Conference on fiscal responsibility

Organized by the State Audit Office and the National Bank of Hungary with assistance from the Ministry of Finance on May 19 2006, the conference on a Fiscal Responsibility Framework (FRF) responded to the topical issue of the lasting grievances and the continuous deterioration of the transparency of budget processes as well as the strengthening social demand (rather than pressure) for change. The participants of the conference included high-ranking foreign experts and recognized professionals from domestic financial and scientific circles. An overview of Hungary's fiscal problems with international experts was expected to provide useful contribution to avoiding the onset of a crisis and to determining possible courses of action.

The passages below present the gist of the lectures, contributions and the discussion (as captured by *Gábor P. Kiss,* a principal economist of the National Bank of Hungary) and the major conclusions of and the lessons learnt from the conference (as summarized by *László Kékesi,* deputy secretary general of the State Audit Office):

LECTURES, CONTRIBUTIONS, DISCUSSION…

■ In his opening address, *Árpád Kovács* (President of the State Audit Office) underscored the importance of a framework of government interventions in terms of substance and technical aspects. That is not simply a question of adaptation, it is a vital issue from the point of view of competitiveness in Hungary. In addition to the steps designed to achieve stability and modernization, it is necessary to develop a controllable system of fiscal planning and execution.

In the past fifteen years, the margin of "planning error" between plans and execution has kept widening, and it would be oversimplification to attribute that to lack of discipline. There are too many governmental tasks and priorities. Public finance suffers from lack of transparency. Rules of administration and procedure would help moderate the public finance deficit and indebtedness and would also reduce the scope of economic policy interference and require political will for compliance.

Expressing an opinion on the draft legislation on the budget and assisting members of Parliament do their job have become one of the most important roles for the State Audit Office. Performing those roles would, however, require at least one month allowed for analyzing the proposed budget act. Moreover, a decision would be needed on the five-to-six fundamental terms about which the analysis has to make black-and-white statements.

Finally, there is a need for a database which contains actual figures.

Fiscal rules should not be looked upon as panacea, but they are a suitable means of ensuring fiscal discipline. The success of the rules hinges first and foremost on whether or not the government in office has the political intent to abide by them.

■ A speech by *György Kopits* (Member of the Monetary Council, National Bank of Hungary) offered a comprehensive overview of the international experience of the past decade. Set against an increasingly integrated international backdrop, several countries with emerging markets and many of their developed peers have been hit by financial crises as a result of their chronic propensity to run into fiscal deficits and the resulting unsustainable trend of indebtedness. Several countries have introduced a rule based Fiscal Responsibility Framework (FRF) as a remedy for the propensity to incur deficits and for managing (or preferably avoiding) the related crises. Most of the solutions were modeled first of all after an Act (Fiscal Responsibility Act) New Zealand introduced in 1994.

Essentially, rule based FRF contains four key components:

❶ Fiscal policy rules: limit values set mainly for the balance (total, primary or structural definition), expenditure (primary if possible, i.e. net of interest expenditure) or for debt;

❷ Rules of fiscal procedure (fiscal planning, debate, execution) including medium term fiscal planning;

❸ Transparency standards, including inter alia regular, factual and timely reports that are easy to access and are complemented with result oriented data reporting and careful forecasts based on macro-fiscal assumptions regarding the sector of government finance as a whole;

❹ A control and enforcement mechanism operated if possible by an independent government organization.

Over and above the aforementioned common components, FRF shows a variety of institutional features country by country. The FRF is set forth in a charter (constitution, act or international treaty) or simply in a government decree or directive, whichever is suitable for the purpose in a specific country. The effect of the rule, the time horizon and the size of the scope of applicability are more important. Enforcement is also an important aspect: is there an exemption clause or a sanction applicable upon a failure to perform (i.e. an adjustment obligation, pecuniary fine or loss of reputation). It is just as important to identify a control organization (state audit office, panel of experts, court of law or central bank) and its role accurately (normally supervision, control).

