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# **Public Finance Challenges of the COVID-19 Pandemic and Responses of the State Audit Office**



## *Summary*

Measures introduced worldwide in response to the COVID-19 pandemic have brought with them the potential for a crisis to develop. A crisis, by its nature, will pose a challenge to all of us. However, a challenge will also create opportunities to implement a qualitative change. This article presents the challenges the State Audit Office has faced during the COVID-19 pandemic, as part of its day-to-day work and when analysing the effects of the pandemic. Restrictions on personal contacts have induced organizational changes and integrity risks have increased. In response to these challenges, organizational changes have taken place, covering aspects such as work organization and digitalisation. The State Audit Office has introduced new types of audits to increase audit coverage, thereby contributing to a reduction in increased risks of corruption, and thus to the functioning of a well-governed state. The SAO has produced an increased number of analyses on public finance to serve as a basis for its advisory activities intended to help achieve the goals of the Government. In budget management, the concept of resilience had to be reinterpreted and the aim of ensuring fiscal balance had to be subordinated to the financing of measures to strengthen the resilience of the economy as a whole. A new challenge is posed by the fact that, concurrently to efforts for restarting the economy, steps must also be made to consolidate the balance of the budget.

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## INTRODUCTION

The Year 2020 was extraordinary in every respect. The virus and its effects brought about a restructuring both in economy and society. Demand and supply, though relatively predictable before, became unpredictable, with demand emerging in the market for products other than previously. As part of this restructuring of demand and supply, working from home increased in importance, with a great emphasis placed on significantly reducing personal contacts. While some institutions, organizations, and companies fought for survival, others fought their daily struggles to meet a huge demand that suddenly evolved. This was particularly relevant to the public sector, where services provided by institutions increased in value; and, in areas where contact with citizens had been the norm, services were shifted to digital interfaces and solutions.

The State Audit Office, as an independent constitutional institution of the state, facilitates sustainable good governance through its activities. The pandemic exerted impacts in a number of ways on this institution as well, yet, its activities have clearly had an indirect effect on controlling the pandemic. But how can one control a pandemic? To answer this question, first it is worth reviewing academic literature discussing the impacts of the pandemic in the public sector.

While exerting a major impact on the lives of citizens, the pandemic also placed a heavy burden on governments as demand and supply changed. According to a World Bank (2020) study, governments faced three challenges during the pandemic:

- Preventing and slowing down the virus infection
- Reducing food insecurity and other infrastructure insecurity
- Creating public safety.

For addressing these three challenges, it was particularly important to create integrity. Corruption risks have the potential to reduce the speed and scale of ‘treatment’, meaning that measures will be less successful if these risks are not addressed.

Public policies were given special attention during the pandemic, with integrity being one of the essential elements thereof. Milojevic (2021) emphasizes that public policies played a major role during the pandemic, changing as fast as possible so as to provide appropriate responses to challenges, with different policy goals formulated often on a daily basis.

The government faced another rather difficult challenge, as the protection of public employees and civil servants working at ministries, municipalities or other decision-making or executive bodies were also an important aspect during the pandemic. Schuster (et al., 2020) examined those working in the public sector, as they were instrumental to identifying and solving problems and making service provision efficient. Köllő (2020) also examined changes on the labour market during the pandemic. His study shows that the decline in employment caused by the pandemic would have been much more pronounced if a transition to teleworking had not been possible in many sectors. He mentions that teleworking represented above-average benefits for women, citizens living in Budapest, and those working in the public sector; and that a transition to teleworking was observed mainly in services, especially education.

Katona and Petrovics (2021) examined the state and citizens for their readiness to co-operate, as the field of human public services requires co-operative solutions. They suggested that there is a need for increasing the flexibility of public services and improving communication and trust between the parties involved, through cooperation between the state, local governments and citizens. Tan (2020) also raised the need for a different kind of treatment, stating that this recession is different from the ones we have been used to. Túróczi (et al., 2020) highlighted that the current crisis is different from previous ones mainly because it is caused by an external factor rather than any internal problems of the economy in Hungary, which had shown stable growth in the pre-crisis period. Their article details the specifics of the COVID-19 crisis, including two factors, highlighted now as the most relevant for this study: the downturn took place over the course of a few weeks; and a significant transformation took place in demand and supply over that period.

