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FINANCE

The love of money is the root of all evil.
THE NEW TESTAMENT
Lack of money is the root of all evil.
GEORGE BERNARD SHAW

Course objectives

- To understand the basic operational rules of financial markets
- Able to analyse the current macroeconomic environment
- To evaluate the potential effect of various economic policy measures

COURSE CONTENT (FROM 16-20 AT ROOM A4/413)

2020.09.21 - Introduction of subject, Macrostatistics – The structure of SNA systems
Structure of Eurostat, Worldbank and European Central Bank database
2020.10.05.- Financial statements of banks Consolidated bank sector financial statements
Camels analysis Balance of payments
2020.10.19 - Main branches of economic policies. Main goals and tools of fiscal and monetary policy Stability and Growth Pact, Maastricht criteria
2020.11.09 - Polak-model. Extended Polak – model How do the fiscal and monetary policy affect to the real economy?
2020.11.23 - Public finance. Tax policies and concepts, Main taxes and fees Presentation of economic debates
2020.12.07 – Presentation of country reports
2020.12.14 – Supplementary Presentations

Teaching requirements

- Requested readings:
  - Rose: Money and capital markets (available in library)
  - Slides and supplementary readings available at webside of departement http://gtk.uni-miskolc.hu/uzleti/letoltesek?file_category_id=395&order_type=NAME&view_type=GRID
- Offered readings:
  - Kohn: Financial markets
  - Johnson Hazel: Financial institutions and markets (Available in library)
- Exam:
  - Powerpoint report on the Polak-model of a European country Deadline: Last day of semester (20 points)
  - Powerpoint presentation on a financial debate – team work (20 points)

STRUCTURE OF REPORT – 20 MINUTES

- Introduction to the finance of the chosen country
  - Brief history, location, size of population, demographics, ethnic distribution, GDP/capita,
- Describe the extended Polak model in 2018 and 2019 – compare the data with European average
  - Central Budget (main expenses (functional distribution) and main revenues (tax structure)) – deficit
  - Change in corporate and household loan
  - Analyse the activity of the economy (GDP growth, productivity, activity (inc. youth unemployment)
  - Analysis of inflation, courntry risk (CDS), interest rates
  - Analyse the external financial equilibrium (balance of payment)
- Confront the data with Stability and Growth Pact
- SWOT analysis of the country (gdp growth, population, productivity, inflation, interest rates, public deficit, current deficit) + advice

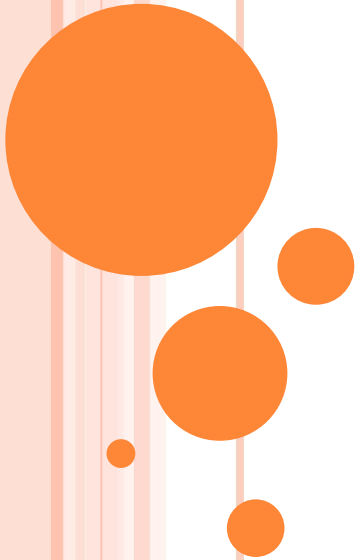
FINANCIAL DEBATES – 20 MINUTES

- „Too big to fail – too big to survive." (Krugman vs Greenspan) Discuss the optimal size of bank concetration. Shall we split the too large banks?
- E-money – bitcoin – shall we regulate or shan't? Advantages, disadvantages, risks (Roubini vs Posner)
- Are financial markets efficient? (Fama vs Kahneman) Perfect pricing versus bubbles
- Future of euro (Friedman vs Draghi) Crisis in the eurozone. Is the eurozone an optimal currency zone?
- What is a real shape of Laffer-curve? (Laffer vs Trabandt) Flat tax versus progressive income tax. Advantages and disadvantages. Examples.
- Debt crisis management – orthodoxy vs unorthodoxy – Can the Washington consensus work? Country cases.

Structure of debate presentation

- Confront the two views (target variable, influencing variables, logic, assumptions)
- Try to explore the hidden assumptions
- Confront the views with empirical facts
- Draw the conclusions

Basic equation of economy
How can you access economic informations?



MEASURING THE MACRO OUTPUT

SNA (System of National Accounts)

- Worked out by the UN
- Introduced in 1953, updated in 1993
- Reworked version for Europe: ESA95

EXAMPLE ON VALUE ADDED

Gros output (HUF)

	Wheat	Flavour	Bread	Total	
Output :	100	220	**350**	= 670	(GO)
- Material :	?...	100	220	= 320	
Net output (Value added):	100	120	130	= **350**	(GDP)
-Depreciation:	30	30	20	= 80	
Income :	70	90	110	= 270	(NDP)

MAJOR SNA INDICATORS

Level of accumulation	**Domestic** 	**National** 	
Gros	GO		
Semi-net	GDP	GNI	GNDI
Net	NDP	NNI	NNDI

ABBREVATIONS

- GO (gros output)
- GDP (gros domestic product)
- NDP (net domestic product)
- GNI (gros national income)
- NNI (net national income)
- GNDI (gros national disposal income)
- NNDI (net national disposal income)

LINKAGE AMONG THE INDICATORS

- GDP = GO- material cost
- NDP = GDP- depreciation
- GNI = GDP + net factor yield
- NNI = GNI – depreciation
- GNDI = GNI+ savings
- NNDI = GNDI-depreciation

MEASURING THE GDP

1. Production side
+ Consumption(C)
+ Gros private investment (I)
+ Government expenses (G)
+ Net export

2. Income side
+ Salaries (w)
+ Interest, rent, dividend (i)
+ Indirect taxes (t)
+ Depreciation (d)
+ Profit (p)

3. Usage side
+ Consumption(C)
+ Savings (S)
± Budget surplus /deficit (T-TR)
+ NFY+NT

Basic equation

Production side $GDP = C + I + G + (X - M)$

Income side $GDP = w + i + d + t + p$

Usage side $GDP = C + S + (T - TR) + NFY + NT$

$$C + I + G + (X - M) = C + S + (T - TR) + NFY + NT$$

$$X - M + NFY + NT = (T - TR - G) + (S - I)$$

MONETARY AGGREGATES

- Bank note: issued amount of bank note and coins. Called monetary basis. Splitted into money at banks and money in circulation.

  M0= C+R
- Commercial bank account money (DS)
- Further money aggregates:

  M1= Cash in circulation +DS

  M2 = M1+DT (short-term deposits)

  M3 = M2+ MI (bank securities)

  M4 = M3 + TN (Treasury – notes)

Fisher equation

$$M * V = P * T$$

M – money supply
V – velocity of money
P – price level
T – volume of transactions

Assumption:
•Closed economy or export and import are equal
•Cash velocity is constant

Money supply as anchor

$$M * V = P * T$$

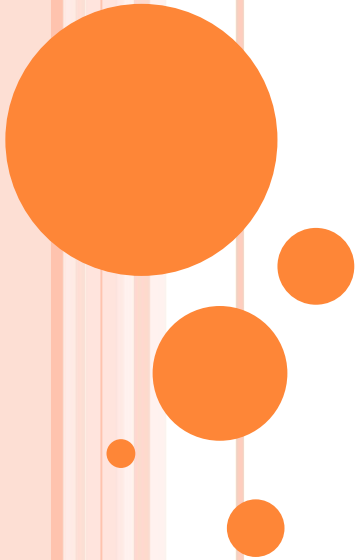
$$\Delta M * \Delta V = \Delta P * \Delta T$$

$$\Delta V := 1 \Rightarrow \Delta P = \frac{\Delta M}{\Delta T}$$

Assumption:

