Chapter 4

Hungary: Regulation of Sustainable Fiscal Policy in Hungary

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Abstract

This chapter presents and analyses the issue of sustainable fiscal management, focusing on the Hungarian budget. Sustainable fiscal management is closely linked to the principles of the European Union (EU); to this end, fiscal policy focuses on the issues of budget deficit and public debt. Adopting this perspective, this chapter presents the Hungarian fiscal framework and examines the rules and institutions that ensure the implementation of EU principles. As the debt of local governments forms part of public debt, the chapter analyses the issue of local government management, demonstrating the limits of excessive indebtedness. Fiscal policy must respond to economic changes; thus, this chapter also describes the fiscal policy instruments used during the economic crisis, which can be applied in accordance with the budgetary rules for dealing with exceptional situations.

Keywords: *budget, public debt, budget deficit, sustainable fiscal management, crisis management*

1. Introductory thoughts

This chapter aims to define the conditions for sustainable fiscal policy in line with European Union (EU) expectations. A central element of sustainable fiscal policy is

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the enforcement of the budget deficit and debt rule. Hungarian legislation lays down detailed, precise principles and provisions on public finance and fiscal policy. The constitutional rules in the new Fundamental Law are broad and provide for the basic legal institutions of public finance. The details of the constitutional rules are also set out in high-level cardinal laws.

The chapter introduces the constitutional regulation of fiscal policy in Hungary, which comprises the starting point and framework for the whole public finance system. The defining elements of rules-based fiscal policy are presented, with a particular focus on the public debt rule. This and related provisions are the defining elements of the Hungarian fiscal system: provisions limiting the growth of public debt permeate the entire budgetary process. Important institutional frameworks ensure compliance with the rules. A good example is the Fiscal Council, which actively shapes the budgetary process, in particular, by playing an important role in the planning and adoption of the budget.

In addition to the central level of public finances, the budgets of local governments form part of the public debt. As such, the state must monitor the management of local governments, especially any increase in debt. To ensure compliance with the public debt rule, the legislation sets limits to avoid excessive indebtedness among local authorities. By authorising local government debt, the government directly intervenes in local government management. This enables it to control debt but, at the same time, naturally limits the financial autonomy of local authorities.

Public financial control is necessary to ensure that budgetary processes and rules are respected. This chapter briefly describes the structure of public finance control and its role in ensuring sustainable fiscal processes. Clearly, rules that operate in normal economic circumstances are not suitable for dealing with exceptional situations, and the rules must allow for this. Hungarian legislation allows for derogations from strict budgetary rules in emergency situations, for example, in the event of an economic crisis. The Hungarian government has taken advantage of this and has introduced fiscal policy rules to deal with exceptional situations. These provisions are outlined at the end of this chapter.

2. Constitutional regulation of budgetary policy

The constitutional foundations of financial law are not a new area of jurisprudence; however, the extent of regulation varies from one period to another.[1] In Hungarian regulation, the Fundamental Law of 2011 opened a new path by extending the constitutional rules of financial law.[2] The constitutional regulation

1 Nagy, 2022, pp. 88–91.
2 Fundamental Law of Hungary.

of public finance, the public finance constitution, forms part of a larger unit, the economic constitution. The economic constitution, in turn, is the part of the constitutional regulation that dictates fundamental economic rights and principles, provisions on the market economy, the duties and powers of the individual state bodies in relation to the economy, and the rules limiting them. Within the broadly interpreted economic constitution lies the public finance constitution, which primarily concerns monetary and fiscal policy. The literature emphasises that state power and public finance cannot be understood in isolation from each other, given that public finance is a condition and instrument of state power, and that, consequently, the provisions relating to it require constitutional regulation.[3] Constitutions prescribe which financial relations are to be regulated by law. However, these norms have changed throughout history and have been expanded from specifying only legislative subjects to incorporate chapters on public finance, which define detailed rules.

This process has also taken place in Hungarian constitutional law. The current Fundamental Law now presents detailed financial law rules; as such, today's constitutional rules on public finance can be seen as public finance constitutional law.[4] The public finance provisions define the legal institutions of public finance, the essential rules of money and property management, and public charges. Nevertheless, the constitutional law is not exhaustive, and the constitutional rules are laid down in detail in so-called cardinal laws adopted by a two-thirds majority. As a result, Hungarian constitutional law on public finance is two-tiered, with the cardinal laws also defining basic public finance rules of a constitutional nature.[5] There are several relevant sources of law among the individual constitutional regulatory subjects; however, the Stability Act is particularly significant in terms of its comprehensive regulation in several areas.[6]

The financial regulatory method of the Fundamental Law is two-fold, setting out both principles and specific provisions. In general, the Fundamental Law sets the standards for balanced, transparent, and sustainable budget management. Additionally, in the context of fiscal management, this law also establishes prohibitive norms to help reduce public debt.[7] Examining the structure of the constitutional rules of financial law reveals that many of these rules are presented in a separate chapter on public finance; however, public finance rules are also scattered throughout other chapters.

