Ana Corbacho:[1] Hungary: Fiscal risks from public transport enterprises

Public enterprises may play an important role in government finances and pose substantial fiscal risks. However, these risks are not always adequately reflected in the fiscal accounts. This hampers the transparent assessment of the fiscal stance, provides incentives to move fiscal activities off budget, and increases risks that unrecorded liabilities materialize unexpectedly. The IMF's Fiscal Affairs Department proposed a framework to the coverage of public enterprises in fiscal indicators and targets based on the fiscal risks posed by public enterprises' operations. This paper applies this approach to the Hungarian State Railways and the Budapest Transport Company and draws some lessons for enhancing the transparency, quality and predictability of fiscal policy in Hungary.

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1. INTRODUCTION

Public enterprises (PEs) may pose significant fiscal risks on account of their quasi-fiscal activities (QFAs) and contingent liabilities. QFAs can lead to financial difficulties, unless they are adequately and transparently compensated by government budget transfers.[2] Contingent liabilities can arise, for example, when there is political interference or mismanagement leading to excessive borrowing and poor profitability. These liabilities can be explicit, as in the case of guarantees, or implicit, if there is an expectation or precedent that PEs in financial distress will be eventually bailed out by the government.

Good practices in fiscal transparency call for the reporting on all activities of a fiscal nature and their associated risks. When PEs undertake QFAs, these operations are not captured in the conventional measures of the government fiscal balance, distorting the nature and extent of fiscal activities. This can lead to poor fiscal policy design and also creates incentives to move fiscal activities to PEs to make the reported government fiscal balances appear better than they actually are. At a minimum, therefore, the operations of PEs should be systematically monitored and transparently reported to the public. This requires adequate frequency and comprehensiveness to allow an assessment of fiscal risks.[3]

In 2005, the IMF's Fiscal Affairs Department proposed a framework to assess fiscal risks from PEs and define the appropriate coverage of fiscal indicators. Quantifying QFAs and contingent liabilities can be methodologically challenging. Thus, identifying in first instance those enterprises that pose the most significant risks becomes important. The Fiscal Affairs Department (FAD) proposed an approach to the treatment of PEs in fiscal indicators and targets, focusing on the fiscal risks posed by the operations of PEs.[4] The ultimate goal of this work is to assist authorities and Fund staff in defining the appropriate coverage of indicators and targets for the analysis of fiscal policy. Appropriate coverage is essential to allow an adequate, transparent assessment of the fiscal stance, mitigate incentives to move fiscal activities off budget, and reduce risks that unrecorded liabilities materialize unexpectedly.

This paper assesses fiscal risks posed by two key public transport enterprises in Hungary: the Hungarian State Railways (MAV) and the Budapest Transport Company

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[2] QFAs may be conducted by financial institutions (e.g., subsidized lending; credit ceilings; exchange rate guarantees), or by non-financial public enterprises (e.g., charging less than commercial prices; provision of social services; pricing for budget revenue purposes; paying above commercial prices to suppliers).

[3] For instance, the IMF Manual on Fiscal Transparency recommends that budget documents include statements on QFAs and fiscal risks, and that the consolidated position of the government and non-governmental public sector agencies that undertake significant QFAs be reported. Similarly, *the 2001 Government Finance Statistics Manual (GFSM 2001)* recommends the compilation of accrual-based statistics on the operations of PEs and the non-financial public sector.

[4] In 2004, FAD conducted several pilot studies to identify "commercially oriented" PEs, which could be considered candidates for exclusion from fiscal targets and indicators. Very few PEs were found to be commercially oriented. More importantly, the pilot studies also suggested various changes in the approach to the fiscal coverage of PEs. See IMF (2005) for further details.

(BKV). As noted by the IMF Report on Observance of Standards and Codes, Fiscal Transparency Module (fiscal ROSC), these PEs undertake QFAs on behalf of the government. However, annual transfers from the budget have been ad hoc and insufficient to cover recurring operating losses. As a consequence, MAV and BKV have resorted to borrowing, typically with government guarantees, which has resulted in an accumulation of contingent liabilities for the government. Since PEs are not covered by fiscal indicators and targets which apply to the general government, there are incentives to under-finance QFAs and report a lower headline fiscal balance until the PEs run into financial distress and have to be bailed out. In the past, these bailouts have been treated as "one-off" operations, hampering fiscal transparency and contributing to overshooting of fiscal targets. Against this background, this paper applies FAD's framework to assess the fiscal risks posed by MAV and BKV and draws some lessons for enhancing the transparency, quality and predictability of fiscal policy in Hungary.

The paper is organized as follows: Section 2 provides a brief overview of public sector enterprises in Hungary. Section 3 applies FAD's approach to assess the fiscal risks from MAV and BKV. The final section offers some concluding remarks.

2. OVERVIEW OF THE PUBLIC ENTERPRISE SECTOR IN HUNGARY

Key assets remain under government ownership and operation. Over 85 percent of the economy is in private hands.[5] According to the Privatization Act (Act XXXIX of 1995), assets may remain in long-term state ownership if they belong to a national public utility provider or are considered to be of strategic importance for the national economy or defence. Capital intensive (MAV, BKV, electricity production) and labour intensive (Post) enterprises remain as state property. The Privatization Act also established the Hungarian Privatization and State Holding Company (ÁPV Rt.) to oversee the privatization program.[6]

There is no centralized oversight and management of PEs. The organization of ownership rights follows a decentralized model.[7] This is regulated by the Privatization Act, which assigns rights and oversight responsibilities between ÁPV Rt. and line ministries.[8] PEs under the supervision of ÁPV Rt. aim to maintain an arms-length relationship with the government.[9] Dividends and transfers between these PEs and the budget are set in business plans. Arrangements regulating transfers between PEs under line ministries and the budget are not transparent. Dividend and transfer policies have been ad hoc, and QFAs have not been fully compensated by the government. QFAs are particularly significant in the cases of MAV and BKV, but are also present in the water, post, electricity, and gas sectors.[10]

Consolidated information on the PE sector is not available. The Hungarian budget covers the state budget sector, including central budget institutions, the health and pension funds, and other funds (e.g., Labour Market Fund; Cultural Fund). For the purpose of reporting on ESA-95 basis, and setting targets for the Convergence Programme, the state budget sector is consolidated with local government operations and certain central government units outside of the state budget sector.[11] The government does not report on the consolidated position of the PE sector, either in budget documents or within-year reports. Budget documents also lack information on QFAs. And the discussion on fiscal risks is limited to loan guarantees of the central government. To assess the fiscal impulse, the central bank of Hungary compiles an augmented measure of the fiscal deficit (the "augmented SNA deficit") which consolidates the general government sector with key QFAs, including those from public transport enterprises.

