Conference on fiscal responsibility

For over a decade and a half, Hungary has been facing a significant public sector imbalance. Since the beginning of post-socialist transition, fiscal performance has been dominated by the political cycle, as compared with most other countries where the fiscal position reflects largely the economic cycle. The deficit bias has been particularly pronounced during electoral campaigns. The ensuing buildup of public debt has by now reached an unsustainable path. As a result, Hungary has been subject to the excess deficit procedure under the Stability and Growth Pact since accession to the European Union, and has failed to meet the Maastricht criteria for admission in the euro area.[1] More important, however, the public sector imbalance may lead to a currency crisis, especially in the event of a sudden shift in the currently prevailing favorable investment sentiment and abundant global liquidity conditions.

Arguably, Hungary's endemic fiscal problems is characterized by both time inconsistency and common pool problems. Typically, following some rhetorical commitments to fiscal discipline at the beginning of their mandate, successive governments have engaged in fiscal expansion in the run-up to each election. Similarly, interest group pressures bear irresistibly on each government, without regard to the overall budget constraint. Moreover, contrary to earlier expectations, neither EU accession, nor market forces have exerted a disciplining influence over the conduct of fiscal policy. On the contrary, EU membership, coupled with a predictable and prudent domestic monetary stance, seems to encourage the Hungarian authorities to indulge in moral hazard, partly under the cover of opaque accounting practices – at least insofar as permitted by EU institutions.[2]

In all, given the well-known weaknesses in the enforcement of the Pact and the low credibility of Hungary's fiscal policy, the time has arrived for exploring various institutional arrangements to bring about genuine fiscal responsibility in this country. This task, entails a thorough review of public spending programs, including the administration and design of major transfer schemes, with a view to formulating reform measures. In the same vein, accounting and planning practices in the public sector need to be made more efficient and transparent. In addition, budgetary guidelines must be enhanced in both legal and technical terms – with the support of detailed cost-benefit analyses.

Inspired by New Zealand's Fiscal Responsibility Act of 1994, an increasing number of advanced and emerging-market economies have adopted permanent constraints on fiscal policy. Fiscal responsibility statutes (consisting of guidelines, legislation, or constitutional amendment) serve in essence as a rules-based policy framework. Major elements of this framework are: permanent policy rules (numerical limits on government deficit, expenditures, debt); procedural rules (e.g., accrual accounting, medium-term budgetary planning); transparency standards (e.g., timely publication and comprehensive coverage of government accounts); and a monitoring and enforcement mechanism (possibly by an independent authority).[3] Either as cure for, or as prevention of, financial crises, or simply to restore sustainability of public finances, countries as diverse as Estonia, Brazil, Bulgaria, Chile, Peru and Sweden have adopted such a rules-based fiscal framework. The latter was often accompanied by major reform steps, such as in the case of Sweden's overhaul of the welfare system. The experience of these countries suggests that compliance with the framework has contributed significantly to building credibility, reducing risk premia, and securing sustained growth.

Against this background, a conference will be held in Budapest, May 19, 2006, under the joint auspices of the State Audit Office and the National Bank of Hungary, and with the support of the Ministry of Finance. The principal objective of the conference is to review the international experience with rules-based fiscal policies and to draw relevant lessons for Hungary. The suitability of various rules, along with associated procedural, accountability, and transparency standards, will be brought under scrutiny. The conference will commence with a broad overview of country practices, followed by presentations on the experience of Chile and Sweden by senior officials from these countries. Subsequently, at a panel session, four public personalities with background in policy-making will be invited to discuss the potential usefulness of enacting a fiscal responsibility framework in Hungary and the possible design features of the framework. Participants at the conference will include political leaders, senior government officials, and members of the financial and academic community.

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NOTES

1 For a recent analysis of Hungary's convergence program, see Magyar Nemzeti Bank, Report on Convergence *(November 2005)*.

2 See G. Kopits, „Magyar költségvetési politika: politikai-gazdaságtani megközelítés," [„Hungarian fiscal policy: a political economy perspective"] *Élet és Irodalom (February 17, 2006), p. 4.*

3 For a basic discussion of the issues and practices in advanced economies, see G. Kopits and S. Symansky, Fiscal Policy Rules, Occasional Paper 162 (International Monetary Fund, 1998), and Banca d'Italia, Fiscal Rules (2001). On practices in selected emerging-market economies, see G. Kopits, ed., *Rules-Based Fiscal Policy in Emerging Markets: Analysis, Background and Prospects (Macmillan, 2004)*