In summary, as literature presented above suggests, the strengthening of integrity and trust increased in value during the pandemic, for the reason, among others, that economic indicators and forecasts became practically meaningless. Dudás (2021) also raises this issue when analysing the methodologies of credit rating agencies, as estimates became unpredictable. Changes took place in work organization, and uncertainty more and more affected the unpredictability of economic indicators and a deficit economy emerged.

## CHALLENGES IN THE ACTIVITIES OF THE SAO

When it comes to challenges, mostly negative things come to our minds, while challenges give us the opportunity to change, or to examine things from another perspective. In order to curb the COVID-19 pandemic, citizens had to experience a number of restrictive measures. Restrictions, though imposed to a different degree in each wave, included a limitation on customer visits to commercial units, cultural institutions and restaurants; the introduction of temporary lockdown; a significant reduction in the number of services available in the health care sector; and, moreover, a limitation on the number of participants in family events.

### *Work organisation*

In those social circumstances, the SAO also had to assess the risks associated with its internal and external activities. By internal activities we mean the presence of employees in the office, the use of community spaces, meetings held in the usual way, while external activities mean the control, analysis and advisory function of the SAO. If work had been continued as usual, there would have been a realistic chance that colleagues would become infected in their workplaces, despite the fact that it is a basic requirement to ensure healthy working conditions at all times. In this situation, the SAO's management needed to make a quick and firm decision, and decided to introduce the option of working from home and to make arrangements for a progress in digitalisation as required; this situation remained in 2021, with the difference that the principle of 2x2 weeks is used now for teleworking and working at the office, thus avoiding chances of the spreading of infection.

Although the above is an analysis of the SAO's internal work organization, the SAO also took into account the need to respond to changes in the work organization of auditees, when carrying out its audits. It was known that the audited organizations also tried to protect their employees, so it was important to reduce their workload and involve the lowest possible number of employees in audits performed by the SAO. The SAO's goal, as declared in its strategic documents, is to develop the external and internal responsiveness of the organization in order to provide meaningful answers to challenges that may arise. The SAO's digital switchover was confirmed by the National Assembly in a resolution recognising all activities carried out by the SAO to contribute to the creation of a digital auditing environment. That process was accelerated by the current pandemic situation.

For years, the SAO had been constantly monitoring and evaluating the advancement in digitalisation in its environment, therefore, it had recognised in time that a digital switchover was unavoidable. Therefore, in 2018, the SAO developed its IT strategy, by starting to modernize the operations of its organization and to increase the efficiency of its auditing activities. During the state of emergency, one of the main priorities of the SAO was to ensure continuous and smooth processes for audits to be performed as part of its core activities and for analyses to be prepared. The SAO's efforts paid off, as it successfully completed its first digital working day, for which it had created the foundations in the previous year already.

In recent years, all changes at the SAO have been made with digital criteria in mind. One of the relevant innovations was the electronic data request system that enabled us to modernize not only the work of auditees but that of the SAO as well; to make the SAO's work more transparent and also paperless, thus saving public money; and to ensure an even more efficient enforcement of integrity aspects. As the next step of digital switchover, made in response to the current situation, digitalisation is applied now in the SAO's quality assurance processes and decision-making systems.

With digitalisation gaining ground, the SAO has been able to implement methodological developments and process organization solutions as a result of which, after the elapse of 30 years, the SAO can now reach all settlements (i.e. 3197 of them) at the same time in order to strengthen their integrity. Real-time integrity audits, preventive in nature and resulting in advice, have already begun in the municipal sector. Thus, the SAO's organization has flexibly followed the transition caused by impacts of its external environment. The SAO is capable of working in a digital environment, a fact supporting the operation of good governance.