- Closed economy or export and import are equal
- Cash velocity is constant

Consolidated bank sector financial statements



MAJOR ASSETS OF BANKS

Description	Dec 2001 Audeted			Dec 2008 Audited			Dec 2010 audited			Jul 2012		
	HUF	F/X	Total	HUF	F/X	Total	HUF	F/X	Total	HUF	F/X	Total
Cash and settlement accounts	494,837	149,212	644,049	434,844	171,464	606,308	454,039	118,382	572,421	395,488	283,823	679,311
Securities for trading	459,690	27,522	487,212	1 886,431	17,382	1 903,813	2 321,791	172,633	2 494,424	2 911,875	178,294	3 090,169
Securities for investment*	780,427	223,168	1 003,595	2 323,909	445,828	2 769,737	2 615,259	944,753	3 560,012	2 875,792	808,748	3 684,540
Total securities	1 240,117	250,690	1 490,807	4 210,340	463,210	4 673,550	4 937,050	1 117,386	6 054,436	5 787,667	987,042	6 774,709
Central bank and interbank deposits	667,556	808,818	1 476,374	938,219	497,093	1 435,312	697,148	834,642	1 531,790	749,677	606,196	1 355,873
Of which: central bank deposits	365,046	127,364	492,410	496,328	3,416	499,744	274,824	29,883	304,707	301,895	0,000	301,895
interbank deposits	302,510	681,454	983,964	441,891	493,677	935,568	422,324	804,759	1 227,083	447,782	606,196	1 053,978
Loans (net portfolio)**	3 072,098	1 832,803	4 904,901	5 615,350	14 259,275	19 874,625	5 319,994	12 735,257	18 055,251	5 629,916	9 603,937	15 233,853
Of which: corporate loans***	2 075,950	1 099,733	3 175,683	2 729,894	4 216,862	6 946,756	2 381,315	3 622,742	6 004,057	2 276,862	2 941,312	5 218,174
Retail loans	655,710	21,531	677,241	2 090,443	5 039,635	7 130,078	2 090,613	5 103,529	7 194,142	2 358,504	3 448,250	5 806,754
Participations	146,512	9,695	156,207	230,681	397,902	628,583	251,876	422,770	674,646	267,985	425,966	693,951
Accrued interest receivable	87,911	21,327	109,238	367,239	94,159	461,398	245,098	61,790	306,888	243,719	58,973	302,692
Prepayments and other assets	73,561	15,943	89,504	831,267	84,045	915,312	305,329	94,618	399,947	499,787	69,079	568,866
Own assets	167,860	1,349	169,209	551,984	30,806	582,790	508,321	21,567	529,888	503,879	18,253	522,132
Total assets	5 950,452	3 089,837	9 040,289	13 179,924	15 997,954	29 177,878	12 718,855	15 406,412	28 125,267	14 078,118	12 053,269	26 131,387

Forrás: PSZAF

BankRügyletek

Major liabilities of banks

Description	Dec 2001 Audited			Dec 2008 Audited			Dec 2010 audited			Jul 2012		
	HUF	F/X	Total	HUF	F/X	Total	HUF	F/X	Total	HUF	F/X	Total
Deposits	4 259,784	1 796,502	6 056,286	9 162,656	3 051,355	12 214,011	8 625,882	2 963,310	11 589,192	9 028,379	2 678,036	11 706,415
Of which: Corporate deposits*	1 357,027	358,532	1 715,559	2 395,117	1 052,554	3 447,671	2 323,402	1 187,817	3 511,219	2 353,339	1 123,492	3 476,831
Retail deposits	2 406,785	765,963	3 172,748	4 959,940	1 062,644	6 022,584	4 817,329	1 097,623	5 914,952	5 141,419	912,889	6 054,308
Interbank deposits	366,619	385,739	752,358	1 206,450	3 619,725	4 826,175	1 597,133	3 638,823	5 235,956	1 739,277	2 477,357	4 216,634
Loans taken	104,667	592,026	696,693	1 021,943	3 194,719	4 216,662	758,678	3 171,618	3 930,296	888,155	2 804,945	3 693,100
Debt securities	120,399	37,784	158,183	1 498,533	1 525,727	3 024,260	1 814,067	1 474,048	3 288,115	1 799,142	924,947	2 724,089
Accrued interest payable	38,615	16,113	54,728	369,400	122,584	491,984	221,636	55,572	277,208	238,071	71,651	309,722
Other accruals, deferred income and other liabilities	236,628	102,922	339,550	1 215,245	130,215	1 345,460	1 215,519	89,279	1 304,798	627,465	93,472	720,937
Subordinated liabilities**	18,551	107,257	125,808	23,497	616,922	640,419						
Provisions	87,452	2,512	89,964	214,552	19,173	233,725	165,051	12,689	177,740	184,215	8,357	192,572
Own capital	766,719	0,000	766,719	2 185,787	-0,605	2 185,182	2 321,952	0,010	2 321,962	2 567,762	0,156	2 567,918
Total liabilities	**5 999,434**	**3 040,855**	**9 040,289**	**16 898,063**	**12 279,815**	**29 177,878**	**16 719,918**	**11 405,349**	**28 125,267**	**17 072,466**	**9 058,921**	**26 131,387**

Forrás: PSZÁF

BAD DEBTS

2008.09.08.

Évek	Minősítési kötelezettség alá tartozó összesen (1) = (2) + (7)	Problémamentes (2)	Külön figyelendő (3)	Átlag alatti (4)	Kétes (5)	Rossz (6)	Nem problémamentes (7) = (3)+(4)+(5)+(6)
2002	7 359,625	6 518,092	572,200	131,049	71,241	67,043	841,533
2006	16 410,221	14 766,256	1 246,923	127,114	101,090	168,838	1 643,965
2008	23 966,957	22 350,658	924,887	256,146	198,273	236,993	1 616,299
2010	23 561,881	18 584,804	2 829,816	806,481	655,416	685,364	4 977,077
2012.06.	21 536,161	15 727,494	2 819,358	726,980	1 212,505	1 049,824	5 808,667

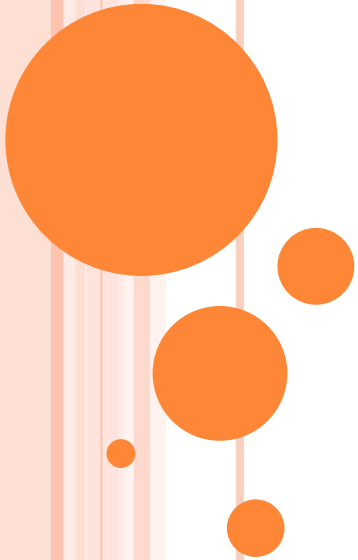
INCOME STATEMENTS

2008.09.