The experiences of the countries applying FRF are positive in general, but final evaluation will have to wait at least until the end of a full economic and political cycle. The majority of these countries conform to the rules, but there are examples of non-compliance and also of mixed experiences. Wherever fiscal rules were adhered to, investments and growth reached above average and stable rates, real interest was modest and inflation was relatively low. Yet, there is mixed experience with external balance, which is not surprising, because the balance on the current account of the balance of payments is also influenced by the savings behavior of the private as well as the public sector. Wherever FRF is complied with, there are no signs of creative bookkeeping, but there have been a few cases when one-off stop gap measures were taken to comply with the fiscal policy rule and the necessary structural reforms were postponed.

To summarize the experiences of about 20 countries: FRF is not a magic wand, it is rather a useful framework, it operates as a signaling system (as a 'third wheel') to help achieve fiscal discipline. In that sense, its helps fortify commitment (commitment technology). However, to achieve that, continuous adjustments, reforms are constant vigilance are needed.

Over the past decade and a half, Hungary has shown a gradually growing and large appetite for fiscal deficit. Hungary has shown clearly discernable signs of the lack of a culture of stability, which we can call also 'fiscal alcoholism' and which has well-known attitudes and symptoms (denial, postponed withdrawal treatment, blaming others, etc.). The introduction of the FRF needs to be underpinned by political commitment and social consensus. Its technical conditions precedent include transparency, strengthening rules of procedure (including medium term fiscal planning) and the launch of comprehensive reform steps (particularly the reform of large distribution systems). As far as the structure and operation of the FRF are concerned, there are several potential solutions, but one cannot do without limiting primary expenditure supported by a system of careful macro-fiscal forecasting and by ensuring control by an independent authority (e.g. by the State Audit Office).

One thing is certain: Hungary's fiscal processes are unsustainable. The question is whether we have reached the tipping point (see 'tipping point' in *M. Gladwell*), which will trigger radical changes and hence the strict application of FRF or we need to wait first for a financial crisis to hit.

■ Next, *Mario Marcel* (Director, Ministry of Finance, Chile) summarized the experiences Chile accumulated over decades. Drawing the lessons from past financial crises and macroeconomic volatility, Chile aspired to achieve fiscal and monetary discipline starting the late eighties. The left wing government elected after the Asian crisis in 2000 introduced a rules-based FRF without enacting it. The framework was built upon four guiding principles: macroeconomic efficiency, efficient allocation, efficiency in the use of budget resources and lastly the principle of transparency. The main practical elements of FRF included a rule requiring a budget surplus, the copper stabilization fund coupled with strengthening and focusing the procedures of budgeting.

By adopting a fiscal policy rule, the government obliges itself to achieve a structural surplus of the budget at 1 percent of GDP. To calculate the structural balance, it is necessary to filter the impact of the cyclical swings of the economy on the budget. Filtering the effect of the cycle is simple through applying well-known and internationally accepted (IMF, OECD) methodology, but the price volatility of copper, the most important export commodity, must also be managed. In practice, a 14-strong panel of independent professionals is in charge of controlling the application of this methodology (including the filtering of the cycle by lengthening trends) and adherence to the rule.

In addition to the above, the occasional profit (or loss) realized due to the fluctuation of the price of copper is invested into (subtracted or compensated from) a stabilization fund. Forecasting the price of copper and determining the trigger price for the fund depends on a prognosis made by 12 independent experts. So far, the obligation to maintain a structural surplus has been met while the actual balance expressed as a percentage of the GDP moved between –1.5 and 4 percent in response to the cycle and the fluctuation of the price of copper. The justification for the structural surplus of 1 percent of GDP is the need for pre-funding central bank losses reaching 1 percent and other future liabilities, including the coverage of PPP programs, guaranteed minimum pensions, the guarantee of bank deposits and the compensation of non-renewable income from copper exports.

The rules of fiscal procedure introduced as of the late nineties increased governmental control over the legislative process such as by granting the right to veto. The authority of

Congress was limited to reducing expenditure. Theoretically, solutions based on hierarchical fiscal institutions may facilitate better fiscal performance, but in that case fiscal discipline could not be guaranteed either due to discretional decisions.

Moreover, 1600 performance indicators were introduced in response to the improved fiscal principles, 60 percent of the expenditures are appropriately evaluated and the remuneration of public sector employees depends on performance. Application of the GFS 2001 standard in accounting is another safeguard for transparency, and an independent committee verifies the foundations for the major macroeconomic assumptions of the surplus rule.