The COVID-19 pandemic has highlighted that a serious, technology-driven change is taking place around us. Data has become the raw material and the main resource of the 21<sup>st</sup> century, unavoidably requiring an appropriate digital environment capable of handling it. We need to take advantage of the opportunities offered by digitalisation, or otherwise our lagging behind may become fatal for us. What used to be special and unique has now become commonplace. A change of attitude is needed; otherwise we ourselves will become a barrier to development. We need to enter a new age of technology, thereby enabling this change to take place in our lives as individuals and as a society. This change is huge and comparable to the scale of the change of regime in Hungary. The SAO has followed the path of digitalisation for some time, a process that has been accelerated, rather than halted, by the emergence of the COVID-19 pandemic.

*New audit approaches*

In order to support and improve the implementation of the principles of public finance as set out in the Fundamental Law of Hungary, the SAO has not only modernized and strengthened its auditing capabilities but also focused more attention to its advisory activities in recent years. To this end, in 2020 we made structural improvements to our audit plans to help increase the efficiency of the SAO's audits and thus to support the utilisation of audit findings, as well as to strengthen the SAO's advisory activities. Such improvements also include the operation of a data request system, meaning reduced workload for audited organizations; and the definition of a list of important documents to be used for audits. Thereby, we can assess much more auditees against materiality criteria through auditing fewer documents than before, by using the achievements of digital and technological developments; and, additionally, a higher number of auditees can receive feedback on our observations in a short period of time, so as to improve the public finance situation as quickly as possible. Following the above, risk- and monitoring-based audits have gradually been given more importance, a trend representing a change in our audit approaches.

Methodological and digital developments can pave the way for further technological developments, enabling us to reduce the workload for audited organizations, to increase the efficiency of our audits, and to keep in touch without personal contact during audits, which is especially important in the current situation, because of the COVID-19 pandemic.

Risk-based audit approaches allow us to significantly reduce the time-requirement of our audits and to increase their efficiency, as audits are performed through the assessment of a few groups of documents selected to fully cover each group of auditees. In this way, the SAO can assess important areas of responsible financial management, accountability and transparency in multiple audited organizations at the same time. All this contributes, through an increase in the number of audited organizations, to a general improvement in the public finance situation and accountability.

Such audits, although related to the past, can draw attention to some risks threatening to arise in future, which may justify further detailed audits to be performed at some organizations in order to draw their attention to areas jeopardizing sound financial management. The SAO has been able to focus on two major areas in the past two years. One of them is an area of management responsibility and is about developing integrity on an organisational level; and the other one is the annual assessment of financial stability.

Information on risk areas identified in this way can also be used as preparatory information for determining focus points for more detailed audits. This detailed structuring enables us to increase audit coverage and the added value of our audits and to broaden the range of options for utilisation.

Using monitoring-type approaches and compliance audit methodologies, our audits can provide an up-to-date "snapshot" of a group of auditees, based on a few important audit documents that are relevant to the subject matter of the audits concerned; so this is about "real-time" auditing. Thus, the purpose of monitoring-type audits is to assess the "preparedness" of a large group of audited organizations. While providing benefits to audited organizations,

monitoring-based audits are also in line with the SAO's audit objectives, namely: to increase the coverage of audits while using resources efficiently; to assess previously unaudited segments in real time; to support audited organizations, thus enhancing the SAO's advisory activities; and to facilitate the functioning of a "well-governed state". Focusing on the relevant documents of the current situation and using key criteria, monitoring-based audits apply real-time evaluation to produce recommendations, partly for the present and partly for the future, thus helping auditees improve their public finance situation by strengthening their basic operational and financial management regulations and their prevention-based organizational integrity frameworks.

Both of the two new approaches enable the SAO to detect deficiencies by verifying the existence of basic conditions in different areas of operation and financial management and to provide feedback related to them in order to support improvement in public funds and public assets management.

