



MINISTRY
FOR NATIONAL ECONOMY

GYÖRGY MATOLCSY
Minister

Mr. Olli Rehn
Vice-president of the European Commission

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European Commission
B-1049 Brussels
Belgium

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Dear Mr. Vice-President,

Let me provide you with recent information on budgetary developments and prospects in Hungary that could be important in the context of the ongoing excessive deficit procedure.

According to preliminary data, the 2011 cash-flow balance of the central government (without extraordinary and one-off items decided during the year) turned out to be in line with the target. The data indicate that the intake of revenues from taxes and contributions was stronger (altogether by close to HUF 100 billion, 0.34% of GDP) than in our estimates which served as a basis for the 2012 budgetary planning.

Particularly, net VAT revenues exceeded our earlier estimate by HUF 41.5 billion. The surplus was realised on the payment side, mainly due to successful efforts by the tax authority to recover revenues. The surplus is considered as a positive base effect regarding 2012, all the more so because the tax authority is equipped with new, enhanced rights and methods of control from 2012. Net CIT revenues exceeded our earlier estimate by a significant amount (HUF 28.6 billion) as well, reflecting also that Hungarian companies were more profitable than we expected.

On the expenditure side, pension expenditures were somewhat below the planned figure (by HUF 15 billion, 0.05% of GDP).

According to our preliminary assessment, these developments are of a structural nature, therefore they will have important carry-over effects into 2012 and 2013 contributing to the safe attainment of the deficit targets in the forthcoming years.

The better tax performance made also possible to carry forward some expenditures of the institutions in the central budget and in the health sector, related to the payment of their suppliers (arrears). While this is neutral from the perspective of the ESA balance, it nevertheless improves the cash-flow position of these institutions in 2012. Furthermore, it will help the liquidity position of the suppliers and, in broader terms, can contribute to better growth prospects for the economy as a whole.

Similarly, we expect that the recent agreement with the Banking Association will have a positive impact on the growth prospects, since the extension of financing of small and medium size enterprises is a condition for eligibility for reduced bank levies. It seems that the Commission services incorporate the direct deficit increasing effect of the agreement into their budgetary calculations, while they probably do not take into account the indirect macroeconomic impact and the related budgetary revenues in their forecast.

Regarding the legislative process related to the elaboration of the legal framework for the expenditure cutting measures of the structural reform programme (Széll Kálmán Plan) in 2013, I would like to call your attention that last December the Parliament adopted all necessary pieces of legislation as scheduled. These include the law on local governments (a so-called cardinal law), as well as the laws on public and higher education, on public employment, on old-age pensions and several laws related to the health sector, in particular pharmaceutical subsidies. As several amendments were submitted to the initial legislative proposals, we are now in the process of scrutinising and quantifying their overall budgetary impact in detail. Our first assessment indicates that the envisaged savings will be realised as planned.

Finally, I note that – as stated in our latest EDP implementation report - Government Decree no. 1365/2011 launched a programme of the revision of tasks and institutions in the public administration. The revision includes inter alia the analysis of the justification for the public provision of tasks and it defines requirements and conditions (quantitative and qualitative indicators, norms on headcount and costs) necessary for the efficient provision of tasks. According to the decree, the full revision will be accomplished by early April 2012.

I trust that the above pieces of information will be duly taken into account in the Commission assessment of Hungary in the context of the ongoing EDP.

Yours sincerely,

György Matolcsy

