

Hungary: Some Thoughts on Why and How to Adjust Fiscal Policy

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The Hungarian Business Leaders Forum (HBLF)
and
ICEG European Center

Financial Summit IV
CHALLENGES - BREAKING THE MOULD?

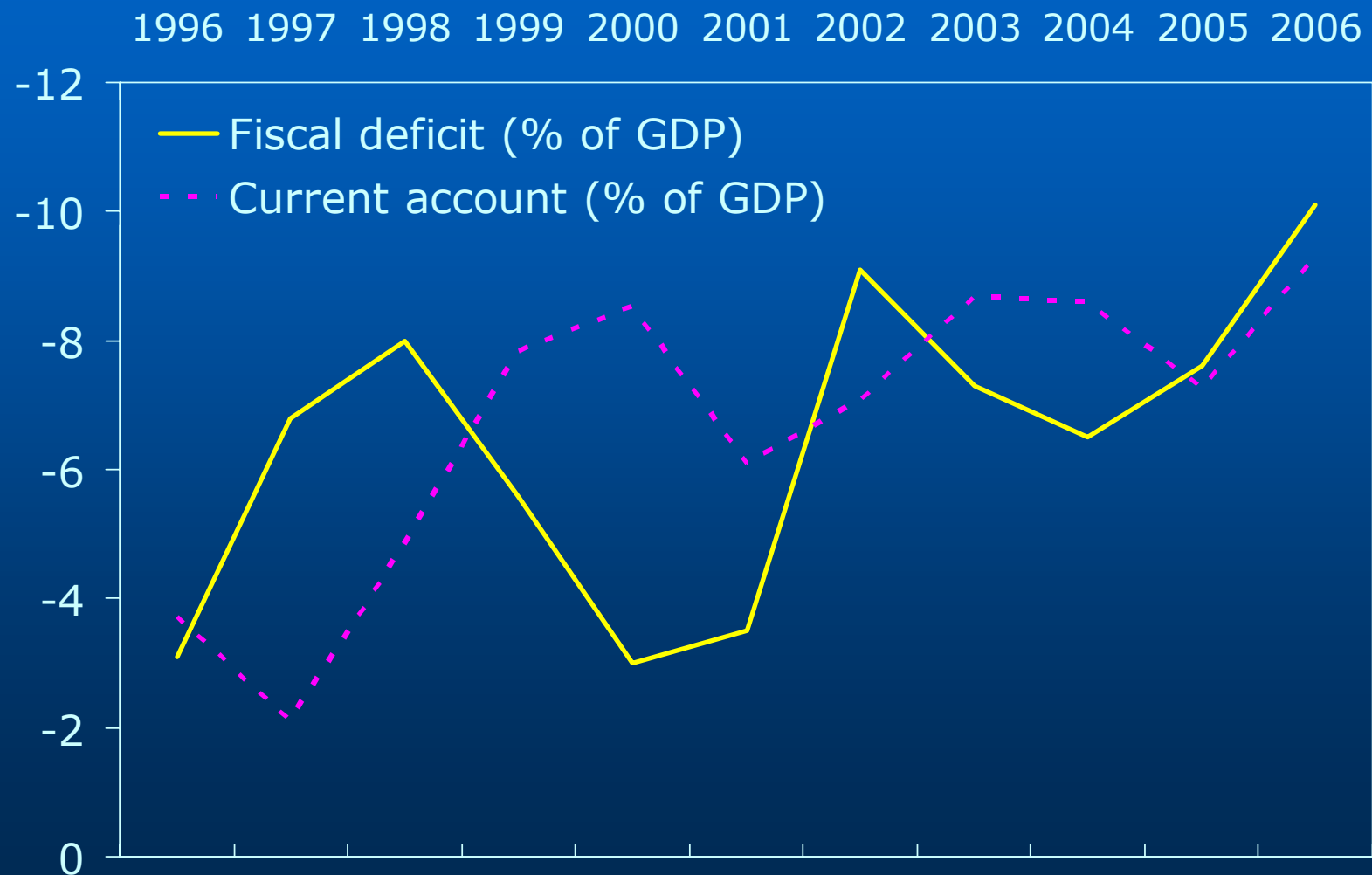
Hungary:

**Some Thoughts on Why and How
to Adjust Fiscal Policy**

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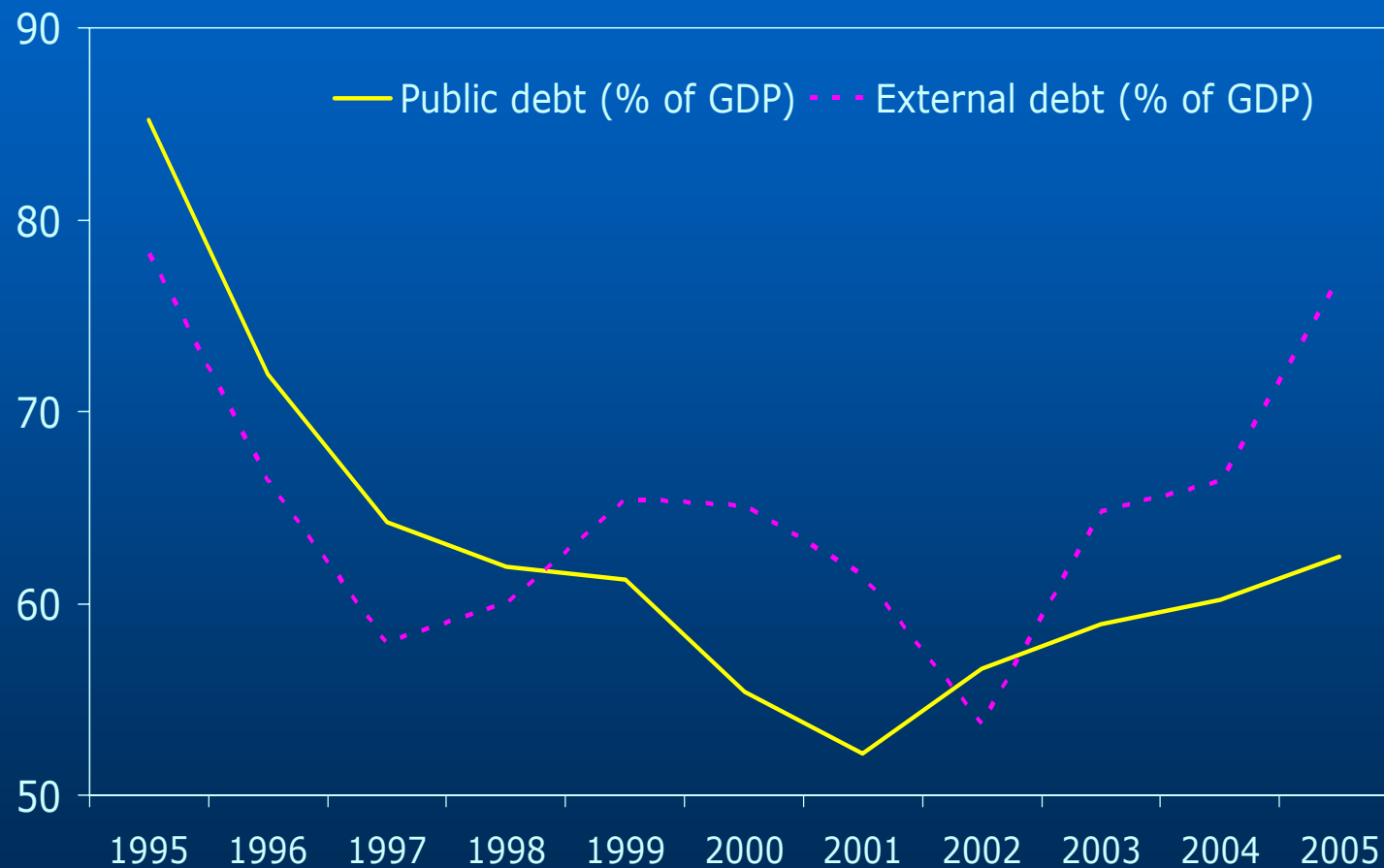
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The twin deficit problem is worsening...



Source: Eurostat, IMF staff estimates.

... accompanied by worrying dynamics in public and external debt.



Source: Eurostat, World Bank external debt statistics, IMF staff estimates.