The operations of MAV and BKV are monitored closely by the government, but within-year data are not reported to the public. The Ministry of Economy and Transport (MET) exercises full ownership rights over MAV, while the Municipality of Budapest (MB) is the sole shareholder of BKV. Recognizing that these enterprises are in a difficult financial situation, their operations are monitored closely by

[5] See Báger and Kovács (2004) for a survey of privatization in Hungary.

[6] The government recently submitted to Parliament a new Act on State Asset Management, which will set up a state asset management company. This company will assume the responsibilities currently assigned to the ÁPV Rt., the Treasury Property Directorate, and the National Land Fund.

[7] See OECD (2005a) and OECD (2005b) for a survey on ownership function models for PEs.

[8] ÁPV Rt. exercises ownership rights over several important public enterprises, including the long-distance bus company VOLANBUSZ and certain power enterprises. The Ministry of Economy and Transport exercises ownership rights over MAV, the National Road Construction Company, and the State Motorway Company, among others. The Municipality of Budapest is the sole shareholder of BKV. See Appendix 1 for a full list of enterprises under long-term state property as dictated by the Privatization Act.

[9] As part of its asset management duties, ÁPV Rt. defines and approves the enterprises' strategies and business plans, continuously tracks enterprises' financial management and liquidity, has enterprises' annual reports compiled, and decides on dividend payments.

[10] See fiscal ROSC for further details.

[11] These include, for example, ÁPV Rt, the National Road Construction Company, and the State Motorway Company. The budget documents include an appendix that explains the relationship between fiscal targets of the state budget sector and general government consistent with ESA 95.

the government. MAV reports to the MET on a monthly basis; and the amounts of capital injections and state guarantees are coordinated and approved by the MET and the Ministry of Finance. BKV also reports to the MB on a monthly basis. Its borrowing plans are approved by the MB, and by the state as well in the case of state-guaranteed loans. These within-year reports are not publicly available, although audited annual reports are.

3. ASSESSMENT OF FISCAL RISKS

This section reviews fiscal risks posed by MAV and BKV. Given precedents of financial difficulties and contingent liabilities, this section assesses the fiscal risks from MAV and BKV in light of the criteria proposed by FAD. These criteria relate to: (i) managerial independence; (ii) relations with the government; (iii) financial conditions; (iv) governance structure; and (v) other risk factors (Box 1).

Box 1: Criteria for Assessing Fiscal Risks of Public Enterprises

I. Managerial independence

Pricing policy: whether prices are in line with international benchmarks for traded goods and services; cover costs (for non-traded goods); and in regulated sectors, whether the tariff-setting regime is compatible with the long-term sustainability of the PE.

Employment policy: whether this is independent of civil service laws, and the government intervenes in wage setting and hiring.

II. Relations with the government

Subsidies and transfers: whether the government provides direct or indirect subsidies and/or explicit or implicit loan guarantees, which go beyond those given to private enterprises; and whether the PE make any special transfers to the government.

Quasi-fiscal activities: whether PEs perform uncompensated functions or absorb costs which are not directly related to their business objective and/or substitute for government spending.

Regulatory and tax regime: whether PEs are subject to the same regulations and taxes as private firms.

III. Financial conditions and sustainability

Market access: whether PEs can borrow without a government loan guarantee.

Less-than-full leveraging: whether PEs' liability-to-asset ratio is comparable to industry averages.

Profitability: whether PEs perform compared to relevant industry.

Record of past investments: whether past investments had an appropriate average rate of return.

IV. Governance structure

Periodic outside audits: whether these are carried out by a reputable private accounting firm applying international standards and are published.

Publication of comprehensive annual reports: whether annual reports are published, and what type of information they include.

Shareholders' rights: whether minority shareholders' rights are protected.

V. Other risk factors

Vulnerability: whether PEs have sizeable contingent liabilities relative to their operating balance.

Importance: whether PEs are large in some significant dimension (for example, debt service, employment, customer base).

Assessment of fiscal risks posed by MAV

1. MAV does not comply with several of the FAD criteria on fiscal risks. As described in detail below, MAV does not meet many of the criteria in the areas of managerial independence, relations with the government, financial conditions, and other risk factors (Table 1). Regarding governance, MAV complies with the criteria on external audits, but reporting could be improved.

Criterion 1: Managerial independence-pricing and employment policies

MAV does not enjoy managerial independence in employment and pricing policies. Employment and wage policies are determined in annual business plans, which have to be approved by the MET in compliance with the Labour Code. Passenger tariffs are set by the government, and these are not fully-aligned with cost-recovery levels. Prices for freight facilities have been set more freely since 1994 and better reflect market conditions. As noted by KPMG (2006), MAV has operated at a loss mainly due to services being priced at below operating costs and pricing policies being outside the control of the enterprise.