Mario Marcel emphasized that the Chile experience suggests (on the basis of a comparison of the impact of the external shock of 1982–1983 with that of 2001–2002) that the fiscal rule has reduced the exposure of the economy to cyclical fluctuations and set it on a higher level, lasting growth curve. The increasing level of efficiency and competence set a strengthening 'angelic circle' into motion, which supported macroeconomic stability and higher growth. That result drew heavily on a high level of transparency, congressional support (abandoning discretional measures) and accountability. Interestingly, the FRF introduced by the left-wing government is also supported in full by the opposition.

▫ Speaking about the fiscal rules of Sweden *Yngve Lindh* (Chief Counsel, Ministry of Finance, Sweden) explained that the FRF introduced in the mid nineties was justified by both the catastrophic status of public finances and the lack of transparency in procedures comparable only to Greece within the EU. That statement received wide publicity and shocked the community of experts. Swedish fiscal policy responded to the adverse changes in the international environment by running up demand, but eventually the country could not avoid a financial crisis in 1991–1993. The fixed exchange rate had to be abandoned and the Swedish Crown depreciated. GDP growth diminished for three years. Rising unemployment and the support required by shaken banks drove the rate of the deficit to 12% of GDP and national debt, expressed as a percentage of the GDP was up 35 percentage points in a few years.

In 1992, a new left wing government took office and several measures were taken thereafter. A consolidation program started. A system of inflation targeting was introduced and forecasting the inflation target and productivity created a new platform for wage bargaining. The pension system was reformed. The country joined the EU and market deregulation became comprehensive.

▫ In the second part of the presentation, *Ake Hjalmarsson* (Director, Ministry of Finance, Sweden) reviewed the operation of the FRF. The reform of procedural rules was prepared in 1992–1994 and the new arrangements were used first in 1996 for the budget act of 1997. Among other measures, the new system reversed the former 'bottom up' approach, which started from the details, and began the budgeting procedure from the level of aggregate figures (i.e. 'top down'). Fiscal policy being integrated into a rolling medium term perspective or framework is an essential element of the reform. The government monitors the execution of the budget carefully. An organic public finance act was adopted, including provisions about the new steps of the procedure.

Starting the second half of the nineties, a left wing government adopted and committed to three fiscal policy rules. After completing the program of fiscal adjustment, the government introduced a nominal primary expenditure limit, which is projected for three years as part of medium term planning. Two years later, the government committed itself to a structural surplus of 2 percent of the GDP (without a formal act). The actual size of the surplus was calculated in proportion to the needs of an aging society, or more accurately by factoring in the profits of the newly established private pension funds. (If Eurostat disapproves of calculating the balance of the budget this way, the surplus rule will in all likelihood be replaced by a structural balance rule.) Moreover, local governments must maintain a balance on current account (known as the golden rule).

There are three de facto independent governmental institutions cooperating in responsible manner during the supervision of compliance with the rule: the National Debt Bureau, the National Finance Bureau, and the National Research Institute. These have clearly defined roles in macroeconomic and fiscal analysis as well as in both short and medium term forecasting. Their core principles demand professionalism and publicity.

Swedish fiscal rules have functioned well and the expenditure rule was always respected in the period between 1997 and 2005. The top down approach to budgeting was also successful. On average, fiscal surplus reached 1.9 percent of the GDP in 2000–2005, that is to say the rule was successful and government debt dropped to 50 percent of GDP. Local governments also respected the golden rule and reached equilibrium in their balances on average in 2000–2005.

Ake Hjalmarsson drew the lesson to be learnt by saying political decision making circles learnt from the crisis and accepted the paradigm shift. However, technical and legal solutions alone are insufficient. The heart of the matter lies in the values prevailing in government financial affairs and living up to political commitments. An alleged disadvantage of the rule involves on the one hand the restricted room for discretional decisions. On the other hand, it may reduce capital expenditure in theory. To avoid that eventuality, funds were set aside for a 20 year infrastructure program while the strict expenditure rule was in effect, and a golden rule exempting capital expenditure was introduced at the municipalities. Thirdly, attempts to evade the system could be seen as a disadvantage. To circumvent that a rule more stringent than those set forth under ESA95 was adopted and PPP capital expenditure was charged as cost in each case. A slight degree of evading the expenditure rule was observed only in connection with granting tax concessions.