To sum up, the constitutional law on public finance in Hungary is regulated by the Fundamental Law in four areas: the management of public money and assets, public debt, public finance, and the monetary system.

3 Drinóczi, 2012, pp. 6–7.

4 Nagy, 2003, pp. 35–38.

5 Simon, 2019b, pp. 2–11.

6 Act CXCIV of 2011 on the Economic Stability of Hungary, Act CXXXIX of 2013 on the National Bank of Hungary, Act LXVI of 2011 on the State Audit Office of Hungary.

7 Simon, 2019a, pp. 36–39.

3. Rules-based fiscal policy and the level of public debt

The fiscal sovereignty of nation-states is not absolute. The literature shows that at the global level, two important sets of rules affect the fiscal policies of nation-states: international standards set by standard-setting bodies and international sovereign debt rules.[8] In the first set of rules, recommendations are made by international organisations and become part of domestic law, being either voluntarily incorporated by states, or directly or indirectly incorporated into domestic law through integration rules (EU rules). The second set severely constrains economic governance because public debt has to be financed. In this case, market players influence economic policy decisions as indebted countries become more vulnerable on the international financial market and obliged to finance debt. This is particularly true when countries are unable to finance their debt through market instruments and need direct financing from international financial institutions such as the International Monetary Fund (IMF). The IMF also intervenes directly in the economic policies of individual countries by imposing economic measures as a condition for lending. These measures aim to restore financial balance; however, they also impose austerity economic policies.[9]

All these international constraints push fiscal policy to regulate and set limits on the growth of the budget deficit and public debt. The level at which these rules are legislated may vary, but the constitutional level significantly increases their weight. The constitutional system of rules on public finances is not new in domestic Hungarian legislation, although the previous Constitution did not contain such detailed provisions. However, the 2008 financial and economic crisis forced the re-regulation of public finance. The new Constitution enshrines the essential provisions of rules-based fiscal policy. There have been many technical debates about its introduction and, as a solution, several countries have introduced rules on the size and limitation of deficits and public debt. These rules are expected to reverse fiscal overspending and the increase in public debt.[10]

The extant literature describes the essential elements of rules-based fiscal policy, including fiscal policy rules, planning requirements, procedural rules, transparency standards, accountability systems, and institutional guarantees for compliance.[11] The first issue is the constitutionalisation of public debt.[12] The fundamental objective of fiscal policy has become the achievement of a long-term sustainable level of public debt, which this policy seeks to ensure by guaranteeing a sustained close-to-balance status; in other words, the stabilisation of public debt is the main determinant of

8 Lőrinczné Istvánffy, 2004, pp. 602–612.
9 Simon, 2019b, pp. 8–9.
10 Bethlendi, Lentner and Póra, 2020, pp. 787–788.
11 Kovács, 2016, p. 321.
12 Varga, 2022, pp. 235–236.

fiscal policy.[13] Moreover, public debt is linked to the budget deficit: as a general rule, public debt is created by financing the deficit.[14] Strengthening fiscal discipline is a necessary step because the level of public debt has been rising steadily due to the large government deficit.[15]

The size of the budget deficit is governed by EU law in the form of the Maastricht Treaty, which sets the convergence criteria. An important condition for sustainable public finance management is that the annual general government deficit does not exceed 3% of the gross domestic product (GDP). If an EU country does not meet the criteria, it is subject to an excessive deficit procedure. Hungary was subject to an excessive deficit procedure from the time it joined the EU in 2004 until 2013, when the procedure was terminated. The basis for this termination was a budget deficit below 3% for two years that was likely to remain below 3% in the coming years.[16]

The systemic importance of public debt is justified by the implementation of the debt rule in the budgetary procedure, that is, the objective of a steady decline in the public debt, or at least no increase, and achieving the optimal debt ratio (50% of GDP) in the longer term. The debt rule has, thus, become a central legal instrument of fiscal policy.[17] The provisions on the debt rule are explained in detail in the Stability Law, in addition to the Fundamental Law.[18] The essence of the rule is that, in the interest of sustainable public finance management and responsibility for future generations, Parliament may adopt a fiscal law that results in a public debt not exceeding half of the total GDP; in other words, the optimal public debt level as defined by the Fundamental Law.[19] This principle can be considered general because fundamental rights and the efficient functioning of the state can only be guaranteed if the social and economic balance of the country is not jeopardised by public finance problems.[20] Therefore, in budgetary management and planning, Hungary applies the basic general principle of balanced, transparent, and sustainable fiscal management, which all bodies operating in both subsystems of public finances are obliged to respect. Balance is intended to ensure predictable public operation, transparency aims to ensure democratic public life with the participation of informed and responsible citizens, and sustainability seeks to ensure responsibility for the fate of future generations.[21] Sustainable public finance management encompasses a range of

13 Act LXXV of 2008 on Prudent Public Management and Budget Responsibility. The introductory provisions of this Act set out the expectation to establish and pursue a disciplined, transparent, and long-term sustainable fiscal policy while ensuring ongoing economic competitiveness.