Criterion 2: Relations with the government-transfers, subsidies, and QFAs

MAV undertakes significant QFAs on behalf of the government, but these are not fully compensated by the

Table 1

Quasi-fiscal activity (under-financed public services, provision of preferential loans and guarantees) with subsequent settlement of debt

Public Enterprise	Managerial Independence						Government Relations		
	Pricing Policy		Employment Policy			Only Commercial Objectives	No Loan Guarantees	Quasifiscal Activities?	Standard Tax and Regulatory Rules
	Prices Reflect Costs	Subsidies	Civil Servants	Market Wages	Over-staffing				
Hungarian State Railways	No	Yes	No	Determined by the enterprise and trade unions	Yes; but decreasing	No	Loan guarantees exist	Yes; services provided at below commercial prices and for social purposes	Yes except for tax (rebate, and exemption on local business tax)

Public Enterprise	Financial Conditions			Governance Structure				Other Factors		
		Creditworthiness							Size	
	Profitability[1]	Debt Level[2]	Debt Cost[3]	Stock Listed	Outside Audits	Annual Reports	Minority Rights Protected	Contingent liabilities	Number of Employees	Annual Sales
Hungarian State Railways	Negative	100.8% (2006)	6.0%	Not listed	Yes	Yes	100% state owned	Hedging, guarantees	46,814 (2004)	131,119 million forint (2006)

Sources: Hungarian authorities; and IMF staff estimates.
[1] *The enterprise has had negative profitability over the last years. In 2006, MAV's net worth has also been negative, requiring capitalization.*
[2] *Debt level is defined as the ratio of total liabilities to total assets in most recent year in percent.*
[3] *Debt cost is defined as the ratio of accrued 4-year financial costs to average total debt, including short and long-term debt, in percent.*

budget. Subsidies or free tickets are provided for several groups, including students, children, senior citizens, families, civil servants, pensioners, and others. About 25 percent of passengers do not pay for transport services. The government makes annual transfers to MAV under two concepts: consumer price supplements and public service obligations. These transfers have been insufficient to cover the cost of QFAs. The share of passenger operating costs covered by budget transfers has fallen since 2003, from 57 percent to about 47 percent in 2005 (Table 2). MAV also receives budget support for investment and other goals (Table 3).

Table 2

Hungarian state railways: Passenger operations, 2000–2005

(In billions of forint; unless otherwise indicated)

	2000	2001	2002	2003	2004	2005
Revenues from passenger transport	101.9	114.4	122.0	122.5	121.8	116.1
Budget transfers	63.0	69.5	76.5	80.0	80.1	74.6
Consumer price supplement	16.9	19.3	20.7	22.2	23.6	24.2
Public service obligation	46.1	50.2	55.8	57.8	56.5	50.4
Inflow to cashier from paid fares	38.9	44.9	45.5	42.5	41.7	41.5
Costs from passenger transport	119.9	137.8	151.1	141.1	156.5	159.8
Share of costs covered by:						
Budget transfers (in percent)	52.5	50.4	50.6	56.7	51.2	46.7
Inflow to cashier (in percent)	32.4	32.6	30.1	30.1	26.6	26.0

Sources: KPMG (2006); and IMF staff estimates.

Table 3

Budget support to Hungarian State Railways, 2000-2006

(In billions of forint; unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006[1]
Public service obligation transfer	46.0	50.2	55.8	57.8	56.5	50.4	74.4
Consumer price transfer	17.0	19.3	20.7	22.2	23.6	24.2	24.3
Investment subsidy	26.0	21.6	27.5	17.2	12.6	18.4	36.5
Fuel tax rebate	6.9	6.7	6.5	6.5	6.1	5.7	5.7
Severance compensation	0.0	0.0	0.0	0.0	1.0	2.8	0.8
Budapest Transport Company Alliance Compensation	0.0	0.0	0.0	0.0	0.0	0.2	1.0
Other subsidies	0.2	0.0	0.0	0.0	0.0	0.0	0.5
Debt takeover	35.7	0.0	121.1	0.0	0.0	0.0	0.0
State guarantees	28.7	38.4	24.3	38.7	59.0	131.3	55.0
Total	160.7	136.2	255.9	142.4	158.8	233.1	198.3
In percent of GDP	1.2	0.9	1.5	0.8	0.8	1.0	0.8

Sources: Hungarian authorities; and IMF staff estimates.

[1] *2006 data excludes freight operations.*

Table 4

Hungarian State Railways: Summary of financial indicators, 2000–2006

	2000	2001	2002	2003	2004	2005	2006[1]
				(In percent)			
Liabilities/Assets	25.5	73.7	73.7	76.2	82.9	91.4	100.8
Liquidity[2]	59.5	57.3	34.2	44.2	42.7	37.2	45.7
				(In percent of GDP)			
Net operational losses							
Before government transfers	-0.6	-0.6	-0.4	-0.6	-0.6	-0.7	-0.8
After government transfers	-0.2	-0.2	0.1	-0.2	-0.2	-0.4	-0.4
Investment	0.5	0.3	0.4	0.4	0.3	0.3	0.3
Liabilities	1.2	3.3	3.0	3.0	3.1	3.3	3.6
Short-term	0.7	0.7	1.0	0.9	0.8	1.0	0.8
Long-term	0.5	2.5	2.0	2.1	2.3	2.3	2.8
of which: guaranteed	0.2	0.3	0.1	0.2	0.3	0.6	0.2
Debt takeover	0.3	...	0.7	...	...	...	...
Share capital increase	...	...	...	...	...	...	0.1

Sources: Hungarian authorities; and IMF staff estimates.

[1] *2006 data excludes freight operations.*

[2] *Current assets divided by current liabilities.*

The tax treatment of MAV is broadly in line with that of private enterprises. Since MAV does not use public roads, it receives a rebate from the government on paid excise taxes on fuel. The same treatment applies to water and air transportation enterprises. As MAV has been running losses, it has not paid dividends or corporate income taxes to the central government. MAV has also not paid the local business tax collected by municipalities.[12] However, loss-making private enterprises, which do not provide public services, do not receive the latter favourable treatment.

[12] Act C of 1990 on Local Taxes exempts public service enterprises from the local business tax when these enterprises do not incur corporate tax liabilities.