■ The paper presented by *Jacques de Larosiere* (Councilor, BNP) discussed international experiences keeping EU member states in focus. Introducing rule-based fiscal policies is an option worth considering for countries that have a propensity to run up budget deficits and to submerge into debt. Wherever slippage into deficit is more and more frequent and lasting, applying a medium term framework of limits is necessary. All the more so, because the time horizon of political decision making is frequently determined by the date of the upcoming elections and reducing expenditures which had been programmed for a number of years is problematic in policy terms and sometimes even technically. Analyzed from this perspective, certain successful countries have resorted to nationally applicable rules (for instance, the Netherlands and Sweden in the EU). These adopt a medium term view and seek to avoid structural imbalance and pro-cyclic fiscal policy by combining numerical expenditure limits with structural efficiency targets. Hungary could draw lessons from the Stability and Growth Pact (SGP), which seems to be a truly prudent system, but its practical success is limited by five factors:

The system:

- fails to allow automatic stabilizers work in both directions, i.e. fails to prevent spending the extra income realized in a positive boom cycle;
- failed to set the reduction or elimination of structural deficit as a requirement for the initial stage;

- failed to better adapt the equilibrium rule to the specificities of individual countries (e.g. stricter application in highly indebted countries);
- failed to capture the fiscal impact of longer term demographic processes; and
- the fiscal debates conducted at Commission and Council level should be devoid of political considerations, and member states should not interpret the rules as exerting external pressure.

The softening up of the SGP introduced last year does not guarantee improved efficiency, although it has become more realistic and more flexible by taking the differences between countries into account. The problem is that 'other relevant factors' can also be considered when evaluating compliance with the fiscal deficit limit of 3 percent of the GDP. Also, the deadline for adjustment was expanded from one year to two years. The symmetric application of the SGP continues to be unresolved.

Jacques de Larosiere said politicians must look upon substantial deficit and debt and a major national issue as the costs of delay are immense. That is why the introduction of a rules-based medium term framework at national level is so important within the Pact (recognizing that the Pact itself is not efficient enough).

Finally, the speaker underscored that the creation of a national FRF is almost inconceivable without a wide consensus between political powers and the public. He made reference to the most recent experience of France, where an independent committee appointed by the Minister of Finance plays a key role, as (chaired by *Michel Pébereau* with members representing a wide political spectrum) the committee submitted consensus based recommendations to the government among others about reaching fiscal balance in the next four years by adopting a nominal expenditure limit and about reducing national debt from the current 53 percent to 45 percent of the GDP in ten years.

During the round-table discussion, *János Veres* (Minister of Finance) stressed in his keynote speech that it was not capturing in the constitution or an act that ensures giving effect to a rule. Current fiscal procedures would allow the enforcement of predetermined limits. However, the situation in Hungary is special in that there was no consensus among the parties neither on the need for nor on the direction of reducing the deficit. The prevailing trend has so far been stretching existing limits, but now reforms would be needed, some of which include the amendment of acts by a two-third majority (e.g. on the legal status of representatives, municipality system, elections, emoluments). Regulating these areas requires amendments.

Some of the international experience can be put to good use. The expenditure target may not be modified in Hungary after the first reading of the budget act. There may be a need for specifying rules-based macro frameworks. Three areas (public administration, local governments and the health system) require changes in merit. Also, the control over government revenues should be improved, along with the appropriate monitoring of expenditures. There will be a uniform system for registering commitments in the future. Divided into 27 parts, the fixed system of Swedish expenditure targets is an appealing solution, which János Veres would support, because it would be more favourable for the country as well as the Ministry of Finance. Setting up a new organization (a fiscal council) seems unnecessary, though, as it would not bring additional control over and above that exercised by the State Audit Office. It could only have an advisory role without decision making powers. An independent body should not be involved in performing other activities; hence the participation of the central bank in such a council is unacceptable.

Mihály Varga (Chairman of the Parliamentary Fiscal, Financial and State Audit Committee) thinks it is a false dilemma to contemplate how to balance out public finance as the level of redistribution is also important. There are two models, one of a low and one of a high level of redistribution, but both can be successful. Stabilization can be achieved in conjunction with reducing the level of redistribution, and it is easier to get support for that.