Description	2001 Audited	2004 Audited	2006 Audited	2008 Audited	2009 Audited	2010 Audited	2011 Audited	Q1-2 2012
Net intereset income	**340,695**	**549,581**	**697,794**	**713,943**	**756,393**	**865,746**	**848,391**	**405,077**
Interest income	784,617	1 438,905	1 514,894	2 196,523	2 464,386	2 042,666	2 019,665	1 050,018
Interest expenditure	443,922	889,324	817,100	1 482,580	1 707,993	1 176,920	1 171,274	644,941
Non-interest income (net)	**86,200**	**242,635**	**300,628**	**339,156**	**541,913**	**179,365**	**250,642**	**-141,609**
Commissions and fees	98,594	181,015	229,933	242,646	258,172	262,056	232,574	111,254
Dividends	4,949	19,140	28,098	163,482	66,718	68,495	89,669	48,972
Net profit or loss on financial and investment services *	169,281	89,826	115,957	139,792	301,368	190,216	256,478	18,874
Other non-interest type profit *	-186,624	-47,346	-73,360	-206,764	-84,345	-341,402	-328,079	-320,709
Operating expenditures	**301,013**	**417,949**	**525,547**	**642,276**	**588,059**	**598,777**	**566,971**	**280,465**
Change in specific provisions and value adjustments **	**n.a**	**-52,495**	**-76,699**	**-144,351**	**-442,530**	**-377,098**	**-681,948**	**57,679**
Result of ordinary business activity	**n.a**	**321,772**	**396,176**	**266,472**	**267,717**	**69,236**	**-149,886**	**40,682**
Extraordinary profit/loss	**7,193**	**0,196**	**29,694**	**14,760**	**-21,604**	**-34,822**	**-61,246**	**-32,294**
Pre-tax profit	***133,077***	***321,968***	***425,870***	***281,232***	***246,113***	***34,414***	***-211,132***	***8,388***
Tax liabilities***	25,723	46,894	69,075	44,610	37,025	22,132	32,192	8,669
After-tax profit	**107,354**	**275,074**	**356,795**	**236,622**	**209,088**	**12,282**	**-243,324**	**-0,281**

Bankügyletek

Camels analysis



CAMELS

C

1. Capital
(Solvency risk)

A

2. Assets quality
(Credit risk)

M

3. Management
(Operational risk)

E

4. Earnings
(Profitability)

L

5. Liquidity

S

6. Sensitivity to market risk
(Market risk)

Bankismeret

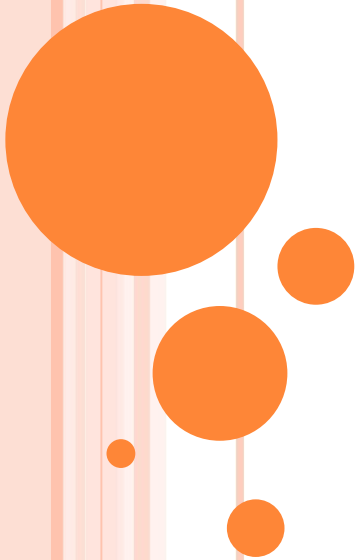
1. Capital

Capital adequacy ratio $\dfrac{\text{Guaranteed capital}}{\text{Risk weighted assets}}$

2. ASSET QUALITY

Non performing ratio $\dfrac{\text{Bad and doubtful debt}}{\text{Total outstandings}}$

Elements and Analysis of balance of payments



The balance of payments is
"a statistical statement that systematically summarizes, for a specific time period, the economic transactions of an economy with the rest of the world."
(IMF official definition)

Current Account

Measures the *net* flow of goods, services, and unilateral transfers between a country and all foreign countries.

- merchandise trade balance
- trade in services
- net investment income
- unilateral transfers

International Asset Transactions (*NET FINANCIAL FLOWS*)

- Two broad categories:
  - governments' transactions (***official settlement balance***, or *reserve balance*)
  - private capital flows
    - portfolio investment
    - direct investment
- Other minor asset transactions

Current Account Balance

+

Net Financial Flows

= 0

A current account deficit *must* be financed by capital inflows, or it cannot be incurred in the first place

Economic policies

Branches of economic policy

Branches	Goal	Tools	Responsible organisation
Monetary policy	Price stability Monetary stability	open market operations reserve ratio	National bank
Fiscal policy	sustainable, long-term growth	tax policy social and economic transfers	Government
(Foreign exchange policy)	solvency exchange rate stability	reserve policy peg	National Bank (Government)

Monetary policy

- Target: inflation below desired level (in Europe – 2%, in Hungary – 3%)
- Instruments:
  - Direct
    - reserve rate
    - loan limits
    - special loan facilities
    - moral pressure
  - Indirect
    - **open market operations**
    - refinancing