[13] See Appendix 2 for full details on the income statement and balance sheet of MAV.

Criterion 3: Financial conditions and sustainability

MAV is in poor financial health. The liability-to-asset ratio has increased from 25 percent in 2000 to over 100 percent in 2006 (Table 4). The company's equity and reserve position has declined significantly over the past 5 years, reaching below capital adequacy levels in 2004 (KPMG, 2005). Liquidity indicators also show marked deterioration. Net operational losses before government transfers were close to 1 percent of GDP in 2006. Investment levels have been compressed to under 0.5 percent of GDP in recent years.[13]

The government provides loan guarantees to MAV and has taken over MAV's liabilities in several occasions in the past. The state took over MAV's liabilities in 2000 and 2002. Despite these bailouts, liabilities have remained on the rise, reaching over 100 percent of assets in 2006. The cost of debt has been around 6 percent. This is close to government costs, arguably reflecting the state's backing of MAV's liabilities. State guarantees have averaged 0.3 percent of GDP in the past 6 years.

The recent separation of freight and passenger branches has increased transparency. A new and legally-independent firm for freight transport was established in January 2006. As noted earlier, prices for freight transport have been better aligned with market conditions, and freight operations are expected to post profits following the split in operations from passenger transport. This separation will increase transparency and will make it easier to define public transport services that are to be compensated by the state. However, unless passenger fares or budget transfers are increased, losses from passenger operations will continue and will cease to be cross-subsidized from freight operations. Following the separation of freight and passenger operations, MAV will also undergo a rationalization program (e.g. closure of underutilized branch lines).[14]

Criterion 4: Governance structure: External audits and shareholders' rights

MAV's accounts are audited externally on the basis of International Accounting Standards, and these reports are available to the public. Currently, the auditor is KPMG Hungária Kft. (KPMG Hungária Limited Liability Co). Annual reports are not posted on-line and there is no within-year reporting on MAV's financial position. MAV is not listed on the stock exchange and has no minority shareholders.

Criterion 5: Other risk factors

MAV dominates railway transport in Hungary. MAV faces little competition in passenger rail transport, serving over 150 million passengers a year. Gyor-Sopron-Ebenfurt Co., a joint Hungarian-Austrian enterprises, also offers rail transport services, but on much smaller scale. Five small private railway enterprises offer freight services. In terms of employment, the number of employees has declined in recent years, but with a staff of around 45,000, MAV continues to be a large employer in need of further restructuring.

Assessment of fiscal risks posed by BKV

BKV also fails to meet many of the FAD criteria on fiscal risks, including in the areas of managerial independence, relations with the government, financial conditions, and other risk factors (Table 5). External audits are performed and publicly available, and BKV's annual reports are also posted on-line.

Criterion 1: Managerial independence-pricing and employment policies

BKV does not enjoy managerial independence in pricing and employment policies. Prices are set administratively by the MB and fall short of cost-recovery levels. Given the current tariff structure, operating revenues before government transfers cover less than 50 percent of operating expenditures.[15] Employment and wage policies are set out in annual business plans, which have to be approved by the Budapest Municipal Owners' and Municipal Operations' Committees and comply with the Labour Code.

Criterion 2: Relations with the Government-Transfers, Subsidies, and QFAs

Budget transfers are not sufficient to make up for the cost of QFAs. Student, pensioners, and other groups receive discounted or free tickets. BKV receives subsidies to compensate for these QFAs under two concepts: price subsidies (linked to consumers) and normative subsides (linked to public service obligations). Both the central government budget and the MB provide financial assistance to the company (Table 6). Budget transfers are determined annually and cover about 40 percent of operating costs. In 2004, BKV and the MB signed an 8-year public service contract the defines quality standards, volume of services, compensation schemes, etc.

[13] See Appendix 2 for full details on the income statement and balance sheet of MAV.

[14] The OECD (2007) notes that the returns on this programme for 2007 and 2008 are uncertain, and that even with EU funds financing, the level of government support for this project is estimated to be large.

[15] Tariffs would need to increase by 134% to fully finance operations without any budgetary compensation.

Table 5

Budapest Transport Company: Summary of compliance with criteria on fiscal risks

Public Enterprise	Managerial Independence						Government Relations		
	Pricing Policy		Employment Policy			Only Commercial Objectives	No Loan Guarantees	Quasifiscal Activities?	Standard Tax and Regulatory Rules
	Prices Reflect Costs	Subsidies	Civil Servants	Market Wages	Over-staffing				
Budapest Transport Company	No	Yes	No	Yes	Yes	No	Loan guarantees exist	Yes; services provided at below commercial prices and for social purposes	Yes (except for on local business tax)

Public Enterprise	Financial Conditions			Governance Structure				Other Factors		
		Creditworthiness							Size	
	Profita-bility[1]	Debt Level[2]	Debt Cost[3]	Stock Listed	Outside Audits	Annual Reports	Minority Rights Protected	Contingent liabilities	Number of Employees	Annual Sales
Budapest Transport Company	-12% (2006)	28.4% (2006)	6.2%	Not listed	Yes	Yes	100% state owned	Legal cases related to damage claims	12,745 (2004)	63,322 million forint (2006)

Sources: Hungarian authorities; and IMF staff estimates.

[1] *Profitability is defined as the ratio of net profits to net worth in most recent years in percent.*

[2] *Debt level is defined as the ratio of total liabilities to total assets in most recent year in percent.*

[3] *Debt cost is defined as the ratio of accrued 4-year financial costs to average total debt, including short and long-term debt, in percent.*

Table 6

Budget Support to Budapest Transport Company, 2000–2006

	2000	2001	2002	2003	2004	2005	2006[1]
Public service obligation transfer	14.2	14.2	16.2	3.0	8.9	11.9	32.1
Central budget	0.0	0.0	0.0	0.0	5.9	11.9	32.1
Municipal budget	14.2	14.2	16.2	3.0	3.0	0.0	0.0
Consumer price transfer	14.5	15.8	16.8	18.8	18.7	19.0	17.9
Debt takeover	0.0	0.0	37.4	0.0	0.0	0.0	0.0
Share capital increase	0.0	0.0	0.0	5.0	3.0	11.9	10.6
State guarantees	0.0	0.0	0.0	0.0	0.0	15.0	0.0
Total	28.7	30.0	70.4	26.8	30.6	57.8	60.6
In percent of GDP	0.2	0.2	0.4	0.1	0.1	0.3	0.3

Sources: Hungarian authorities; and IMF staff estimates.

BKV is broadly subject to the same tax regulations as private firms. However, as noted below, BKV's poor liquidity position prompted the enterprise to apply for deferred tax payments to the tax authority (APEH) in 2004.[16] As BKV has been running losses, it has not paid dividends or corporate income taxes. Similarly to MAV, BKV also does not pay local business tax.

Criterion 3: Financial conditions and sustainability

The government assumed BKV's liabilities in 2002 and provided loan guarantees in 2005. The central government provided special assistance to BKV in 2002, taking over debt obligations worth HUF 36 billion (about 0.2 percent of

[16] A similar situation arose in 2000.

GDP). About 60 percent of these liabilities corresponded to short-term credits. Reflecting poor liquidity and difficult access to market financing in 2004 (see below), state loan guarantees in the amount of HUF 15 billion were provided for the first time in 2005.

BKV's financial conditions are weak. Following the government's bail-out in 2002, the ratio of total liabilities to assets continued to increase from 8 percent to close to 30 percent in 2006. Liquidity indicators also worsened (Table 7), rendering the financial position critical in 2004, due in part to shortfalls in expected price subsidies. At that point, BKV was granted deferred payments of tax liabilities to APEH and was authorized to issue new debt. The issuance was undersubscribed as banks regarded BKV's creditworthiness as less favourable compared to previous years. Net operating losses before transfers were 0.3 percent of GDP in recent years. Weak financial conditions have constrained investment at 0.2 percent of GDP, and equity levels have been on the decline.

Criterion 4: Governance structure: External audits and shareholders' rights

BKV's accounts are audited externally on the basis of International Accounting Standards, and annual reports are published on-line. Currently, the auditor is Deloitte & Touche, and audited reports are publicly available. BKV also publishes annual reports on its website, with useful and clearly presented financial information. As in the case of MAV, there is no public within-year reporting. BKV is not listed in the stock exchange, has no minority shareholders, and is not rated by any credit rating agency.

Criterion 5: Other risk factors

BKV is the largest local public transport enterprise in Hungary. BKV provides transport services to 1.4 billion passengers a year and does not face meaningful competition. It employs close to 13,000 people and its orders are significant in the local input markets.

4. CONCLUDING REMARKS

MAV and BKV pose important fiscal risks. Both enterprises fail to meet key FAD criteria. In particular, financial arrangements with the budget are not transparent and QFAs are not fully compensated by the government. The enterprises' financial conditions have been weak, and despite bailouts in recent years, liabilities have continued to rise. Some part of these liabilities are backed by government guarantees and, in the absence of improvement in financial conditions, could impact the government accounts in the near future. Externally audited reports are publicly available, but the assessment and disclosure of fiscal risks from PEs in budget documents is lacking. This hampers fiscal transparency and increases uncertainty regarding the true extent of fiscal activities.

Table 7

Hungarian State Railways: Summary of financial indicators, 2000–2006

	2000	2001	2002	2003	2004	2005	2006[1]
				(In percent)			
Liabilities/Assets	14.8	14.7	8.1	12.7	24.3	29.0	28.4
Liquidity[1]	60.9	51.1	103.2	42.3	28.4	36.2	16.7
				(In percent of GDP)			
Net operational losses							
Before government transfers	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
After government transfers	-0.1	0.0	0.1	-0.1	-0.1	-0.1	0.0
Investment	0.1	0.2	0.2	0.1	0.1	0.2	0.3
Liabilities	0.2	0.2	0.1	0.2	0.3	0.4	0.4
Short-term	0.1	0.1	0.1	0.1	0.1	0.1	0.2
Long-term	0.1	0.1	0.0	0.1	0.2	0.2	0.2
Debt takeover	...	...	0.2	...	...	...	...

Sources: Hungarian authorities; and IMF staff estimates.

[1] *Current assets divided by current liabilities.*

While these PEs pose risks to the government budget, government policies also entail risks for these PEs. Pricing policies are set by the government and tariffs have lagged behind cost-recovery levels. The enterprises' dependence on budget transfers poses risks to their operations. Incentives to under-finance QFAs and bail out the enterprises every few years will remain, until transparent financial arrangements between the budget and these enterprises are set out, and consistent pricing policies are determined.

The government is taking steps to improve transparency and governance. Over the past few years, the government has been discussing a public service contract with MAV. In the 2006-10 Convergence Programme, the government reaffirmed its commitment to increase the transparency of financial arrangements. The goal is to clearly define the principles governing operating subsidies in public service contracts. Under these contracts, subsidies would reflect the entire cost of efficient delivery of the service that the government requires the enterprise to undertake. Timely and proper completion of these contracts is essential to provide stability and transparency to funding arrangements. The government also increased budget support to MAV in 2007 and provided a capital injection.

The assessment in this paper suggests that additional efforts could enhance the quality, transparency and predictability of fiscal policy in Hungary. Although the general government balance on an ESA 95 basis is the key fiscal policy indicator and target, the extent of QFAs in these public transport enterprises, the history of bail-outs, and incentives to under finance QFAs, support the view that the existing coverage does not reflect the true extent of fiscal activities.[17] Best practices in fiscal transparency suggest that the government should include an analysis of these PE operations in budget documents, present a statement on QFAs, and report on the consolidated position of these PEs with the general government on a frequent basis. The budget should also provide a medium-term perspective of financial support to these PEs. Consideration could also be given to applying the criteria on fiscal risks to other sectors to identify other loss-making or vulnerable enterprises which may need closer monitoring.