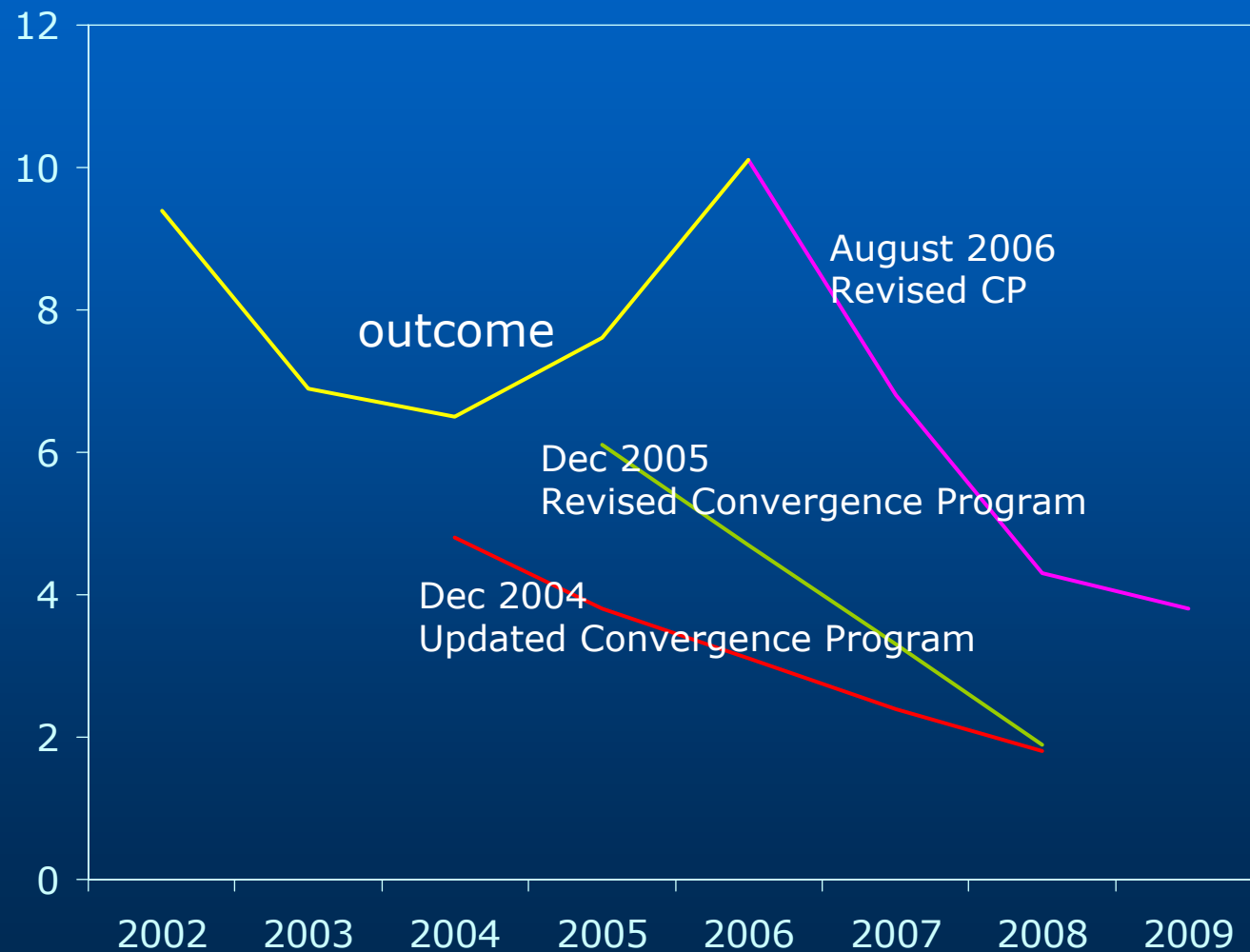
Hungary now appears more vulnerable than other key emerging market countries.

Public Debt and External Debt and Deficits, 2005, % of GDP.