14 Vígvári, 2005, pp. 175–178.

15 Sivák, Szemlér and Vígvári, 2013, pp. 49–51. In 2006, the general government deficit was 9.4% of GDP.

16 Sivák, Szemlér and Vígvári, 2013, p. 61.

17 Kovács, 2016, pp. 325–326.

18 Art. 36 paras. (4)–(5) of the Fundamental Law. Act CXCIV of 2011 on the Economic Stability of Hungary Arts. 2 and 10/F.

19 Art. N of the Fundamental Law.

20 Nagy, 2014b, p. 5.

21 Drinóczi, 2012, pp. 2–6.

financial principles, although the above-mentioned public debt rule is of particular importance.[22]

3.1. Rules limiting public debt

The Stability Law also sets out in detail the limits that govern the growth of debt. The regulatory objective of the Stability Law is economic stability, fiscal sustainability, and the reduction of public debt, based on the provisions of the Fundamental Law. The law explicitly refers to its compliance with EU rules. The regulation of public debt is divided into two parts: rules on debt reduction and rules limiting the creation and growth of debt.

The way in which the public debt indicator is calculated is also defined in the framework of the debt reduction rules.[23] In order to preserve the level of public debt, the law fixes the maximum level of the government sector balance at 3% of GDP. The legislation emphasises that the government sector balance must be consistent with medium-term budgetary objectives.

The rate of decline in public debt is also fixed: the government debt ratio must decrease by the rate set in the Budget Law, and by at least 0.1%, while respecting EU rules. However, this may change during the course of the budget year, and the legislator will, subsequently, formulate provisions to be applied in the budgetary procedure in order to reduce the debt. Such provisions include a review of the debt rule, a macroeconomic budget forecast, questioning the values not included in the debt indicator, and the suspension of debt reduction.

The government reviews the debt ratio during the budget year. As a result of this review, the Budget Law may be amended if, by the end of the fiscal year, the public debt ratio increases compared to the ratio set in the Budget Law. In the event of a persistent and significant downturn in the national economy and a decline in the real value of GDP, the rule on the budget deficit and the public debt does not apply. In such a case, the amendment of the Budget Law may be aimed at suspending the obligation to fulfil the value set in the central budget. Twice a year, the government prepares macroeconomic and budgetary forecasts for the four coming years. These forecasts assist with budget planning by identifying risks and expected trends in the economy, informing central budget planning.

The calculation of the debt indicator is defined by the legislator; however, certain items are excluded from the indicator by means of permissive regulation. An increase in debt due to delays in the disbursement of EU funds is not taken into account. In a situation where the stability of the financial system is threatened, a loan to a credit institution established in Hungary also cannot be included in the debt

22 Barcza, 2015, pp. 444–447. The author points out that economic theories differ in their assessment of the optimal level of public debt.

23 Art. 2 of Act CXCIV of 2011 on the Economic Stability of Hungary. The government debt indicator is a ratio expressed as a percentage of government debt to GDP.

indicator. Furthermore, the indicator is not increased in a given financial year by any surplus of debt resulting from a change in the calculation methodology during the year or from exchange rate changes of foreign currency debt. These items soften the indicator and exclude issues that are temporary in nature and likely to change rapidly, such as the exchange rate.

Another area of public debt regulation comprises the rules limiting the creation and growth of debt. Such rules include the adoption of measures, the imposition of a public charge to balance the budget, restrictions on debt-creating transactions, restrictions on the expansion of EU resources, and provisions limiting municipal indebtedness.

In the course of annual budget management, expenditure may be charged to the state for which the budget does not provide. In this case, the public finance rules give the government the right to take extraordinary measures: it may block, reduce, or cancel budget appropriations. However, this right does not apply to expenditure appropriations of which the modification falls within the exclusive competence of Parliament. The government also has the right to introduce new taxes to finance new expenditures. The government used this instrument in 2022, introducing the special 'extra-profit' tax to balance public finances.[24] The tax affected several sectors, including credit institutions, insurance companies, pharmaceuticals, and telecoms. It is a temporary tax as the last date of payment is 2024 under the current rules.

To limit debt-generating transactions, the Stability Law stipulates that only with the prior approval of the Minister of Finance can such transactions be entered into for entities in the government sector. This, of course, applies to entities other than budgetary entities, which are prohibited from entering into this type of transaction. Such transactions include, *inter alia*, loans, the issue of bills of exchange, financial leasing, and deferred payments exceeding one year. The legislator precisely defines the scope of the transactions, aiming to prevent indebtedness and limit the financing of revenue from outside the budget.

In the case of EU grants, the legislator applies permissive rules. The law allows the pre-financing of this type of aid and the provision of the country's own resources, even if this increases the public debt ratio. Thus, the law allows borrowing or additional financial commitments over and above the planned appropriations. Furthermore, the debt ratio does not consider any increase in public debt resulting from a delay in the disbursement of EU funds.