In addition to increasing its advisory activities to leaders, the SAO helps to achieve that processes become compliant in the most effective way and in time, by supporting the establishment of management control points and the correction of detected irregularities and deficiencies in the shortest possible time. All of this supports "real-time" counselling.

During the transformation of its control technologies and other organizational processes, the SAO has been applying change management for many years, a fact greatly contributing to its ability to efficiently and quickly cope with the situation, even in the midst of the new challenges posed by the pandemic. Domokos (2019, 2020) also emphasizes the importance of this, highlighting that, without change management, the requirement of sustainability cannot be fulfilled, even by public or municipal organizations using public funds as independent legal entities.

### *Integrity*

In addition to the SAO's internal activities, its external ones also raised more and more questions, as the auditing of institutions and organizations that were playing strategic roles in controlling the pandemic would not have been practical from several aspects. The most important goal was to save lives. On the other hand, it was clear that public confidence had to be strengthened, given that institutions of public administration and, for example, local governments were providing a number of services where cooperation was important. One of the most important tools for building trust is raising awareness of the integrity approach. Realising that, during the pandemic, citizens would face other integrity risks than before, the State Audit Office summarized its experiences in an analysis titled "Rethinking Integrity Risks and Controls during the Pandemic", highlighting the anomalies experienced in operations by organisations during the COVID-19 pandemic and the challenges faced by them, in addition to restricting personal contacts (Németh et al., 2020).

The analysis drew attention to the fact that while corruption is present in all societies, its forms may vary depending on whether there is an abundance of supply or a deficit economy. The situation caused by the COVID-19 pandemic has led to the emergence of conditions

characterising a demand market. In such a market, sellers will dictate, which is unusual but not unprecedented. A “seller’s market” has similar consequences to the deficit economy experienced during state socialism; and the state’s control over scarce health goods follows a logic similar to military resource management. The analysis found that the period of the COVID-19 pandemic was characterized by an information vacuum and a high degree of uncertainty. Meanwhile, in many cases, there was a lack of information on market realities and pricing, as well as a lack of expertise for conducting global procurements. The sudden increase in demand gave rise to extreme price volatility, so the customer side did not have the opportunity to establish a fair market price and judge cases of obvious profiteering or overpricing. As needs had to be satisfied immediately, the situation represented a significant burden for the financial management and legal infrastructures of public institutions (Németh et al., 2020, Kistóth et al., 2021).

In addition, the protection of human lives made it necessary in several areas to deviate from standards that had been applied before. This in itself cannot be considered unprecedented; each legal system includes empowering provisions allowing derogation from certain rules to deal with exceptional situations. The effects of the COVID-19 pandemic on the competitive market, on the public procurement market and on regulatory solutions for public procurement are examined in detail in two analyses published by the SAO in 2021 (Kistóth et al., 2021; Nagy et al., 2021).

Bureaucracy and over-regulation represent aggravating circumstances in the control of the COVID-19 pandemic. In addition to causing excessive bureaucracy and unjustified slowdown in processes, over-regulation may lead to unclear responsibilities, may reduce transparency and the predictability of decisions, and may therefore increase the risk of irregularities and corruption. One of the risk areas examined by the SAO’s Integrity Survey methodology is over-regulation, the complexity of regulation and its contradictions.

A high degree of uncertainty in organizational decision-making has created an increased need for making complex decisions. As integrity management systems of public institutions are designed to address risks in a traditional environment, it has become important to accurately identify new challenges. Overall, therefore, corruption schemes previously known from the deficit market are turning around, and the pattern of integrity risks is changing.

## MACRO-LEVEL PUBLIC FINANCE CHALLENGES

### *Macroeconomic and budget-related analyses*

In 2020, the SAO prepared 18 analyses covering budgetary processes and some areas of macroeconomics. The direct purpose of these analyses was to assist the work of the Fiscal Council of Hungary (FC), in accordance with the SAO’s legal obligations. In addition, the primary objective was to present the implications of the COVID-19 pandemic on public finances. The analyses handed over to the FC are necessarily retrospective due to the SAO’s mandate, and they highlight risks, draw attention to new opportunities, or ask relevant questions based on changes taking place recently or in the past 3-5 years. The COVID-19 pandemic has, at

least temporarily, broken the economic trends of the previous years, which had been rather favourable; therefore, the analyses prepared after March 2020 placed great emphasis on the challenges of 2020 and on presenting important context for post-pandemic recovery. Some of these analyses are highlighted below.

The most comprehensive analysis of this subject, titled “Analysis of the Budget for Sustainability”, revealed that a continued decline in deficit-to-GDP ratios and public debt ratios during the years analysed (2011-2019) was supported by a number of factors, in addition to a favourable economic environment (Simon et al., 2020). Although the nominal debt grew year after year, public debt ratios showed a steady improvement, due to a faster growth in the GDP. The analysis identified a number of risks increasing as a result of the pandemic, mentioning, in particular, the risk factors that affect the growth of public debt and the evolution of the GDP.

The analysis titled “Impact of EU Grants on Public Debt and Deficit” (Simon et al., 2020) explained, as a starting point, that EU grants exerted impacts not only on economic growth but also on the liquidity position of the central budget. The fact that EU grant funds are settled ex-post with the European Commission and the related time requirement represented a significant funding challenge for the central budget. The protracted settlement process of EU grant funds (advanced from the budget but not yet reimbursed by the European Commission) increased the amount of Hungary’s public debt for several years. In addition to quantifying these effects, the analysis highlighted that the Hungarian budget was able to undertake the extra burden of financing grant advances while complying with rules on general government deficit and the reduction of public debt. Concerning additional expenditures required during the pandemic, the analysis underlined that advancing EU revenues over several years was a form of making reserves, as the European Commission will have to repay such advances over the next two to three years, which will result in a significant reduction in the public debt of Hungary.

The analysis exploring changes in the financial vulnerability of the population in 2007-2019 (Kádár et al., 2020) revealed that retail savings significantly exceeded retail borrowing starting from 2010. That situation allowed the population to play an increasing role in financing the public debt. The analysis highlighted that this role is also important during the pandemic, as a greater willingness of the population to save will create favourable conditions for a situation where a significant part of the increased public debt is financed by domestic actors. The analysis concluded that the measures introduced to avoid an over-indebtedness of the population during the period analysed were appropriate to reduce the financial vulnerability of the population. The analysis underlined the need to keep in mind the risks of high indebtedness because, as the outbreak of the COVID-19 pandemic shows, situations may arise that make it very difficult to repay loans. This fact was cruelly demonstrated by the COVID-19 pandemic, as government action was needed again to prevent tens of thousands of households from becoming insolvent. The analysis emphasized the need to further strengthen public financial awareness in order to avoid excessive risk-taking.

The analysis titled “Labour market impacts of the economic protection action plan related to the pandemic situation” (Lajó et al., 2020) assessed labour market processes during the pe-



riod of the first and the second waves of the pandemic, starting from the announcement of the state of emergency through to late August. The analysis presented that the emergence of the COVID-19 pandemic broke the improving trend observed in employment rates in recent years. Changes caused by shutdowns in March and April took place in a differentiated manner on the labour market. A decline in employment data was immediately visible in some areas/sectors. A significant number of companies expected merely a temporary decline in production and a rapid restart of the economy, so employers typically sought to take temporary measures concerning workers (e.g., temporary layoffs, unpaid leave, reduced working hours, renegotiated wages, and training). This employer attitude was supported by government measures aimed at protecting jobs. Wage support programmes protected nearly 230 thousand jobs. Wage support for job protection was provided to as many as 185 thousand employees, and wage support for job creation enabled the employment of 25 thousand people. In addition, applications for wage support for employees engaged in research and development were submitted relevant to more than 16 thousand people. After an initial dramatic deterioration in employment, there was an improvement in employment starting from late July. The analysis identified it as a risk that the pandemic affected different sectors to different degrees, so recovery is expected to be of different degrees as well. Based on the above, the analysis suggested that it might be appropriate to provide more intensive support for employees to move from sectors affected over a long period to businesses recovering faster (e.g. in economic sectors that are front-runners in digitalisation).