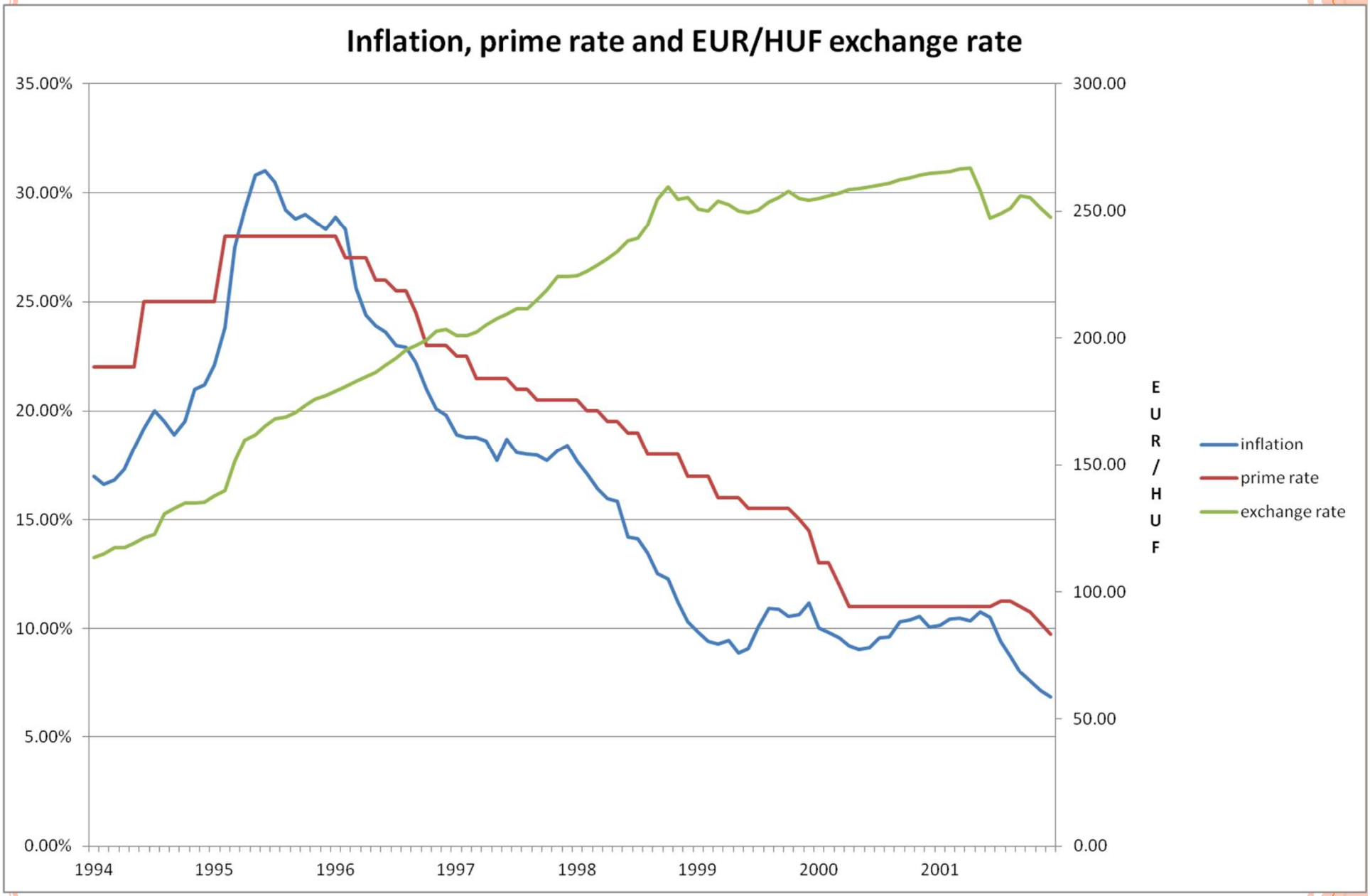
Goal of Monetary Policy

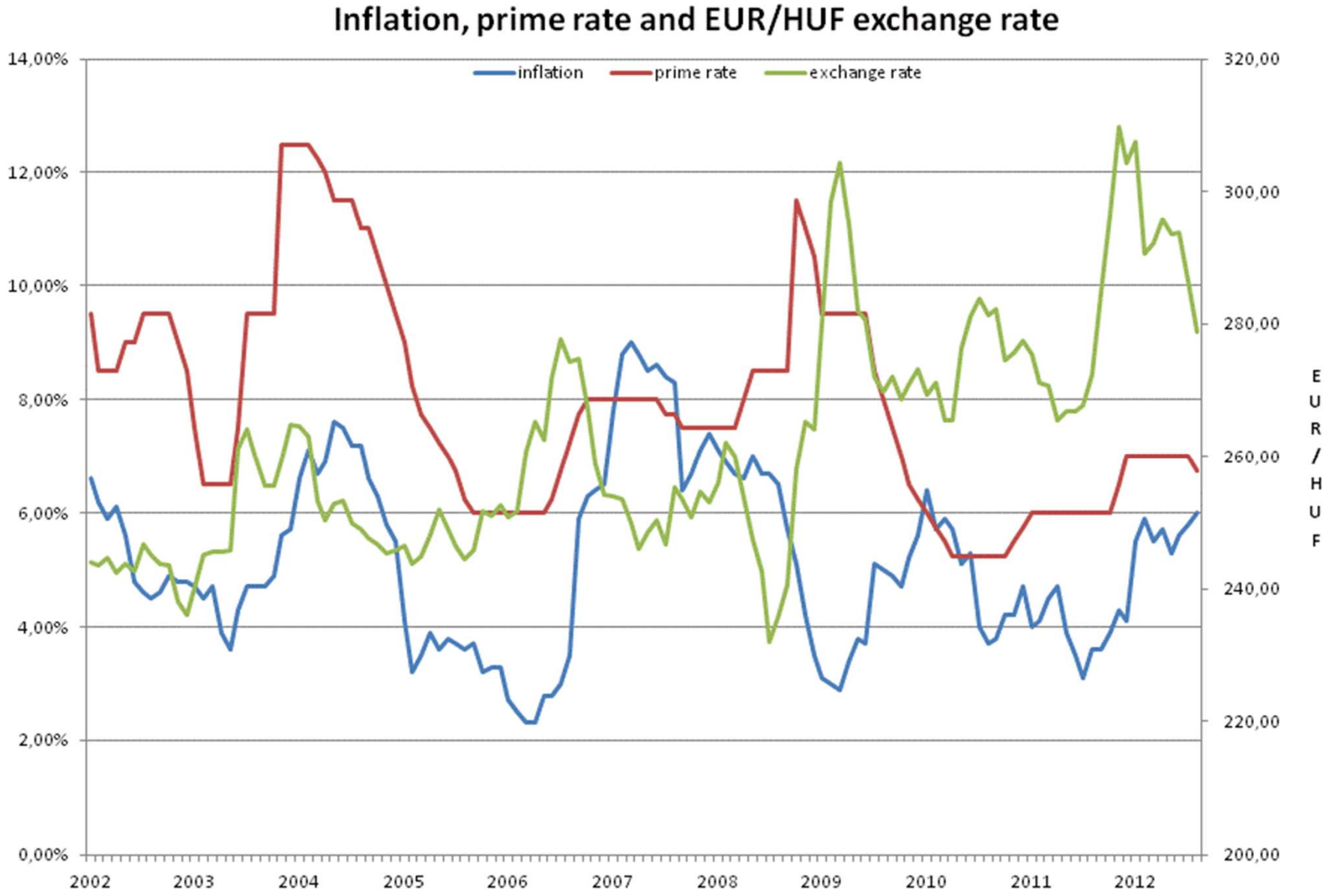
- Price stability
- Monetary stability

- Anchors:
  - Money supply
  - Exchange rate
  - Direct inflation targeting

EXCHANGE RATE AS ANCHOR

- Devaluation of currency ⟹ Inflation increases
  - Price level of import goods increases
  - Price level of domestic goods increases through import purchase
  - Profit of exporters increases the disposable income
- Appreciation of currency ⟹ Inflation decreases
  - Price level of import goods decreases
  - Price level of domestic goods decreases through import purchase
  - Profit of exporters declines


Inflation, prime rate and EUR/HUF exchange rate
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
300.00
250.00
200.00
150.00
100.00
50.00
0.00
1994
1995
1996
1997
1998
1999
2000
2001
EUR/HUF
inflation
prime rate
exchange rate


Inflation, prime rate and EUR/HUF exchange rate
inflation
prime rate
exchange rate
14,00%
12,00%
10,00%
8,00%
6,00%
4,00%
2,00%
0,00%
320,00
300,00
280,00
260,00
240,00
220,00
200,00
EUR/HUF
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012

Inflation targeting (Mishkin)

1. Declaring a fixed medium term inflation target.
2. The National Bank is committed to price stability -> it should be independent.
3. The National Bank operates on a basis of a wide information base.
4. The monetary policy is transparent. One goal – one tool.
5. Reporting commitment.