In the context of the common budget of the EU, domestic Hungarian legislation, as set out in the Public Finance Act, provides for the possibility of the government entering into a payment obligation with a Member State, on the basis of an individual decision. This can be done to meet a debt obligation entered into by the European Commission on behalf of the EU and to grant a loan or guarantee by a financial institution jointly owned by EU Member States. The provision allows this expenditure

24 197/2022 (VI. 4.) Government Decree on Extra Profit Taxes.

to be effected in the absence of an appropriation or in excess of the amount foreseen.[25] However, a restrictive rule on this provision was introduced in 2023, which stipulates that Hungary does not support an exceptional and temporary increase in the upper limit of the EU's own resources if it is intended to provide the guarantee or cover necessary for borrowing on the capital markets on behalf of the EU. Only an Act may allow an exception to this rule. The rule applies as long as domestic public debt exceeds half of GDP. In effect, this means that the Hungarian government does not want to contribute to EU common borrowing or to increase national contributions to this end, given the current high level of public debt.

3.2. Role of the Fiscal Council in enforcing the debt rule

The relationship between the executive power and the legislature plays a key role in the budgetary process. A balanced relationship between the two branches and the division of powers is particularly important. In the Hungarian system, the Fundamental Law and the Public Finance Act provide the appropriate legal framework, with fundamental decisions stemming from state sovereignty being made by Parliament.[26] However, it has become essential to also establish independent budgetary institutions that are able to exercise control over the budgetary process and public debt. The literature points out that rules alone may not be sufficient to ensure fiscal discipline. This was the basis of the establishment of the Fiscal Council as an independent institution in Hungarian legislation.[27]

The role of the Fiscal Council is crucial in ensuring that Parliament can make an informed decision on the approval of the budget and that it is adopted by a professionally competent body independent from the executive power. The Council's involvement is essential in the budgeting process and to ensure compliance with the public debt rule.

The Fiscal Council is the body that supports the legislative activity of Parliament and examines the soundness of the central budget. The Council contributes to the preparation of the law on the central budget, and its prior approval is required for the adoption of this law. Using the powers it has been given, the Council exercises a substantive influence on the budget's compliance with the requirements of the Fundamental Law, in particular, by monitoring compliance with the rules on the level of public debt. Its organisation and functioning are regulated in detail in the Act on the Economic Stability of Hungary.[28]

25 Art. 95 of Act CXCV of 2011 on Public Finances.
26 Sivák and Vígvári, 2012, p. 108.
27 Bethlendi, Lentner and Póra, 2020, pp. 790–794.
28 Arts. 15–27 of Act CXCIV of 2011 on the Economic Stability of Hungary. The members of the Council are the President of the Fiscal Council, the President of the National Bank of Hungary, and the President of the State Audit Office of Hungary. The President of the Council is appointed by the President of the Republic for a term of six years.

The Council's duties and competences cover three areas: giving an opinion on the central budget, deciding on the ex-ante contribution, and examining the level of public debt. Its opinion is expressed at several stages of the budgetary procedure. The Council's right to give its opinion is not simply a right to give advice or comment; in many cases, the legislator also attaches consequences to the order of the procedure. The decision to give prior consent is also a strict power of veto. The Fundamental Law gives the Council this power, stating that the adoption of a central Budget Law requires the prior consent of the Council in order to comply with the public debt rule. The Council's main task is to monitor compliance with the debt rule.[29] The essence of this rule is that, in the interests of sustainable public finance management and responsibility for future generations, the National Assembly may adopt a Budget Law that results in a public debt not exceeding half of the total GDP. At present, however, the public debt is significantly above this level; therefore, until the optimal level of public debt is reached, the National Assembly must adopt a budget that aims at reducing the public debt. The Council acts to this end throughout the budgetary procedure.

4. Curbing excessive indebtedness in local government management

Local government budgets are the local level of public finances and are closely linked to the central level (i.e. the central budget). Local government management is autonomous, and the central budget is not responsible for loss-making management.[30] Although the state is not directly responsible for the management of local governments, as local government debt forms part of the public debt, local government indebtedness has an impact on the overall management of public finances. In any case, responsibility for public debt obliges the state to monitor local government management closely and to prevent municipalities from becoming over-indebted.

There is a close link between central and local government through the financing of public service provision,[31] which is shared between the state and local governments. Over the last decade, there has been a change in both the division of tasks and the financing, with the state taking over more tasks from the municipalities and introducing task funding. Centralisation has, thus, led to a reduction in public tasks but also to a reduction in the level of state support.

29 Art. 36 paras. (4)–(5) of the Fundamental Law.
30 Simon, 2019a, pp. 137–138.
31 Horváth, 2016, pp. 25–33.

One of the reasons for the new financing method was the debt crisis in local government.[32] Municipal operational and management disturbances increased municipal debt. The 1990s witnessed decentralisation, with a high degree of municipal economic autonomy. However, municipal responsibilities increased without adequate funding from the central budget, resulting in an operational deficit. In addition, there were problems with financing for development and investment, not to mention the exchange rate risk of foreign currency loans. Furthermore, the financing of municipal-owned enterprises was also problematic, with an increase in debt in this area. As a result, the fiscal stability of local governments was weakened.[33]