#### *Strengthening the resilience of the economy*

One of the most important pillars of resilience against the COVID-19 pandemic is a sound public finance system. For many years, the SAO has been dealing with the issue of resilience relevant to the budget, i.e. how to adapt flexibly to interim changes during the implementation of the budget, while protecting the basic objectives of the budget and complying with public debt rule (Pulay et al., 2020; Domokos, 2020). In recent years, the SAO has primarily called for the establishment of a multi-level and multi-element system for making reserves; the mitigation of the end-of-year formation of budget residues; and the development of a transparent system for using residues.

However, at the time of the COVID-19 pandemic, resilience related to the budget had to be given a new meaning, as the primary task for the budget policy was no longer to preserve the balance of the budget but to create funds for efforts to control the pandemic, including the protection of both human health and jobs. In other words, resilience against the devastation of the pandemic had to be created in society and the economy as a whole. To that end, a stable budgetary basis and appropriate legislative powers were required. The Fundamental Law of Hungary provided the legal basis for creating the above.

Article 36 (5) of the Fundamental Law stipulates that "As long as government debt exceeds half of the total gross domestic product, the National Assembly may only adopt an Act on the central budget which provides for a reduction of the ratio of government debt to the total gross domestic product". We can recall the key experience of the global financial crisis that broke out in 2008: those countries were able to recover from the crisis faster and at lower los-

ses that had previously pursued nearly balanced fiscal policies and had ensured stable footing for financing their public debts. The fact that Hungary reduced its public debt to the GDP ratio year after year for nine consecutive years is attributable, among others, to the so-called public debt rule stipulated in the Fundamental Law as cited above. This is one of the reasons why we can state that the economic shock caused by the pandemic reached Hungary in a much better standing than the global financial crisis of 2008.

However, the drafters of the Fundamental Law were conscious of the fact that periods of economic growth will, from time to time, be interrupted by developments bringing about decline. Therefore, the Fundamental Law stipulates a rule for that situation, stating that “Any derogation from the requirement of reducing the public debt ratio shall only be allowed during a special legal order and to the extent necessary to mitigate the consequences of the circumstances triggering the special legal order, or, in the event of an enduring and significant national economic recession, to the extent necessary to restore the balance of the national economy” (Article 36 (6) of the Fundamental Law).

Lawyers refer to the rule cited above as the “escape clause”. However, as an economist, it is more appropriate to consider it as an enabling provision. An enabling provision means that a higher-level legal regulation provides authorisation for the enactment of a lower-level legal regulation, for example, an Act authorizes the Government to make a government decree on a particular subject. As general legal position holds, the authorization also represents an obligation to make the given legal regulation.

Why do I use this analogy? Because the term ‘escape clause’ gives the impression that someone has done something wrong and we waive the negative consequences thereof, having regard to the given circumstances. In the present case, however, it is not at all a matter of turning a blind eye to a forced increase of the public debt ratio. We need to put the emphasis on something quite different. The cited provision of the Fundamental Law should be considered as an authorization for the Government to deviate from the requirement to reduce the public debt ratio, to the extent necessary for mitigating the consequences caused by the triggering circumstances or for restoring the balance. Interpreting this authorisation as an obligation, I can argue that the Government would have acted improperly if it had not exercised this authority and had given priority to the aspects of fiscal balance over the measures needed to remedy the emergency situation. I have consciously used the term remedy, as the lives of many people depended on whether the Government provides funds for the measures needed to curb the pandemic. It was no less a task to preserve jobs amid the economic conditions caused by the pandemic.

Why are we talking about an escape clause then? Because subsequently in the European Union and in many other countries around the world, exemptions from compliance with some rules had to be granted after the outbreak of the pandemic. In contrast, the Fundamental Law of Hungary contained the provisions that empowered the Government to act, right from the moment when it was adopted. Here, I mean not only the above-mentioned authorization, but that the law also empowered the Government, in case of a state of emergency, to rearrange the structure of the budget adopted by Parliament in quite different circumstances and to reappropriate some budget resources to controlling the pandemic and to protecting the economy by creating two new funds, in deviation from the provisions of the Public Finance Act.

Prior to the onset of the COVID-19 pandemic in Hungary, macroeconomic and fiscal developments in Hungary had been favourable, as the real GDP increased every year between 2013 and 2019, the budget deficit to the GDP ratio stood below the Maastricht deficit target (3%) starting from 2012, while the public debt to the GDP ratio fell from 80.4% in 2011 to 64.2% in 2019. Thus, the outbreak of the COVID-19 pandemic in March 2020 exerted a shock-like negative impact on a national economy that had strong fundamentals and had been expanding for years. The first and second waves of the pandemic caused a sharp economic downturn during the year, as a result of which Hungary's GDP in 2020 fell by 4.7% in real terms compared to the previous year. This rate is more than one percentage point better than the EU average (-5.9%) due to stable fundamentals and government measures taken during the year.

In order to alleviate the economic shock caused by the COVID-19 pandemic, the Government implemented a supply-side crisis management economic policy aimed at curbing the economic downturn and achieving economic recovery as soon as possible. As a result of this supply-oriented economic policy, the investment rate in Hungary was able to increase, at least moderately, despite the unfavourable macroeconomic environment. The improving trend in the investment rate was mainly attributable to an increase in investments in the public sector in Q4 2020 and a dynamic rise in housing investments.

We must also highlight the role played by the state in preserving and creating jobs, carried out, among others, through tax incentives and exemptions, as well as targeted support for the development of knowledge and technology. As a result of crisis management, employment and unemployment data has improved by the end of the year, after reaching a low in Q2 2020. The effectiveness of the measures is also remarkable in international comparison, as in Hungary in 2020 the employment rate of those aged 15-64 decreased by 0.3 percentage points less than the EU27 average.

#### *The challenges of restarting the economy*

As the employment rate and the investment rate were kept at a high level, it provided a good basis for restarting the economy, a fact reflected in an extremely dynamic economic growth in Q2 2021, through which the amount of the GDP exceeded its level observed in 2019. However, the maintenance of this rapid economic growth is threatened by a number of factors, in addition to the new wave of the pandemic. I mean, above all, the shortages that evolved in world economy, which, on the one hand, are hampering continuous production and, on the other hand, the resulting shortage – a new phenomenon to welfare states – is causing hysterical reactions and that prices of energy and other essential articles are skyrocketing. The fact that most states pumped money into the economy without performance during the COVID-19 pandemic creates favourable conditions for the cost-side inflation to break loose. Back then, due to various physical constraints, income holders could not spend money, so it had no inflationary effect. However, after restrictions had been lifted, consumers started to buy and their needs could not be met smoothly by disordered global production chains.

In this situation, it is difficult to decide whether fiscal policy should still support the restart of the economy or should rather curb inflation by reducing the budget deficit. Therefore, a close monitoring of economic processes can serve as a basis for deciding whether it is expedient to step on the brakes or on the gas. The public debt rule also serves as a compass for decisions in such situations, as it makes the reduction of the public debt ratio mandatory once the economic downturn has ended. Consequently, the economic stimulus policy can be continued as long as the resulting GDP growth is higher than the increase in public debt. However, the reverse is also true, meaning that such austerity policies should not be pursued that result in only a slight increase in public debt, but lead to an even more pronounced slowdown in economic growth.