The visible increase of the margin of error in planning is not a mere coincidence. The level of transparency has deteriorated and control has become a formality as the State Audit Office had a single day for expressing an opinion on the budget last year. It was his impression that staff was working under pressure.

Asserting his view that it is illusionary to wait for an external force (EU, capital markets), Mihály Varga recommended drafting a new law on public finance, which would be based on a cost-benefit analysis, as the present act has become vacant and imposes no sanctions. There is a need for independent actors who will press for responsibility and help restore credibility. Legislation should be enacted about PPP programs. The presence of PPP is not a problem, but the lack of statutory control is a grievance, which is why parliamentary authorization would be necessary. Members of Parliament could be assisted in their work by an office, which would be independent of the government and would be similar to the Congressional Budget Office operating in the United States. It is necessary to rethink the mechanism of the National Development Plan along with the strengthening of cooperation and transparency. The introduction of personal liability in addition to institutional liability is also recommended and could take the form of pecuniary or financial sanctions.

■ *László Csaba* (professor, Central European University, Hungary) quoted the statement that whenever policy falls victim to interest groups, it culminates in the decline of the nation. He also quoted Buchanan, who said voters were short-sighted and failed to recognize that present expenditures trigger future tax hikes and needed protection therefore. On the other hand, Kydland and Prescott suggest that only rules can protect public figures from repeated errors due to temporal inconsistency.

Deficit tends to reduce GDP through crowding out. There have been no or only transitional growth sacrifices of adjustment in the past 25 years. Adjustment will not give rise to mass unemployment, which is more likely to occur in circumstances where problems are treated by running up deficits. Fiscal stimuli fail and large-scale government CAPEX projects also tend to increase corruption. Conversely, the fiscal rule increases GDP.

In practice, several decision making powers have been granted to trade agencies but remained under control. The delegation of certain powers by Parliament does not mean the end of democracy.

Speaking about changes in Hungary, László Csaba stressed the lack of fiscal transparency and the lack of reliable reporting methods. Figures are important or at least should appear to be so that we can measure up against something. A top down approach to fiscal planning could be beneficial. The role of independent forecasting is an important institutional aspect, including, for instance, the preliminary verification role of the State Audit Office and publicity, both of which can help a lot.

■ *István Csillag* (Chairman of the Board, Eximbank Zrt., Hungary) began his speech by asking two questions. First, is a paradigm shift possible without a crisis? Second, can fiscal responsibility be strengthened by setting up institutions?

We should learn from the mistakes made by others. We should examine what is considered to be normal and acceptable nowadays and how it would be possible to introduce something new so as to avoid repeating past mistakes in the future. At present taxpayer money is spent without restraint or control and the only limit is set by the balance of payments. Hungary cannot remain isolated and should pursue fiscal and monetary policies with a view to international capital markets. The twin deficit may force changes upon us, but adjustments are insufficient, internal controls should be enforced. An internal rule should be set up in support of the internal limit. It is a question whether or not domestic circles will be willing to accept that. Also, the most important component is a question.

István Csillag would borrow five internationally tested components. Cyclically adjusted deficit should balance out. On the other hand, demographic phenomena render fiscal problems more severe and the revamp of the social security system could prevent the annual recurrence of deficit overshoots. The Danish or the UK model of reducing government debt should be made mandatory and deficit should be reduced simultaneously with redistribution. The rate of redistribution should be reconsidered due to international competition. The power of publicity is weak as regards the consequences of political promises. The statistical accuracy of data should be increased. The budget should not be based on official forecasts, rather on those by professional institutions. Setting up a Fiscal Council with a single mandate of 18 months, which Mr. Csillag himself had recommended earlier, does not substitute an internal limit and the control of behaviour. He disagreed with the option that the State Audit Office or the Central Bank should delegate members to such a council.

■ *László Nyikos* (Research Advisor, Institute of Development and Methodology, State Audit Office, Hungary) remarked that he sensed some scepticism concerning the relevance of legislation in János Veres' speech. The constitution does not address the issue of public funds and how taxpayer money is used. At present, there are three laws in effect about those matters: first of all, the act on public finance, which has slowly become incomprehensible. There are two improvements to be made: first, it should require the presentation of time series and second, it should define the principles of budgeting, e.g. the principle of detail. The second law is the government decree on government accounting, which used to be an act between 1897 and 1950. The accounting regulations should adopt international standards. The third law is the act on the State Audit Office, which provides no more than the State Audit Office's obligation to express an opinion about the budget.

Tamás Mészáros (Rector, Corvinus University, Budapest; Chairman of the Board, State Privatization and Holding Zrt., Hungary) highlighted that the profession itself should reach a consensus before recommending that politicians should come to one. Failing that, politicians will have the discretion to select whichever expert they please depending on what the experts are saying at the time. International institutions and independent credit rating agencies try to be objective, the latter do so because they want to see their loans repaid.

■ *György Szapáry* (Deputy Governor, National Bank of Hungary) quoted Rogoff's maxim, which suggests that each brilliant idea goes through three stages. First it seems ridiculous, then possible to implement and finally self-evident. 80 years ago the idea of central bank independence was in the first stage; nowadays the idea of a Fiscal Council has reached the second stage. The question is not who will sit on the council, but what licenses the council will hold. It could have the power to decide whether or not reaching a convergence trajectory was likely, whether or not income and expenditure targets were realistic, and if the answer is in the negative, it could return the budget to Parliament.

■ *György Kopits* mentioned that it was the role of the Council that mattered. The literature frequently referred to it as a decision making body, but that was a foredoomed idea. Fiscal policy decisions cannot be outsourced as monetary policy is outsourced to the central bank, i.e. the Monetary Council under a clear-cut principal-agent relationship. The only country that is planning to introduce a Fiscal Council with decision making powers is Nigeria. But they have a special reason for that (federal fiscal system with regional states enjoying a high degree of sovereignty). In Hungary it would seem more practical to strengthen the control function of the State Audit Office than to set up a new institution called a Council.

■ Closing the event, *Zsigmond Járai* (Governor, National Bank of Hungary) said the goal of the conference was to bring together economists and decision makers to create a dialogue about whether or not a rules-based fiscal responsibility framework was worth introducing, and if the answer was in the affirmative, then how should we go about it. That is only one step out of one hundred steps towards fiscal discipline. Summarizing the proceedings, Mr. Járai detected a consensus about the need for a steady balance showing a surplus, reaching a 3 percent deficit is insufficient. Complying with the Maastricht criterion is not enough, the requirements of the SGP should be met. As Mario Marcel suggested in his speech, savings on interest rather than debt may be used to increase social support. But it is very difficult to give up fiscal alcoholism. The question is whether or not a financial crisis is needed to have things fall in place. Elsewhere such a crisis was required. The lesson to be learnt from history is that no one ever learns from the past. It is likely that there is consensus among the parties about the critical state of the budget and that after the elections one can see that the emperor is naked. Ten out of eleven speakers stressed the importance of the rules and the person that represented a slightly alternative position was János Veres, who put more emphasis on the role of determination without questioning the need for rules. Several of the speakers mentioned the level of redistribution. István Csillag stressed the importance of true measures, so that this does not end up being a balloon. Regarding the matter of a Fiscal Council, the majority would want something to happen, but there is no consensus on what it should be. Presumably, independent control enjoys supremacy over setting up a council. We ignored discussion corruption and the lack of transparency, only László Csaba made mention of them. We have come closer to discussing fiscal discipline. Is there a consensus in the profession on deficit? Politicians are not convinced that deficits are necessarily bad. The public should be convinced that international experience proves that deficit harms a country.

…AND THE MAJOR CONCLUSIONS AND LESSONS

❶ A consensus seems to have been reached suggesting that although there are significant differences between individual countries in terms of government mechanisms, capacities and economic frameworks, politicians and governments share the tendency to promise a lot in the run up to an election and tend to fulfill their promises once they are voted into office, disregarding forecasts and the capability of the economy to perform. Consequently, to avoid major disasters (crises)

- the way politicians approach fiscal issues must (or should) be changed, and
- the public must (or should) be convinced of the essence and effects of the various adjustment measures, and
- guarantees (framework rules) should be created to help implement decisions.

In 2000, Chile implemented serious measures that also affected the election system and the influence and accountability of the executive power for the sake of reaching fiscal discipline. The measures were sufficient to reach 1 percent structural growth, GDP growth and both politicians and the public felt the tangible benefits and utility of the strict fiscal framework.

❷The loosening of the fiscal framework culminates in fiscal alcoholism (with graduated withdrawal and weakening distributions), to borrow the figure of speech used by György Kopits. There is not a single country whose fiscal and political systems does not present symptoms of the potential or the actual lack of such discipline. Country experiences naturally strengthen the temptation, but it is common knowledge that the budget never fails to be the focal point of political conflicts.

❸Past international experience suggests that measures designed to strengthen fiscal discipline have been taken under the pressure of crises, but the effects (consequences) of the latter dictate that it would be worth avoiding crises by timely action. Hence the universal truth that political parties should reach consensus on major issues (for instance on the future of laws requiring qualified majority in Hungary, by abandoning the recent tactical arsenal of tools that were mostly targeted at blocking) and should agree on improvement measures based on rational rather than political considerations.

❹The efficient operation of the fiscal process can receive support from the creation of a fiscal responsibility framework, which is frequently said to realign lines of responsibility and to curb the appetite for investments, etc. The Chilean and Swedish presenters showed that the above general statement is not true on its own because the operation of certain limits (a fiscal framework) will

- accelerate (or at least set on) growth,
- keep inflation low,
- increase investor confidence.

Practical experience from Sweden demonstrated the need for iron hands in developing the rules and tight control over observing them. Sweden set expenditure limits for 27 items, each of which were strictly applied. As a result, employment increased (to 77.5 percent), government debt dropped (50.5 percent), and all in all the structural reforms brought a surplus of 2.5-2.6 percent. Politicians (also) understood that the condition precedent to sustainable development is a sustainable budget (in surplus).

❺To reach the goal, complying with the Maastricht criteria is not enough; fiscal balance with a surplus is needed to set the budget (the management of finances) straight, and the balance of the budget must be planned for economic cycles. Simply put: a structural surplus is needed.

A structural surplus – as the example from Chile demonstrates – can be spent on the risks of the budget or on managing the backlog of severe social tensions. (Since 2000, Chile has had the opportunity to double her social spending without threatening economic development and progress.) Restoring fiscal discipline produced a favorable cycle.

❻It is necessary to rethink the mechanisms of redistribution radically; expenditures should be matched to the capacity of the economy to perform, and true expenditure cuts are also required: reforms are inevitable (including tax hikes).

❼Naturally, there is no universal panacea for treating these maladies, but the solution must be started definitively without ado. Each country makes its own decision, but facts from the countries that have done so prove the utility of fiscal austerity. The fiscal responsibility framework is a complex system, and the associated tools (rules, figures and other requirements) must be captured in legislation – the conference agreed unanimously. The necessary steps include:

- strong governmental commitment to change the direction of processes (and obtaining the required support for the purpose),
- a review of the softened fiscal mechanism, fiscal hierarchy (and competencies),
- modernization of the provisions of the parliamentary House Rules about the discussion of public finance related issues, sectioning the process of discussion,
- setting straight the issues of liability for the decision,
- defining consolidated fiscal ratios and medium term expenditure limits (unemployment benefits, sick pay, pensions, etc.) for a whole economic cycle, developing tighter procedures (of planning and coherence testing) than those applied currently,
- strengthening control mechanisms (State Audit Office, NGOs, publicity), guaranteed terms for the necessary reviews and modernizing the methods and procedures of control,
- developing a tight monitoring system to drive back corruption,
- setting rules that set the mainstream of political debate and directions for planning,
- convincing politicians and the public with the media playing an appropriate role.

8 The conference considered the role of a fiscal (or budgetary) council from several perspectives: János Veres suggested that operating such a council would narrow the powers of the National Assembly and the State Audit Office; others (including László Csaba and Gyögy Kopits) did not think such a council would violate the principles of parliamentary democracy, Mihály Varga, former Minister of Finance and chairman of the Parliamentary Budget Committee referred to the budget office working for the US Congress as an example worth copying. Everyone agreed, however, that the question is of a caliber that it is necessary to rethink once again the issue of fiscal control, which could in turn lead to additional strengthening of the role of the State Audit Office or to devising the terms of another form of control or oversight.

And to conclude, a maxim from Cicero quoted by Mr. Kopits: “*The budget should be balanced; the treasury should be refilled; public debt should be reduced.*”

Gábor P. Kiss – László Kékesi