Against this background, the state decided to assume the municipal debt in several phases (2011–2014). The debt assumption, which ended in 2014, only covered debts owed to financial institutions. Such transactions included loans, debt securities, bills of exchange, financial leasing, deferred payments of at least 365 days, and instalment payments.[34]

In parallel with the assumption of debt, the legislator limited the reproduction of debt. One of the reasons for this is that the government's primary objective in rules-based budgeting is to reduce public debt, which can only be achieved by limiting municipal indebtedness. This is also allowed by the Fundamental Law, which states that in order to maintain a balanced budget, it may, by an Act, make municipal borrowing or other commitments subject to a condition or the consent of the government.[35] This debt brake significantly restricts local governments' financial autonomy: in the case of large borrowing operations, the government shapes the financial possibilities of each municipality on the basis of individual decisions and actively intervenes in municipal finances.[36] Based on the mandate of the Fundamental Law, the debt brake is regulated in detail by two pieces of legislation: the Stability Act[37] and the Government Decree laying down the detailed rules.[38] Generally, the legislator stipulates that local authorities may only enter into guarantees, sureties, and debt-generating transactions with the prior consent of the government. This rule covers both a company wholly owned by the municipality and any company wholly owned by such a company.

Two absolute limits or conditions are also formulated in relation to debt-creating transactions, both of which require the government's consent. One condition is that if a municipality does not introduce a local business tax, a property type tax, or a personal municipal tax, it cannot enter into a debt-increasing transaction. The other condition is that the total amount of payment obligations arising from the debt-creating transaction in the reference year must not exceed 50% of the municipality's

32 Horváth, Péteri and Vécsei, 2014, pp. 121–147.
33 Bethlendi and Lentner, 2019, pp. 1020–1023.
34 Lentner, 2019, pp. 64–70.
35 Art. 34 para. (5) of the Fundamental Law.
36 Bencsik, 2017, pp. 64–66.
37 Arts. 10–10/F of Act CXCIV of 2011 on the Economic Stability of Hungary.
38 Arts. 1–11 of 353/2011 (XII.30.) Government Decree.

own revenue. The regulation contains exceptions where the government's consent is not required to enter into the transaction. Such cases include, *inter alia*, statutory guarantees and indemnities, the pre-financing of EU or international aid, debt maturing within a calendar year, and limited debt for development purposes as defined by law. It is, therefore, clear that the government wants municipalities to rely primarily on their own revenues rather than borrowing.

Another condition is compliance with the public debt rule in public finance management. The government will agree to the deal if, provided the conditions are met, the local government debt does not jeopardise the annual public debt target and the financing creates the sufficient capacity to perform the municipal functions. The government may also approve or reject the debt rescheduling transaction in part. The regulations provide guidance on this, but the government essentially has discretionary powers in such cases.[39]

5. The public finance control system as a guarantee of the sustainability of public finance management

The public finance control system serves to balance public finance management by identifying problems in the course of the control process that, if corrected, can prevent the budget deficit from increasing. At the same time, the conclusions and lessons learned from the audit will also allow for sound budgetary planning and implementation in the coming years. Public funds used in the management of public finances must be accounted for and reported to the government on the implementation of the budget after the close of the financial year. Budgetary reporting is a technical and legal act, the conditions for which are laid down in several legal acts in addition to the Fundamental Law.[40] The government is obliged to implement the central budget lawfully and expediently, manage public funds effectively and ensure transparency, and report to Parliament. The National Assembly approves the report and the implementation of the budget, while at the same time supervising its implementation. The responsibility for the implementation of the budget lies with the government; therefore, by approving the budget, the National Assembly accepts its implementation and relieves the government of its responsibility.

Additionally, the reporting system allows for monitoring the implementation of the budget, although it is also necessary to establish a system of control for public

39 Art. 10/B of Act CXCIV of 2011 on the Economic Stability of Hungary. The Act sets out the circumstances that the government shall consider when assessing a municipality's debt write-off transaction. Thus, the government may refuse to make a contribution if the municipality intends to finance a non-mandatory municipal task, if the municipality's own resources are sufficient for the development objective, or if the development objective and its implementation are not financially sound.

40 Győrffi, 2009, p. 639.

finances. The purpose of public finance controls is to ensure the regular, economic, efficient, and effective management of public funds and national assets by guaranteeing that reporting and data reporting obligations are properly fulfilled. The public finance control system covers both subsystems, which in theory are divided into external control and internal financial control.[41] The Public Finance Act, in contrast, divides the public finance control system into three areas: the external control of public finances, the control of public finances at the government level, and the internal control of public finances.

The State Audit Office of Hungary is responsible for the external audit of public finances.[42] This Office is the main financial and economic audit body of the National Assembly and is independent of any other organisation in its audit activities. It has general powers to control the responsible management of public funds and state-owned assets. An explanatory memorandum also points out that the legislator has opted for the office model of the Court of Auditors, instead of the court and authority models. Thus, the State Audit Office has no direct sanctioning powers, and its recommendations and findings are implemented through the activities of other bodies.