Based on the dynamic growth of the Hungarian economy between 2017 and 2019, and the high investment rate underpinning it, as well as investments attracted to Hungary since then, we can state that the economic growth of 5-8 percent has got its internal conditions, and they could be exploited in case of a not too unfavourable evolution of conditions in world economy. This would allow the Hungarian economy to catch up with the surge in public debt during the pandemic and gradually, but at a good pace, reduce the public debt ratio to the level of 50 percent of the GDP envisaged in the Fundamental Law.

However, reducing the general government deficit to below three percent of the GDP will also require cuts in government spending. This requirement can be fulfilled within two to three years after spending is no longer needed to deal with the negative effects of the pandemic.

But it is also clear that setting the economy on a sustainable growth path is not a matter of quantity but of quality. Sustainable growth requires sustainable competitiveness. For this purpose, various synergies should be exploited. I will only briefly describe these synergies, as the SAO's analysts have recently prepared detailed analyses on these topics, which are published on the SAO's website.

- Firstly, the link between economic growth and environmental impacts must be pointed out. The goal of achieving climate neutrality by 2050 means that the amount of greenhouse gases emitted per unit of production needs to be reduced at a rate that is significantly higher than the growth rate of the economy. This is only possible if climate protection measures are part of a complete modernization process.
- Secondly, I mention the issue of security, a term that may include many kinds of security to think of (national security, security of supply, protection against pandemics). The experience of the pandemic suggests that strong security cannot be built on international cooperation alone, and that national frameworks also need to be strengthened. From the aspect of our topic, the issue of secure financing of public debt needs to be explained in more detail. It is obvious that the most secure way of financing public debt is when it is mostly financed by domestic investors and, in particular, retail government securities. Citizens are the investors who, in the event of financial turbulence, do not withdraw their savings from the state, but rather invest them. And interest paid to them will flow back into the economy or further increase their savings. For curbing inflation, it is also important for the government

to place savings of citizens in long-term government securities bearing interest at appropriate rates.

- A key component of sustainable economic growth is sustainable whitening, i.e. making grey employment transparent through the reduction of labour taxes. In parallel with that, the transparency of financial management is increased by means of digitalisation. This endeavour will not only mean extra revenue for the budget, but will also meet the sense of justice in society. An essential component of sustainable whitening is that the state does not keep the extra revenue coming from whitening of the economy, but “returns” it to taxpayers by reducing personal income tax and wage contributions. One form of this could be the recognition of investment in vocational training through a proportionate reduction in personal income tax.
- Expanding employment has so far been an extremely successful means of aligning economic and social aspects. This goal should not be abandoned, despite the fact that reserves of economic activity that can be easily mobilised have already been exhausted and that increased efforts, such as custom-tailored support would be needed to achieve that additional groups (disadvantaged young people, people with disabilities, people living in small villages) also start working. A goal could be to raise the employment rate above 80 percent.
- Another important social policy, which has proven successful so far, is the broadening of sharing the burdens of child-rearing, which can, through its positive results, be the key to long-term social sustainability (by reducing population decline and ageing).
- Of course, we must not forget about political stability, which has been an important factor in Hungary’s ability to attract capital, due to the resulting predictability.

#### CLOSING REMARKS

This article detailed how the State Audit Office responded to the challenges posed by the COVID-19 pandemic. At the same time, we consider it important to emphasize that the pandemic also provided an opportunity for institutions, organizations and citizens to change their mindsets, and to use a risk-based approach in the future for making decisions, by focusing on prevention and relying on planning. As a special feature of planning, we must think in terms of deadlines and assess our own possibilities. We need to prioritize our expenditures and set on a path towards high quality spending processes. This is how citizens together can become a responsible and self-sufficient Hungarian society. Moreover, it is in the interest of society, especially in the current situation, to save and to get our share of consumption. This means there is a shared interest and a shared burden to bear at the same time. In this way, we can, through solidarity, get out of the trouble we lived through together. A population that can make plans, and can set aside and manage funds will provide added value to society as a whole that can be relied on even in crisis situations.

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