	Fiscal deficit	Public debt	CA deficit	External debt
Hungary	-7.6	62.4	7.3	75.3
Argentina	-2.5	85.9	-1.8	74.4
Uruguay	0.8	69.9	2.0	68.4
Turkey	3.1	67.9	6.3	49.5
Brasil	3.3	75.1	-1.8	21.3

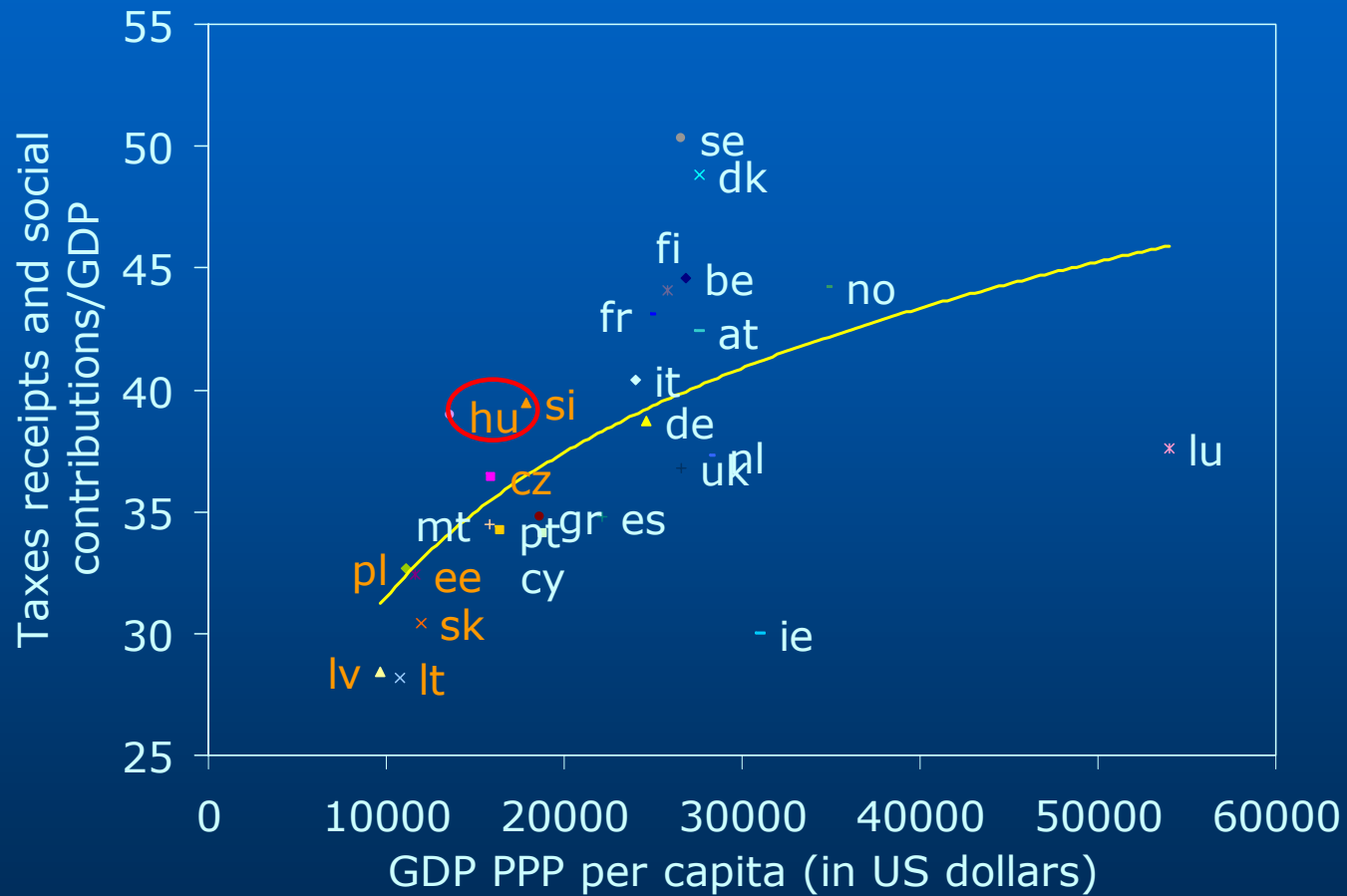
Source: IMF staff estimates.

Fiscal outcomes have fallen short of targets,
suggesting a fundamental rethink of fiscal accountability



Source: National authorities, IMF staff estimates.

Tax Burden and GDP per capita in Europe

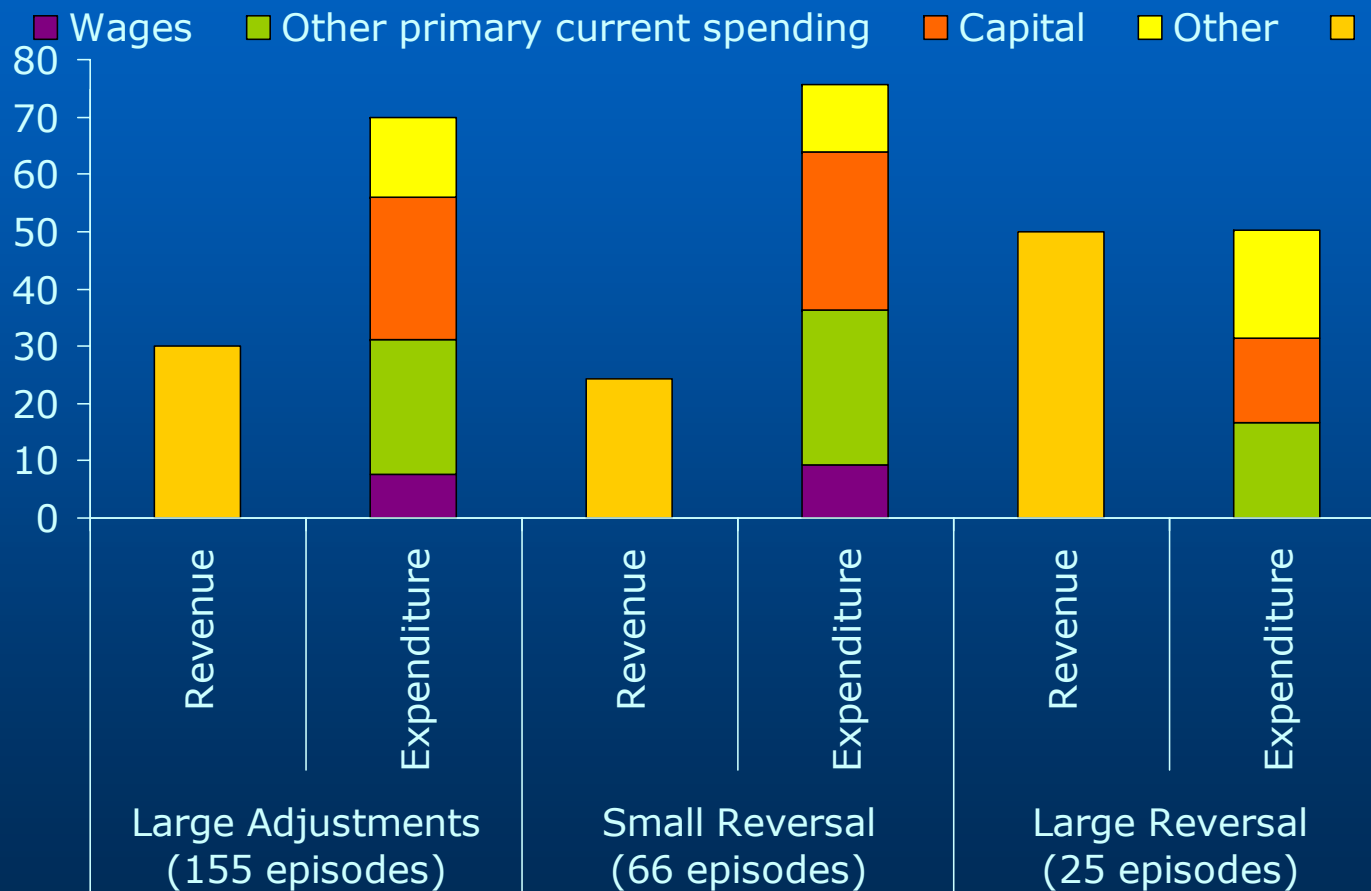


Source: Eurostat.

IMF Study: Experience with Large Fiscal Adjustments

- Examined about 300 episodes of fiscal adjustment 1971-2001 (in 165 countries)
- 155 “large” adjustments (top 1/3, with adjustment $> 6.3\%$ of GDP and >22.8 of expenditure)
- 63 “front-loaded” adjustments (2/3 of adj. in the first year)
- Large adjustments are implemented under more difficult macro circumstances than small adjustments.

Components of sustained vs. reversed fiscal adjustment (in percent of contribution to the change of primary balance)



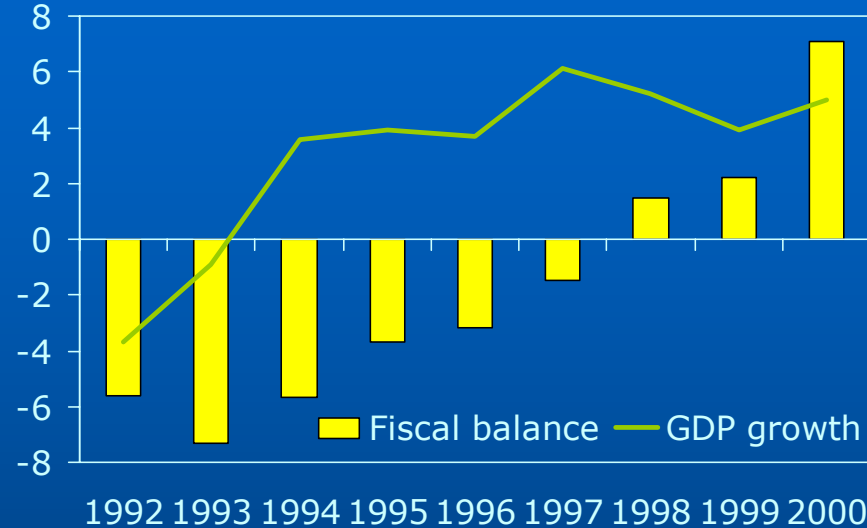
Source: George C. Tsibouris, Mark A. Horton, Mark J. Flanagan, Wojciech S. Maliszewski, Experience with Large Fiscal Adjustments, IMF Occasional Paper No. 246, Washington 2006.

Key Findings

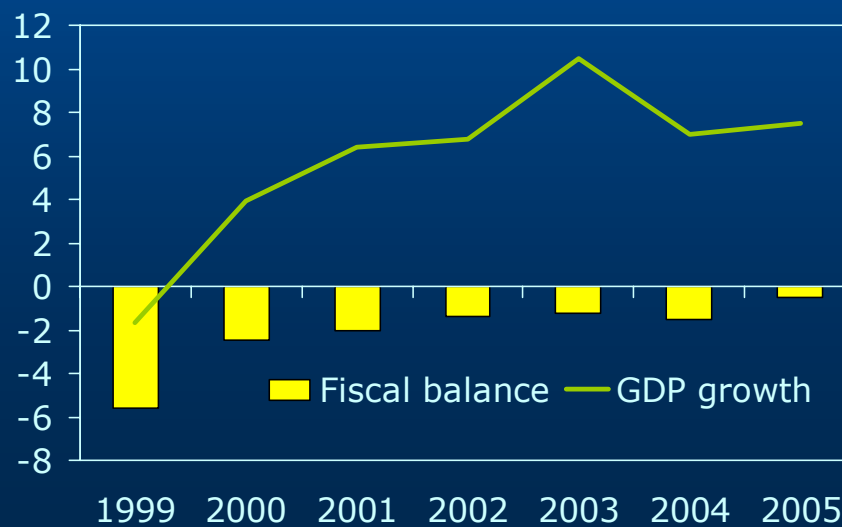
- Expenditure-based consolidations are more likely to be sustained
- Cuts in current spending (wage bill, subsidies) are particularly effective and may also have positive side-effects
- Failed adjustments rely primarily on revenues, especially PIT and trade taxes
- Adjustments during crisis are more likely to be reversed
- Large and sustained adjustments are associated with positive macro effects (on growth, C/A deficit)

Large Fiscal Adjustments And Growth: Some Recent Country Cases

Finland 1992-2000



Lithuania 1999-2003



Source: Eurostat.

Conclusions

- The government is rightly committed to strong fiscal effort, which is necessary to reduce vulnerabilities.
- International experience suggests that adjustment should rely on budgetary savings rather than tax hikes.
- There is a need to create binding and multi-year fiscal commitments, transparency and accountability.