Controls at the government level are carried out by the government audit body, the European aid control body, and the Treasury. The government audit body is the Government Audit Office, which is a central budgetary body operating as a central office. It is managed by the Minister in charge of the Prime Minister's Office.[43] The Office's audit powers are wide-ranging, covering the audit of the management of all budgetary bodies, appropriations, and other organisations belonging to the government. This government audit body is empowered to impose fines in the event of failure to cooperate or comply with obligations that prevent control. With certain exceptions, it can also request the blocking of payment accounts in the event of the illegal, improper, or wasteful use of public funds or public property. The European aid control body (DG AUDIT) has control powers over budget aid from EU funds. It may carry out audits on the organisations involved in the implementation, beneficiaries, and the contractors responsible for delivering the scope of contracts in the context of budget aid.

As the government-level control body of public finances, the Hungarian State Treasury performs control activities in relation to budget appropriations and budget subsidies, in addition to implementation and management tasks. The system of internal control in public finances is implemented through the internal control system and internal audit of budgetary bodies. The processes of this internal control system are designed to manage risks and obtain objective assurance. The internal control system's purpose is to ensure that the auditee carries out its activities in an orderly, economical, efficient, and effective manner; that it fulfils its accountability

41 Sivák, Szemlér and Vígvári, 2013, p. 152.

42 Act LXVI of 2011 on the State Audit Office of Hungary.

43 Government Decree 355/2011 (XII. 30.) on the Government Audit Office.

obligations; and that the auditee is protected from losses and damage. The head of the budgetary authority is responsible for establishing and operating the internal control system.

6. Hungarian fiscal policy in times of economic crisis

Fiscal policy processes are affected by economic crises, while fiscal policy also affects these crises, meaning that the role of the state as an economic regulator is enhanced.[44] A low unemployment rate, economic growth, and stable, low inflation are important objectives of economic policy.[45] Governments are addressing the consequences of the economic crisis with these objectives in mind and are in the process of reducing the adverse effects of the crisis on their nations' economies. Fiscal policy instruments act on the economy in conjunction with the fiscal rulebook. The instruments can adopt different approaches, both *indirect and direct*,[46] or *affect budget revenue and expenditure.*

The economic crisis created a double challenge for fiscal policy on both the revenue and expenditure side, and the tools to address this challenge are presented here by examining both segments.[47] On the revenue side, the crisis led to decreasing tax revenues, rising unemployment, and falling consumption due to underinvestment, among other factors. On the other side, expenditure rose due to an increase in subsidies. At the same time, transfers and structural changes restructured the budget, which was reflected in the amendment of the Budget Law. From 2008 onwards, Hungarian fiscal policy set the objective of sound public management and responsible fiscal policy.

At present, however, public debt is significantly above the stipulated level; therefore, until the optimal debt is reached, Parliament must adopt a budget focusing on the reduction of public debt.[48] Obviously, factors affecting the management of public finances may be subject to exceptional situations, such as serious problems arising from external causes that cannot be avoided. To remedy such issues, the Fundamental Law allows derogations from the strict rules (permanent decline in the national economy, restoration of the balance of the national economy). The rule referring to the economic crisis is interpreted in an expansive way by the Stability Law, which states that any case of a permanent and significant decline in the national economy shall be interpreted as a decline in the real value of the annual GDP. In this

44 Horváth and Nagy, 2022, pp. 361–365.

45 Samuelson and Nordhaus, 2012, p. 570.

46 Simon, 2019a, pp. 31–32. 'Direct instruments' refer to a specific decision related to the budget, whereas indirect instruments, such as taxes, have effects without specific intervention.

47 Horváth and Nagy, 2022, pp. 175–179.

48 Nagy, 2014a, p. 12.

case, the Stability Law allows the government sector deficit to exceed 3% of GDP and the public debt ratio to fall.[49] The economic crisis resulting from the COVID-19 pandemic, therefore, justified a derogation from the public debt rule. An increase in public debt is a natural process in the event of an economic crisis as government overspending and budget support increase the budget deficit. More important than the size of the deficit is the absorption of the extra resources because if budget money is spent efficiently, it lays the foundations not only for recovery from the crisis but also for future economic growth.[50]

Both a significant fall in GDP and a rebalancing of the economy will increase public debt: as the debt ratio is linked to GDP, a fall in GDP alone will increase the debt ratio without changing the budget deficit. The budget could be affected on the revenue side by a crisis due to revenue shortfalls and on the expenditure side due to an increase in central budget support.