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[17] As recommended in the fiscal ROSC, a first priority should be to align the coverage of the budget with the ESA 95 definition of government. This requires extending the coverage of the state budget to certain central government units that are currently excluded (e.g. the National Road Construction Company, the ÁPV Rt., the State Motorway Company, the State Debt Management Company, the State Treasury Company, public media enterprises, and certain non-profit institutions and enterprises).

APPENDIX I

Table 8

Business associations operating with company shares in long-term state ownership, percentage of state ownership, and agencies exercising the state's membership (shareholder's) rights according to the Privatization Act

Name of company	Minimum long-term state holding
Body exercising owner's rights: Állami Privatizációs és Vagyonkezelő Rt.	
Nemzeti Tankönyvkiadó Rt.	25% + 1 vote
MOL Magyar Olaj- és Gázipari Rt.	1 preference share with prior voting rights
Tokaj Kereskedőház Rt.	99%
Magyar Villamosművek Rt.	99%
Budapest Airport Rt.	25% + 1 vote
CD Hungary Ingatlanforgalmazó és Szolgáltató Rt.	1 preference share with prior voting rights
Balatonfelvidéki Erdő és Fafeldolgozó Rt.	100%
Délalföldi Erdészeti Rt.	100%
Észak-Magyarországi Erdőgazdasági Rt.	100%
Gemenci Erdő- és Vadgazdaság Rt.	100%
"Gyulaj" Erdészeti és Vadászati Rt.	100%
Ipoly Erdő Rt.	100%
Kisalföldi Erdőgazdaság Rt.	100%
Kiskunsági Erdészeti és Faipari Rt.	100%
Mátra-Nyugatbükki Erdő és Fafeldolgozó Rt.	100%
Mecseki Erdészeti Rt.	100%
Nagykunsági Erdészeti és Faipari Rt.	100%
Nyírségi Erdészeti Rt.	100%
Pilisi Parkerdőgazdaság Rt.	100%
Somogyi Erdészeti és Faipari Rt.	100%
Szombathelyi Erdészeti Rt.	100%
Tanulmányi Erdőgazdaság Rt.	100%
VADEX Mezőföldi Erdő- és Vadgazdálkodási Rt.	100%
Vértesi Erdészeti és Faipari Rt.	100%
Zalai Erdészeti és Faipari Rt.	100%
TISZAVÍZ Kft.	100%
Hungaropharma Rt.	1 preference share with prior voting rights
PICK Szeged Rt.	1 preference share with prior voting rights
Zsolnay Porcelángyár Rt.	1 preference share with prior voting rights
HERZ Szalámigyár Rt.	1 preference share with prior voting rights
KAGE Rt.	1 preference share with prior voting rights
Herendi Porcelánmanufaktúra Rt.	25% + 1 vote
Szerencsejáték Rt.	100%
Eximbank Rt.	25% + 1 vote
Name of company	Minimum long-term state holding
MEHIB Rt.	25% + 1 vote
Országos Takarékpénztár és Kereskedelmi Bank Rt.	1 preference share with prior voting rights
Magyar Posta Rt.	100%
Hitelgarancia Rt.	50% + 1 vote

Table 8

Business associations operating with company shares in long-term state ownership, percentage of state ownership, and agencies exercising the state's membership (shareholder's) rights according to the Privatization Act (cont'd)

Name of company	Minimum long-term state holding
Minister exercising owner's rights: Minister of Economic Affairs and Transportation	
Magyar Államvasutak Rt.	100%
MAVIR Magyar Villamosenergia-ipari Rendszerirányító Rt.	1 preference share with prior voting rights
Állami Autópálya Kezelő Rt.	100%
Győr-Sopron-Ebenfurti Vasút Rt.	50% + 1 vote
Közlekedéstudományi Intézet Rt. (KTI Rt.)	50% + 1 vote
Villamosenergia-ipari Kutató Intézet Rt.	50% + 1 vote
ExVÁ Robbanásbiztos Villamos Berendezéseket Vizsgáló Kht.	100%
Magyar Fejlesztési Bank Rt.	100%
Kisvállalkozás-fejlesztő Pénzügyi Rt.	50%+1 vote
Északdunántúli Gázszolgáltató Rt.	1 preference share with prior voting rights
Középdunántúli Gázszolgáltató Rt.	1 preference share with prior voting rights
Délalföldi Gázszolgáltató Rt.	1 preference share with prior voting rights
Tiszántúli Gázszolgáltató Rt.	1 preference share with prior voting rights
Déldunántúli Gázszolgáltató Rt.	1 preference share with prior voting rights
Paksi Atomerőmű Rt.	1 preference share with prior voting rights
Dunamenti Erőmu Rt.	1 preference share with prior voting rights
Vértesi Erőmű Rt.	1 preference share with prior voting rights
Bakonyi Erőmű Rt.	1 preference share with prior voting rights
PANNONPOWER Energiatermelő, Kereskedelmi és Szolgáltató Rt.	1 preference share with prior voting rights
Mátrai Erőmű Rt.	1 preference share with prior voting rights
Tiszai Erőmű Rt.	1 preference share with prior voting rights
Budapesti Erőmű Rt.	1 preference share with prior voting rights
Északdunántúli Áramszolgáltató Rt.	1 preference share with prior voting rights
Dunántúli Áramszolgáltató Rt.	1 preference share with prior voting rights
Délmagyarországi Áramszolgáltató Rt.	1 preference share with prior voting rights
Tiszántúli Áramszolgáltató Rt.	1 preference share with prior voting rights
Északmagyarországi Áramszolgáltató Rt.	1 preference share with prior voting rights
Budapesti Elektromos Művek Rt.	1 preference share with prior voting rights
Országos Villamostávvezeték Rt.	1 preference share with prior voting rights
Magyar Befektetési és Kereskedelemfejlesztési Kht.	50%+1 vote
Minister exercising owner's rights: Minister of Agriculture and Regional Development	
Állattenyésztési Teljesítményvizsgáló Kft.	75%
Érdi Gyümölcs- és Dísznövénytermesztési Kutató-Fejleszto Kht.	100%
Ceglédi Gyümölcstermesztési Kutató-Fejlesztő Kht.	100%
Fertodi Gyümölcstermesztési Kutató-Fejlesztő Kht.	100%
Újfehértói Gyümölcstermesztési Kutató-Fejlesztő Kht.	100%
Konzervipari Kutató és Fejlesztő és Minoségvizsgáló Kft.	100%
Magyar Tejgazdasági Kísérleti Intézet Kft.	100%

Table 8

Business associations operating with company shares in long-term state ownership, percentage of state ownership, and agencies exercising the state's membership (shareholder's) rights according to the Privatization Act (cont'd)

Name of company	Minimum long-term state holding
Országos Húsipari Kutatóintézet Kft.	100%
Zöldségtermesztési Kutató Intézet Rt.	100%
Agroster Besugárzó Rt.	25% + 1 vote
Concordia Közraktár Rt.	100%
ATEV Fehérjefeldolgozó Rt.	25% + 1 vote
Geodéziai és Térképészeti Rt.	25% + 1 vote
Országos Mesterséges Termékenyítő Rt.	25% + 1 vote
Minister exercising owner's rights: Minister of Environmental Protection and Water Management	
Hortobágyi Génmegőrző Kht.	100%
Hortobágyi Halgazdasági Rt.	100%
Dunamenti Regionális Vízmű Rt.	50% + 1 vote
Dunántúli Regionális Vízmű Rt.	50% + 1 vote
Észak-dunántúli Regionális Vízmű Rt.	50% + 1 vote
Észak-magyarországi Regionális Vízmű Rt.	50% + 1 vote
Tiszamenti Regionális Vízmű Rt.	50% + 1 vote
Vízgazdálkodási Tudományos Kutató Kht. (VITUKI)	50% + 1 vote
Body exercising owner's right: National Foundation for Employment	
Agora Ipari Kft.	100%
Erfo Ipari Kft.	100%
Fővárosi Kézműipari Rt.	100%
Főkefe Ipari Kft.	100%
Savaria Nett-Pack Kft.	100%
Szegedi Fonalfeldolgozó Rt.	100%
Minister exercising owner's rights: Minister of Health	
Gyógynövénykutató Intézet Rt.	25% + 1 vote
Minister exercising owner's rights: Minister of Cultural Heritage	
Nemzeti Színház Rt.	100%
Minister exercising owner's rights: Minister of Defense	
HM ARCOM Kommunikációtechnikai Rt.	50% + 1 vote
HM ARZENÁL Elektromechanikai Rt.	50% + 1 vote
HM CURRUS Gödöllői Harcjárműtechnika Rt.	50% + 1 vote
HM Elektronikai Igazgatóság Rt.	100%
HM Budapesti Erdőgazdasági Rt.	100%
HM Kaszói Erdőgazdasági Rt.	100%
HM VERGA Veszprémi Erdőgazdasági Rt.	100%
Dunai Repülőgépgyár Rt.	1 preference share with prior voting rights
Minister exercising owner's rights: Minister directing the Prime Minister's Office	
Regionális Fejlesztési Holding Rt.	100%
Magyar Hivatalos Közlönykiadó Kft.	100%
KOPINT DATORG Szervezési és Adatfeldolgozási Rt.	50% + 1 vote

Table 8

Business associations operating with company shares in long-term state ownership, percentage of state ownership, and agencies exercising the state's membership (shareholder's) rights according to the Privatization Act (cont'd)

Name of company	Minimum long-term state holding
Minister exercising owner's rights: Minister of Finance	
Államadósság Kezelő Központ Rt.	100%
Minister exercising owner's rights: Minister of Justice	
Országos Fordító és Fordításhitelesítő Iroda Rt.	50% + 1 vote
Minister exercising owner's rights: Minister of Information Technology and Communications	
Magyar Távközlési Rt.	1 preference share with prior voting rights
Minister exercising owner's rights: Minister of Regional Development and Land Use Planning	
VÁTI Magyar Regionális Fejlesztési és Urbanisztikai Közhasznú Társaság	100%
Építésügyi Minőségellenörző Innovációs Kht.	50% + 1 vote
Body exercising owner's rights: National Bureau for Sports	
Sportlétesítmények Vállalat Rt.	75%

APPENDIX 2

Table 9

Hungarian State Railways: Income statement and balance sheet, 2000–2006

(In millions of forints)

	2000	2001	2002	2003	2004	2005	2006[1]
				Income statement			
Sales at purchasers prices	142,717	148,118	150,097	161,752	174,770	183,222	162,520
of which consumer price transfer	16,989	19,302	20,705	22,161	23,597	24,226	24,306
- Indirect taxes on sales	9,832	10,795	9,605	11,824	21,534	23,249	31,321
= Revenues from sales	132,885	137,323	140,492	149,928	153,236	159,973	131,199
- Total employee compensation	89,658	98,611	108,396	117,102	130,426	130,976	124,616
of which social security contributions	24,428	25,909	27,177	28,480	30,939	30,638	28,840
- Purchases of goods & services	38,442	41,095	42,590	42,921	42,261	43,366	48,029
- Services provided by outsiders	50,016	54,683	56,017	56,327	58,157	69,447	56,290
- Depreciation & amortization	17,346	20,377	29,311	31,292	33,313	34,927	34,405
- Misc. fees/taxes	25,377	19,242	17,197	39,531	23,188	30,305	66,873
- Interest payments	5,724	15,167	6,656	5,903	11,061	13,090	21,015
+ Interest earned	5,086	3,840	5,055	3,302	7,177	2,883	6,934
+ Foreign grants	0	0	0	0	0	0	0
+ Transfers from government (public service obligation)	46,048	50,208	55,845	57,815	56,534	50,384	74,407
+ Other income	20,476	28,813	71,888	48,978	32,006	28,228	54,846
= Profit before tax	-22,068	-28,991	13,113	-33,053	-49,453	-80,643	-83,842
- Corporate income tax	143	191	29	13	8	0	0
- Dividends paid	0	0	0	0	0	0	0
To government	0	0	0	0	0	0	0
To others	0	0	0	0	0	0	0
= Retained earnings for the period	-22,211	-29,182	13,084	-33,066	-49,461	-80,643	-83,842
New investment	62,192	51,898	66,560	74,706	57,859	57,802	68,933
				Balance sheet			
Current assets	59,201	62,109	59,463	73,929	68,150	81,812	87,168
+ Long-term investments	15,365	16,100	18,788	18,237	16,344	14,497	40,025
+ Fixed & other assets at cost	692,305	738,738	802,388	872,891	925,639	976,414	997,215
- Accumulated depreciation & amort.	125,868	143,717	183,710	214,580	244,249	275,868	273,498
= Total assets	641,003	673,230	696,929	750,477	765,884	796,855	850,910
+ Current liabilities	99,445	108,358	173,838	167,347	159,527	219,817	190,653
+ Long term liabilities	64,246	388,119	339,566	404,629	475,314	508,831	667,381
+ Equity and reserves	477,312	176,753	183,525	178,501	131,043	68,207	-7,124
= Total liabilities & equity	641,003	673,230	696,929	750,477	765,884	796,855	850,910
Financing							
Net external	48,875	63,153	7,417	35,213	37,880	54,250	78,873
New loan obligations	...	...	49,289	66,976	62,490	55,035	162,996
Repayment of old loans	...	...	13,061	7,898	7,388	7,115	32,780

Source: Hungarian authorities based on data provided by Hungarian State Railways.

[1] *2006 data excludes freight operations.*

Table 10

Budapest Transport Company: Income statement and balance sheet, 2000–2006

(In millions of forints)

	2000	2001	2002	2003	2004	2005	2006[1]
			Income statement				
Sales at purchases prices							
Fare revenue at purchases prices	28,342	30,527	31,389	35,214	40,933	44,729	50,371
Social reimbursement for concessionary fares (consumer price transfer)	16,281	17,672	18,814	21,094	21,490	21,902	21,283
Revenue of other activities	2,693	13,417	2,873	4,201	2,547	5,413	2,667
- Indirect taxes on sales	5,073	7,781	5,852	6,785	8,554	9,610	10,999
= Revenues from sales	42,243	53,835	47,224	53,724	56,416	62,434	63,322
- Total employee compensation	29,238	30,790	33,643	36,774	42,035	46,158	51,202
of which social security contributions	8,007	8,081	8,472	9,099	10,261	11,243	12,225
- Purchases of goods and services	23,360	27,754	31,467	35,289	37,470	38,497	40,265
- Services provided by outsiders	531	818	1,419	1,469	1,491	1,894	2,243
- Depreciation and Amortization	10,825	11,192	10,930	11,363	11,594	12,275	13,296
- Misc fees/taxes	40	19	18	15	38	39	29
-Interest payment	1,848	1,918	2,034	700	3,862	4,064	5,054
foreign	428	401	395	71	0	0	0
domestic	1,420	1,517	1,639	629	3,862	4,064	5,054
+ Interest earned	24	137	51	105	5	5	57
+ Foreign grants	0	0	0	0	0	0	0
+Transfers from governments (public service obligation)	14,200	14,692	47,006	5,011	11,508	13,552	39,451
of which subsidies from the Municipality of Budapest	13,905	13,905	16,202	3,000	3,000	0	0
+ Other income	5,080	1,200	2,190	1,508	2,723	7,309	3,949
Other expenditure	4,360	6,959	2,855	2,472	3,801	5,682	9,410
Activated own performance	1,796	2,472	2,451	2,705	3,231	2,843	3,024
=Profit before tax	-6,859	-7,114	16,556	-25,029	-26,408	-22,466	-11,696
-Corporate income tax	0	0	0	0	0	0	
-Dividends paid	0	0	0	0	0	0	
To government	0	0	0	0	0	0	
To others	0	0	0	0	0	0	
= Retained earnings for the period	-6,859	-7,114	16,556	-25,029	-26,408	-22,466	-11,696
New investments	14,880	26,667	26,347	21,082	21,688	39,140	74,148
			Balance Sheet				
+ Current assets	6,980	6,402	19,009	7,408	7,843	10,673	8,025
+ Long term Investments	2,731	2,480	2,319	1,633	1,699	1,153	1,160
+ Fixed and other assets at cost	225,970	244,822	268,299	298,766	320,179	365,003	439,814
- Accumulated depreciation and amortization	46,027	53,059	62,848	73,262	83,709	94,578	105,421
Accrued and deferred assets	84	68	295	294	98	118	111
= Total assets	189,738	200,713	227,074	234,839	246,110	282,369	343,689
+ Current liabilities	11,460	12,520	18,420	17,493	27,664	29,523	47,921
+ Long term liabilities	16,549	16,947	0	12,262	32,256	52,305	49,787
+Equity and reserves	146,930	140,213	156,351	136,589	112,865	102,598	101,568
Accrued and deferred liabilities	14,799	31,033	52,303	68,495	73,325	97,943	144,413
=Total Liabilities and Equity	189,738	200,713	227,074	234,839	246,110	282,369	343,689
Financing							
Net external	28,009	29,467	18,420	29,755	59,920	81,828	97,783
New loan obligations	4,202	4,568	25,804	16,542	27,672	22,784	9,932
Repayment of old loans	570	2,965	4,953	6,529	30	3,876	3,770

Source: Hungarian authorities.