

Box 4.2 Hungary's Fiscal Policy Council

As part of the reformed Stability and Growth Pact, member states in the euro area have begun establishing independent fiscal policy institutions in order to monitor and coordinate economic policies conducted at the national level. A fundamental requirement for an institution of this kind is that its independence is maintained and respected. In some EU member states, there are signs that this requirement is not being met; Hungary's Fiscal Policy Council is one example.

Hungary's economy has several weaknesses that have hampered the country's economic growth, such as low productivity growth, high unemployment and a weak fiscal framework. High debt, both private and public, and a large percentage of foreign currency loans have made the economy vulnerable, which was evident not least from the depreciation of the currency, the forint, against the euro by 26 per cent in only a few months during 2008.

Since the early 1990s, budget policy has followed a cyclical pattern correlated with the election campaign. The budget deficit peaked at almost 10 per cent of GDP in the 2006 election year. This cycle, where periods of expansionary fiscal policy are followed by budget consolidation, has been described as "fiscal alcoholism" by George Kopits, former chairman of the Hungarian Fiscal Policy Council.¹ Consequently, Hungary has been subject to the Excessive Deficit Procedure of the Stability and Growth Pact since 2004. In 2008, the country was granted support loans equivalent to EUR 20 billion from the EU and the IMF. In 2012, following consolidation measures, which consisted largely of one-off effects from specific reforms, the budget deficit fell below the Stability and Growth Pact's 3 per cent limit. But the EU Commission warned that the fiscal framework needed to be improved to ensure sustainable public finances in the long run.²

An initiative by the then socialist Government to conduct a more long-term sustainable fiscal policy resulted in the adoption of the Fiscal Responsibility Act in 2008. As part of restoring credibility, an independent Fiscal Policy Council, Költségvetési Tanács, was established the following year.

¹ Wall Street Journal (2010a).

² European Commission (2012d).

Initially, the Council consisted of three members, assisted by a secretariat of about 30 officials. The members were nominated by the President, the Central Bank Governor and the National Auditor and were chosen by the Parliament for a non-renewable nine-year term of office. One eligibility requirement was that a person must not have been active in a political party for the last four years.

The Council's remit, as an independent authority, was to review legislative proposals and bills involving state finances, analyse the effects of reforms proposed by the Government and make its own macroeconomic forecasts. Independent analysis and dissemination of information would result in increased transparency in fiscal policy.³

In spring 2010, the centre-right coalition, the conservative Fidesz and the Christian Democratic KDNP, received a two-thirds majority in Parliament. The new Government's rule has since been described as increasingly autocratic. The independent status of several institutions, including the National Audit Office, the Central Bank, the Constitutional Court and state media, has been curtailed. Important positions have been filled with people having strong links to the Government, and constitutional amendments strengthening the Government's influence have been adopted by Parliament.⁴

The fiscal framework has been weakened in several respects: transparency has been reduced and Parliament has taken several decisions that conflict with the framework. The Government has also introduced a number of unconventional reforms that have been criticised for creating distortions in the economy and undermining important institutions such as property rights and private contracts. The Government has imposed crisis taxes on sectors dominated by foreign companies and a flat income tax of 16 per cent. To cover revenue shortfalls associated with the introduction of the flat tax, private pension funds, with assets equivalent to about USD 14 billion at the time, were nationalised in early 2011.⁵

The Fiscal Policy Council's influence was restricted after the Council criticised the Government's Budget Bill for overly optimistic forecasts and lack of transparency. Despite resistance by the opposition and international criticism, the Council's appropriation was

³ EEAG (2012), pp. 115–28, European Commission (2012e) and Kopits (2011).

⁴ See, for example, the Economist (2012b), Economist (2010), the Guardian (2012) and Kopits (2011).

⁵ Wall Street Journal (2010b) and EEAG (2012).

slashed from HUF 836 million to HUF 10 million (equivalent to about SEK 25 million and SEK 300 000, respectively).⁶ The reasons stated were the need for consolidation and the similarity of the Council's remit to those of the Central Bank and the National Audit Office. The Council's remit was reduced merely to expressing general comments on the Government's Budget Bill. The Council's secretariat was abolished and in its place, the Council was referred to the National Audit Office and the Central Bank for technical support, limiting the Council's ability to make independent forecasts and analyses.

New Council members were appointed: a chairperson was chosen by the President with a mandate of six years (without remuneration and on a part-time basis) and the remaining two positions were filled by the Central Bank Governor and the National Auditor *ex officio*. Two of the new Council members had close links to the Government. Because of potential conflicts of interest, the Council's independent status has been questioned.⁷

Following much external criticism, some parts of the fiscal framework have been improved. Among the changes, a debt ceiling of 50 per cent of GDP and a debt brake, implying that the public debt as a percentage of GDP has to decrease each year until it is below the debt ceiling, have been introduced. A Council Secretariat of two people was established in early 2012 and the chairperson became entitled to remuneration. The Council has also received a kind of right of veto vis-à-vis the Budget Bill, meaning that the Bill can be rejected if the debt brake is not observed. But it seems unlikely that it will be possible to use the right of veto in any meaningful way. A veto would risk resulting in the dissolution of Parliament, and the Council's resources and analytical capacity are not in proportion to the right of veto.⁸ The Hungarian Fiscal Policy Council's future role is uncertain.

⁶ See, for example, the letter to the editor of the Financial Times by Calmfors, Chote and Teulings (2010), the chairpersons of the fiscal policy councils in Sweden, the UK and the Netherlands respectively.

⁷ Bloomberg (2011).

⁸ European Commission (2012e) and OECD (2012d).

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