The Public Finance Act provides a solution to the unfavourable development of the central budget in the form of extraordinary measures aimed at implementing government tasks undertaken during the year and maintaining balanced budget management. The legislator supplements the previous legislation with temporary measures related to the emergency situation. Through these measures, the legislator gives the government broad powers to make budgetary expenditures not provided for in the Budget Law and to impose extraordinary payments. The special legal order provision provides for a relaxation of the public expenditure rules, that is, a derogation from the strict procedural and substantive rules establishing the payment obligations, the extent of which is determined by law as necessary to restore the economic downturn and equilibrium.[51] The assessment of the necessary level has been a matter of debate, given the unprecedented nature of a health emergency affecting the whole country. The literature also points to the need to use a different scale of necessity and proportionality because of the different economic and life situations. It is very difficult to assess the degree of necessity as it is only after a crisis that it can be judged whether a derogation from the rules was necessary. The question is, therefore, what is meant by an emergency situation?[52] The legislator has taken account of the emergency situation in the provisions of the Fundamental Law, which states that in a special legal order, fundamental rights may be restricted beyond the limits of necessity and proportionality.[53] Every crisis is different, and it

49 Art. 7 of Act CXCIV of 2011 on the Economic Stability of Hungary.

50 *Modern monetáris elmélet: Mi a probléma vele? Mit jelent?* [Online]. Available at: https://elemzeskozpont.hu/modern-monetaris-elmelet-mi-problema-vele-mit-jelent (Accessed: 15 January 2024). This study points out that there is good and bad public debt. If the government uses the resources for investment, economic growth, or laying the foundations for future economic growth, then there is no problem for public finance management.

51 Art. 38/A of Act CXCIV of 2011 on the Economic Stability of Hungary.

52 Salgó, 2020, pp. 15–16.

53 Art. 54 para. (1) of the Fundamental Law. In a special legal order, the exercise of fundamental rights may be suspended or restricted beyond the limits laid down in Art. I para. (3), with the exception of the fundamental rights laid down in Arts. II and III and Art. XXVIII paras. (2)–(6).

is, consequently, difficult to dose solutions with the 'pharmacopoeia' of law. If the management of a crisis is successful, the government's efforts will be judged positively by the electorate, who would otherwise suffer the negative effects of the crisis. Excessive legal restrictions on economic instruments may prevent the government from managing a crisis effectively. This is illustrated by the law adopted to combat the COVID-19 pandemic, which strengthened and temporarily extended the government's emergency powers.[54]

Fiscal instruments in Hungary can be divided into *tax instruments, which affect the revenue side of the budget, and subsidy instruments, which affect the expenditure side.* Some of these instruments were already in place in 2020, while others only came into force and began to have an impact from 2021 onwards. Support instruments have a faster impact on the economy, whereas tax instruments have a longer-term impact on economic agents, with some exceptions, such as the introduction of a new tax. The economic problems caused by the crisis resulting from the COVID-19 pandemic made it necessary to amend the 2020 budget.[55] As part of the economic protection measures, the legislator reallocated several thousand billion forints in budget appropriations, creating two separate funds in the budget for epidemiological expenditure and economic protection.[56]

In addition to the transfers affecting the central budget sub-system, legislative changes were also made to the *local government sub-system.* The purpose of these amendments was two-fold: on the one hand, they aimed to transfer resources to the central budget as revenue from the motor vehicle tax, and on the other hand, they sought to reduce municipal fees and taxes, with the government, thus, indirectly subsidising entrepreneurs and individuals.

Economic autonomy is an indispensable condition for local government autonomy, which is supported by constitutional provisions.[57] Resource regulation is closely linked to the provision of public services.[58] Although the state has gradually taken over tasks from local authorities, with centralisation thus taking place in this area, basic public services have remained with the municipalities. Local government revenues are essential for the financing of these public services.[59] However, the emergency situation overrode these principles, and the state sought to centralise resources, redirecting them to emergency defence and economic protection. This, in turn, put local authorities in a difficult budgetary situation. The government tried to remedy this by making up the shortfall automatically in the case of smaller

54 Act XII of 2020 on the Protection against Coronavirus. Art. 2 of this Act stipulates that in order to guarantee the stability of the national economy, the government may, by decree, suspend the application of certain laws, derogate from statutory provisions, and take other exceptional measures.

55 Government Decree 92/2020. (IV.6.) on the different rules of the 2020 central budget of Hungary related to the emergency.

56 Act XC of 2020 on the 2021 Central Budget of Hungary.

57 Lentner, 2017, pp. 136–137.

58 Horváth, Péteri and Vécsei, 2014, pp. 121–123.

59 Horváth, 2014, pp. 185–188.

municipalities, and discretionally in the case of large cities, examining the shortfalls on an individual basis. In doing so, the government imposed a kind of equalisation mechanism, taking resources away from better-off municipalities and giving resources to worse-off ones.

The *rules and measures taken to tackle the economic crisis* caused by the COVID-19 pandemic can be broken down into several areas, such as job preservation and creation, support for priority sectors and domestic businesses, support for families, maintaining the security of supply, the application of official prices, and extra profit taxes.[60] Preserving jobs and creating new jobs was a priority in the government's programme. The fall in demand forced workers to take redundancy or reduce their working hours. The government introduced a subsidy of up to 70% of the net wage for the working time lost in the event of reduced working hours. In addition, in priority sectors, no employer contributions were required and employee contributions were reduced, meaning that no pension contributions were paid, and health insurance premiums were reduced to the statutory minimum. The 2% reduction in social contribution tax also promoted employment, as did tax cuts. Special payment relief and tax mitigation options, such as the temporary abolition of the labour market contribution, were available for employers. Among entrepreneurs active in certain priority sectors (tourism and hospitality, health, food, etc.), the government applied tax reductions and tax holidays for small taxpayers.[61] Investment and technological development were promoted to create jobs. In addition to the environment, priority was given to industries with a promising future, such as artificial intelligence and quantum technologies, and to sectors that were particularly affected by the economic crisis. To ensure sufficient human resources, the programme provided support for retraining and further training. For families, a moratorium on loan repayments was introduced to support housing investment, and expiring social benefits were extended during the emergency.