Forrás: MNB Monetáris politika 2012

Four elements of independence

- Personal independence
- Political independence
- Financing independence
- Economic independence

Responsible body of Monetary Policy: Monetary Board

MUNDELL'S OPTIMAL CURRENCY BELT

Assymetric shock – output of country decreased – devaluation if every country has got own currency

If there is a common currency, devaluation is not an option. Rather

- to make the production factors flexible – liberalisation of capital and labour movement
- to transfer some money to the poor region – poor means that the GDP/capital doesn't exceed the two third of EU average

Optimal currency belt:

- Strong economic connection
- At the same phase of economic cycle
- Easy to migrate the capital and labour force

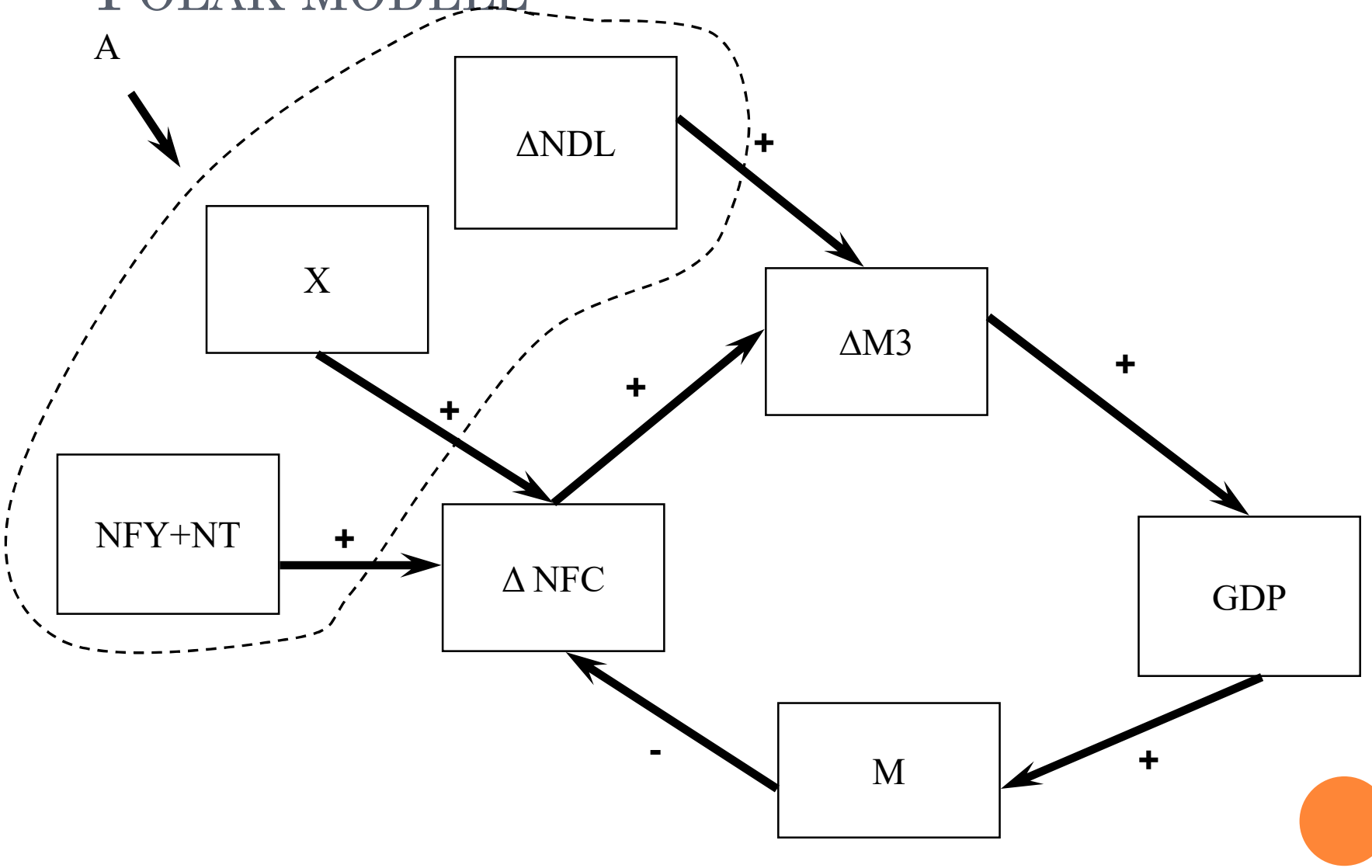
CRITERIAS OF MAASTRICHT-TREATY

- price stability – keep your inflation below 1% over the average inflation rate of three countries with lowest inflation figure
- convergence of long term interest rates – keep your long interest rate 1.5% over the averge long term interest rate of three countries with lowert long term interest rate figure
- foreign currency rates stability – fix your currency against euro with a 15% peg during 2 years
- stability of public finance –
  - public deficit should be lower than 3% of annual GDP
  - public debt should be lower than 60% of annual GDP
  - (Primary balance is positive)

WHY IS THE POLAK MODEL?

- Belongs to the mainstream
- Used by IMF (country report)
- Entire – covers the whole macrostatistics
- Egzact – based on computational linkages
- Focuses on the problems of indebted, open economies

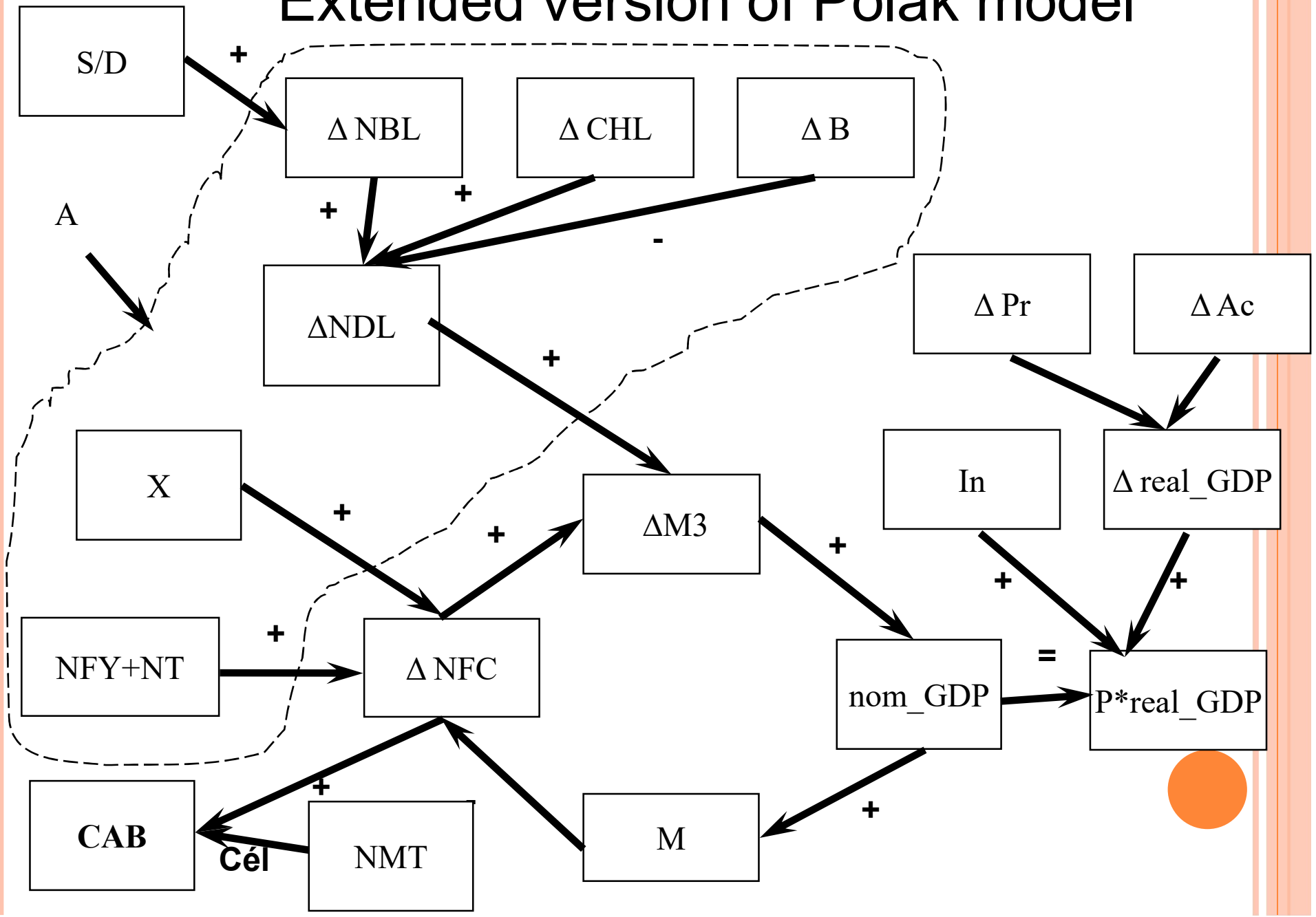
POLAK MODELL



MEANINGS OF ABBREVIATIONS

- ΔNDL – change in net domestic loan
- M3 – change in money supply M3 (cash + deposit in sight and short term deposit)
- GDP – Gros Domestic Product
- M – import
- ΔNFC – change in net foreign claims
- NFY – net factor yield
- NT – net transfer
- X – export

Extended version of Polak model



MEANINGS OF NEW ABBREVIATIONS

- ΔNBL – change in net budget loans
- ΔCHL – change in corporate/households loan
- ΔB – change in long term bank liabilities
- CAB – current account balance
- S/D – budget surplus/deficit
- P – price level
- In – inflation
- Δreal_GDP – economic growth
- ΔPr – change in productivity
- ΔAc – change in activity

WORKING OF MODEL

Budget deficit and loan demand of corporates and households increase the net domestic loan. Its increase enhances the money supply, which leads greater income. The greater income is spent in three way. The income leads to greater real GDP growth or/and leads to higher inflation or/and leads to bigger import. The import decreases the net foreign claims, so it leads to foreign indebtedness. The influancing factors are the followings:

- Demand flexibility of import
- Flexibility of production factors
- Inflation expectations
- Exchange rates and interest rates

Elements of net foreign claims

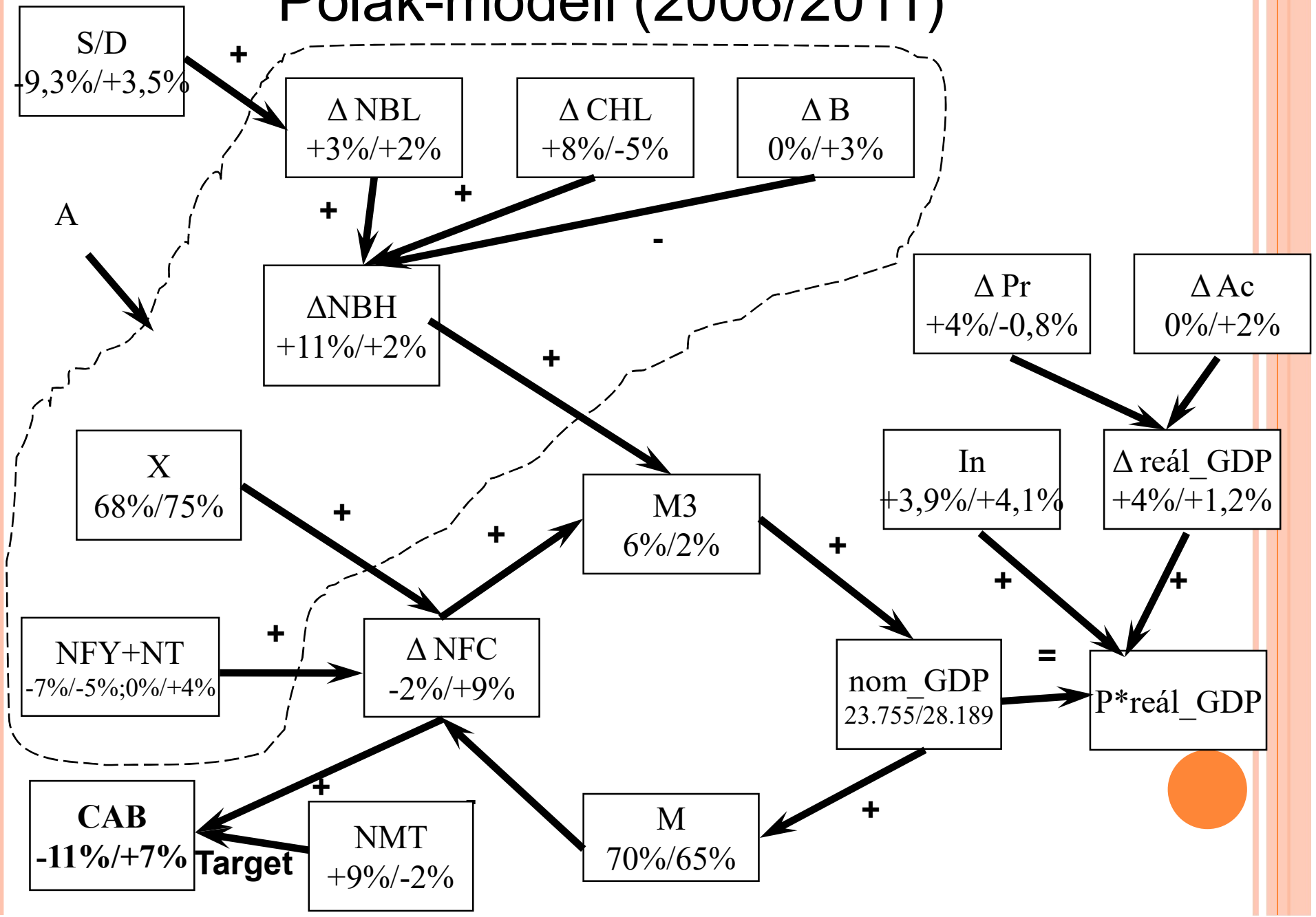
- CAB – current account balance
  - X - export
  - M - import
  - NFY – net factor yields
  - NT – net transfers
- NMT – non monetary transfer (direct foreign investment)

EXOGENIOUS FACTORS(ADSZORPCIÓ)

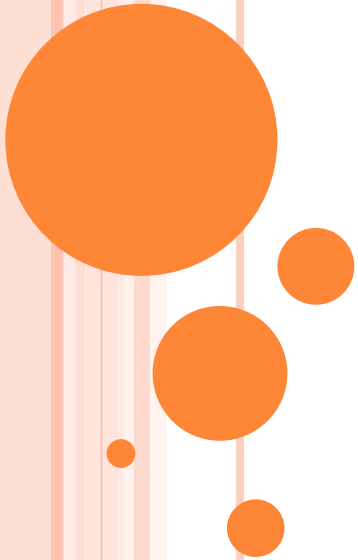
They are independent from the monetary policy (structural factors)

- X – export (depends on international competitiveness
- NFY – net foreign yield (depends on ownership structure)
- ΔNDL – change in net domestic loan (depends on loan demand of state, corporates and households)
- NMT – non monetary transfer (depends on investment climate

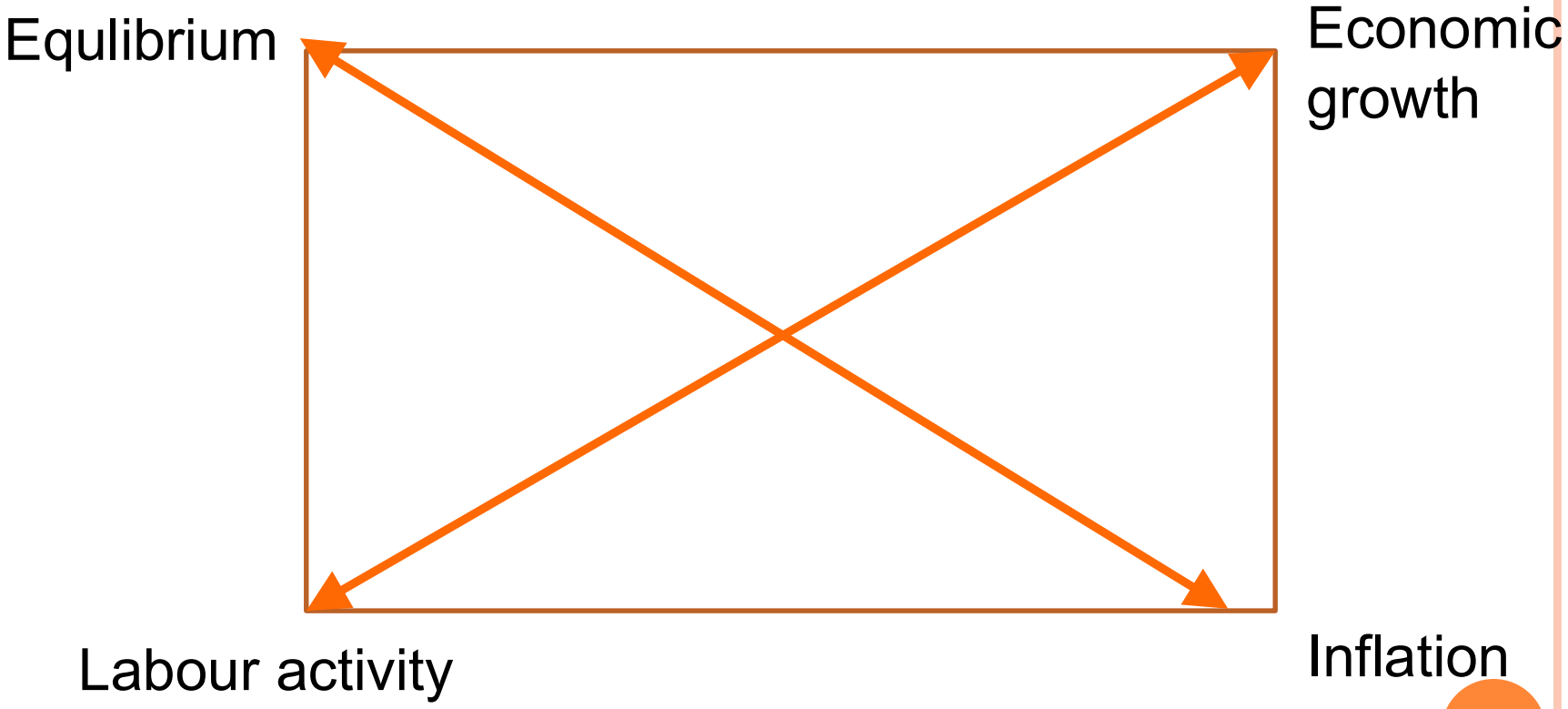
Polak-modell (2006/2011)



Public finance



„Magic square of economic policy



FUNCTIONS OF THE STATE

Public duties: Those duties which the other actors of the society cannot solve.

- *classical*: legal, administrative services (army, police, court, govermental bodies)
- *Social political*: social welfare, education, culture
- *Economical: influencing the economy*

AIMS AND TOOLS OF FISCAL POLICY

- Inflation (price stability)
- Balance (balanced central budget, and balance of payment)
- Activity (increasing)
- GDP (increasing)

- To reach a long-term sustainable growth of the living standard (GDP increase)
- Sustainable
  - Demografically
  - Ecologically
  - Economically (balanced central budget and balanced balance of paymnent)

Fiscal Policy

If an economy is in a depression or a recession, the government may try to energize it by spending more money or by cutting tax rates.

During the Great Depression, John Maynard Keynes recommended massive government spending to re-start the U.S. economy.

CONTRACTIONARY POLICY

CONTRACTIONARY FISCAL POLICY occurs when the government deliberately reduces its deficit in order to slow down the economy (usually with the goal of reducing inflation).

The net effect of contractionary fiscal policy, all other things being equal, is to slow down the rate of growth of the economy.

Contractionary Policy

-- In contractionary fiscal policy, the government cuts its spending (G) or raises taxes (T) or both.

-- Contractionary fiscal policy slows down the economy by decreasing aggregate demand

Expansionary Policy

- -- With an expansionary fiscal policy, the government raises its spending (G) or cuts taxes (T) or both.

- An expansionary fiscal policy expands the economy because it stimulates aggregate demand.

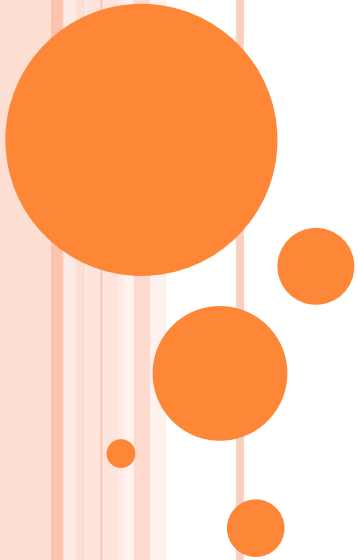
Neoliberal approach (Milton Friedman)

- The government cannot change the long run growth rate, because it depends on the production factors.
  - unemployment is voluntarily
  - capacity are given
  - expansion leads to inflation
  - Import leads to foreign indebtedness

Structure of government sector

- Central budget
- Local governments

Tax policies and concepts



Tax policy

- Tax policy means the types of tax employed, the way of taxation, and the economic concepts behind taxation

Principles

- Coverage
- Enacted by the Parliament
- Utilitarism
- Fair treatment
- Transparency/Openess
- Economical

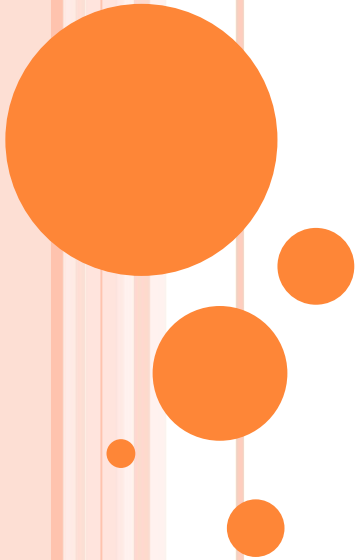
Direct versus indirect taxes

Taxes	Indirect	Direct
Tax object	Sales	Income, property
What is taxed?	Consumption	Income
Tax avoidance	Smuggling, black sales	Black labour
Tax burden	Normative	Differentiate
Economic effect	Increases inflation/lower consumption	Decreases the incentive to work

KEYNESIAN AND MONETARY TAX POLICY

Viewpoint	Keynesian	Monetary
Progressivity of direct taxes	Strong	Weak (flat tax)
Tax allowance	Many	Limited
Taxation of capital yield	Yes	None
Main pillar of taxation	Direct	Indirect

Main taxes and fees



Main incomes of central budget – Incomes from…

- Economic organisations (corporate tax, mining rent, corporate car tax)
- Indirect taxes (Value Added Tax, Excise Tax)
- Households (Personal Income Tax, Social insurance fees)
- Central budget institutions
- Local governments
- International organisations
- Debt service

Main way of incomes: **taxes, customs, charges**

CORPORATE TAX

Viewpoint	Corporate tax
Tax subject	Economic corporates
Tax object	Economic activity
Tax base	Adjusted pre tax profit
Tax rate	10%, above 500 million HUF 19%
Tax allowances	New investments, employment allowances,

Personal income tax

Viewpoint	Corporate tax
Tax subject	Individual with domestic income, or Hungarian resident with foreign income
Tax object	Income
Tax base	Adjusted total income
Tax rate	16%
Tax allowances	Family allowance, personal allowance, farmer allowance

Value Added Tax

Viewpoint	Corporate tax
Tax subject	Economic organisation
Tax object	Sales
Tax base	Net sales
Tax rate	27%
Tax allowances	18% - food, traffic; 5% - book, some medicine

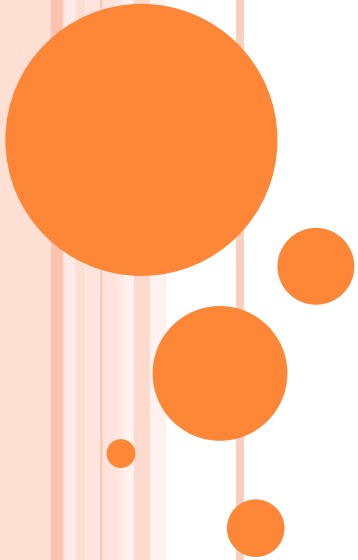
SOCIAL CONTRIBUTION TAX

Viewpoint	Corporate tax
Tax subject	Economic organisation
Tax object	Employment
Tax base	Net wages
Tax rate	27%
Tax allowances	Income from intellectual product selling

Excise Tax

Viewpoint	Corporate tax
Tax subject	Economic organisation
Tax object	Sales of alcohol, tobacco and oil
Tax base	Net sales
Tax rate	various
Tax allowances	various

Public budget cycle



Budget

- **Budget:**
  - Financial plan enacted by the Parliament.
  - Financial fund, which is collected, spent, and contolled by the government.
- **Budget cyle:**
  - Planning
  - Budget Committee approval
  - Minister's proposal
  - Debate
  - Voting. Enacting.
  - Execution and controll (ÁSZ)
  - Report

Budget

- Budget: Accounting the total revenues and total expenses of an organisational unit at a given period
  - Related to the future
  - It is published in a fixed form
  - Legal commitment
- Budget is based on budget of public institiutions.
- Budgeting principles: completed, uniform, transparent, real, detailed

Main expenses of central budget – Expenses for

- Economic subsidies
- Consumption subsidies
- Accumulation
- Social insurance
- Central budget institutions
- Local governments
- Specialised state funds
- International organisations
- Debt service, interest payment
- General reserve

Balance of state budget

- 1. **Technical deficit**: incomes occasionally, expenses continuously – *short term bridge loan*
- 2. **Regulational deficit**: due to imprecisiously measured income – *state securities*
- 3. **Real deficit**: expense unavoidable, but not enough income – *foreign loan, money creation*

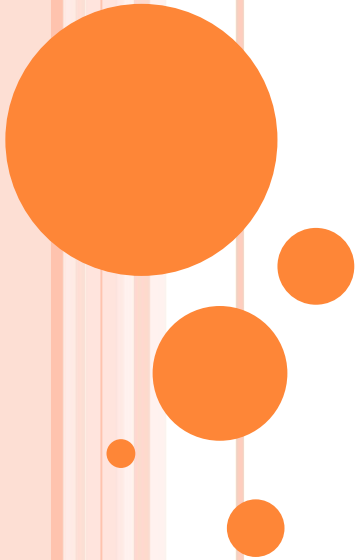
International comparison of budget

- Total expenses or deficit / GDP
  - Redistribution depends on:
    - Economic development
    - Market tradition
    - Social policy

SPECIALISED FUNDS

- Finance some particular duties of the state
- Use own taxes and contributions
- Advantages:
  - Some kind of independence from central budget
  - Attitude of taxpayers is better to see the precise goal of taxes
- Disadvantages:
  - Limited transparency
  - Decentralised cash management
  - Actual preferences of public finance are more difficult to ensure.

Local governments Duties and local taxes



LOCAL GOVERNMENTS

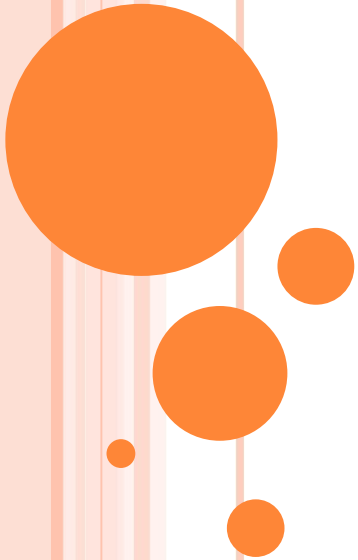
- 1. Finance the local public services
- 2. Encourage the economic development – investments
- Management:
  - *Taxes*: local taxes
  - *Subsidies*
  - *Own incomes:* from operation of public property

LOCAL TAXES

Viewpoints	Tax object	Tax subject	Tax base	Tax allowance
Building tax	Buildings	Owner	Square meter or market value	Church, public service
Site tax	Site	Owner	Square meter or market value	Same
Corporate communal tax	Employment	Enterprises	Number of employees	None
Private communal tax	Buildings, site, rent	Owner or tenant	Lump sum	Economic usage
Industrial tax	Sales	Enterprises	Net sales – material cost	Employment
Turism tax	Hotel service, building or accomodation	Owner of building	Lump sum, sales, night	Children, pensioner

Exchange rate and international finance

How is the exchange rate determined?



Dimensions of global financial governance

- Monetary order: exchange rate systems
- Lending facilities: short-term financial stabilisation; long-term developmental lending
- Macroeconomic policy supervision (limited)
- Banking supervision; regulation of financial markets

3 FUNCTIONS OF MONETARY SYSTEM

- Gives order and stability to foreign exchange markets (fixed vs. floating exchange rates)
- Encourages the elimination of balance-of-payments problems
- Provides access to international credit in emergency situations (lender of last resort)
- B Eichengreen: ‘glue that binds national economies together’.

Fluctuations in monetary history

- Greater friction and discontinuity than trade order
- 4 monetary systems in last 100 years:
  - Before 1914: Gold Standard; high capital mobility;
  - Interwar years: Collapse of GS; decline in capital flows
  - After 1945: Bretton Woods system; gradual recovery of capital flows
  - After collapse of BWS: free floating exchange rates; high capital mobility

Lessons from past 100 years

- Difficulty in creating a stable and lasting monetary order
- Greater hurdles for establishing fixed exchange rates: democratisation of economic policy
- Decline of state power (Susan Strange)?
  - Capital mobility after 1973
- Or continued power of states (Kapstein; Helleiner)?
  - Regulatory role of state

Bretton Woods System

- Dollar/gold base for monetary system;
- