation rules and the exchange rate system in fiscal policy rules interpreted in the broader sense. *See: István Benczes: Fiskális szabályok használata a Gazdasági és Monetáris Unióban, Külgazdaság, 2004.11, page 26* (The use of fiscal rules in the Economic and Monetary Union)

The major lessons of the conference on budgetary responsibility, including the authoritative international experiences of the responsibility framework of rule based budgeting is systematised in the paper compiled by *Gábor P. Kiss* and *László Kékesi. Conference on fiscal responsibility, Public Finance Quarterly, 2006.3, pp. 383–398*

17 Miklós Losoncz: Válasz a körkérdésre, *Külgazdaság, 2006.3, page 34 (Answers to the poll)*

18 Árpád Kovács: Competitiveness and Public Finances, *Public Finance Quarterly, 2005 Consolidated Issue, pp. 39–40*

19 Daniel Bergvall – Ian Hawkesworth – Dirk-Jan Kraan – Philipp Krause: Budgeting in Hungary, OECD study, *Public Finance Quarterly, 2006.3, pages 263–283.* The study presents the main findings of the budget review of Hungary that was carried out by the Secretariat of the Organisation for Economic Cooperation and Development (OECD) in May 2006 as part of the working programme of the Working Party of Senior Budget Officials. The official report prepared about the review, which is much more sizeable than the cited study, also emphasises the anomalies indicated above: *see Budgeting in Hungary (GOV/PGC/SBO/2006/8), OECD, 2006, pp. 28–29.*

20 Zoltán Pitti honoured the author by providing a brief summary of his thoughts.

21 The latter is highlighted by Gábor Papanek in his book titled Tudásáramlás, jogbiztonság, együttműködés (Knowledge flow, legal certainty and cooperation), which maps the invisible resources of the development of the Hungarian economy, when he argues for the need to strengthen the economic role of knowledge. On pages 169 and 170 of his book he also points out that the basic tool for Hungary's progress is technology transfer in the broad sense of the word, and in particular the acceleration of the knowledge flow in every single field. The author presumes that this would allow for an annual growth rate 0.5–1% higher than that developed countries usually realise.

22 András Simonovits: Válasz a körkérdésre, *Külgazdaság, 2006.3, page 49 (Answers to the poll)*