The COVID-19 pandemic was followed by a period of high inflation on both the demand and supply side, which represented the main economic policy challenge. The Russo-Ukrainian War further increased inflation in the world economy. The Hungarian government adopted price control measures to react to this economic challenge. In 2021, a fuel price freeze was introduced, with a gradual change in personal scope to avoid abuses and preserve stocks and the security of supply. However, the intervention in the market price led to a fall in supply as distributors were not compensated. Before the market collapsed and supply problems increased, the government had withdrawn price fixing. A different regime was introduced for energy prices. The energy crisis sent market prices out of control and, in order to keep prices low for the public, the government introduced official prices for electricity and gas. The eligibility for the reduced residential tariff was linked to the level of consumption, above which the market price had to be paid. In this case, the government

60 Government of Hungary, 2020.

61 Act CXLVII of 2012 on the Itemized Tax on Small Taxable Enterprises and Small Business Tax.

compensated the supplier for its losses. However, inflationary pressures not only affected prices for energy and fuel but also for food. Price controls were introduced for basic foodstuffs, with the price of some having to be fixed by retail suppliers at a lower level than in previous periods, which became the prevailing gross retail price. An interest rate freeze on variable-rate loans was introduced to safeguard both the economic situation of households and that of small and medium-sized enterprises. The fixed interest rate prevented loan contracts from enforcing interest rates that had risen significantly as a result of inflation.[62]

In addition to all these measures, the budget sought to find resources to finance the official price of energy and reduce the budget deficit by introducing special taxes and increasing their rates. The surcharges and tax increases affected several sectors, such as banks, oil producers, power plants, retailers, insurance companies, telecoms, and airlines. The fiscal policy objective of taxation is to divert the excess profits generated by inflationary price rises into public spending.

Additionally, fiscal developments in 2023 were not favourable, as Hungary did not comply with the EU requirements.[63] This is likely to result in an EU excessive deficit procedure for Hungary. Under this procedure, the EU rules set out a timetable for deficit and debt reduction. The Hungarian government seems committed to complying with the rules but has taken slower steps to improve the balance indicators to preserve economic balance and ensure economic growth. To strengthen disciplined fiscal management, a new government decision-making forum, the Government Budget Preparation Task Force, has been established. Chaired by the Minister of Finance, this task force is responsible for maintaining a balanced budget and preparing the government's decisions from a budgetary perspective. This policy-making forum has special powers and may issue a dissenting opinion, or its head may issue a veto.[64]

7. Summary

This chapter analysed one aspect of Hungarian fiscal policy. An important factor for sustainable fiscal policy is the budget deficit and debt. This is the main focus of EU regulation as the framework of EU economic policy may be threatened by the excessive indebtedness of individual Member States. Fiscal policy, the definition of the regulatory framework for public finances, has been given special importance in

62 Czeczeli et al., 2023, pp. 86–128.

63 According to the Central Statistical Office, the budget deficit was 5.4% and GDP was 0.9%, based on the first three-quarters of the year. These figures are subject to change based on fourth-quarter data.

64 Government Decision 1529/2023 (XII.5.).

the Hungarian legal system as is clearly shown by the detailed public finance regulation in the country's Fundamental Law. The central provision of the public finance constitution is the definition of public debt below the level required by the EU.

Hungary's commitment to reduce the level of public debt permeates the entire public finance framework and is applied at all levels of the budgetary process. The rules-based fiscal policy sets a strict framework for fiscal management; however, this strict regime has been lifted by the economic crisis through the exceptional rules. The legislator is right to allow flexibility in the rules to deal with extraordinary economic situations, though it is not right for the government to apply the exceptional rules in the longer term. This softens the original legislative and economic policy intentions in favour of a committed sustainable fiscal policy.

It can be concluded that the Hungarian legislation is capable of complying with EU rules. However, the question is whether the budget deficit and the level of public debt alone are sufficient to judge the state of the national economy. How and for what purpose the state and local governments use the budget resources are also important, in other words, whether the resources have been used in a purposeful, efficient, and effective manner, and whether the long-term sustainable functioning of society has been achieved.

In the Hungarian legislation, the debt rules also apply to the municipal level of public finances. The state prevents the excessive indebtedness of local governments through direct rules. These are good instruments to prevent indebtedness in the local government sector, but they limit the financial autonomy of local governments.

There are many more public finance issues that could arise in relation to fiscal policy; however, the scope of this chapter does not allow for a detailed discussion of all the related issues. Other areas of fiscal policy are analysed in separate chapters on public revenue and public expenditure issues.

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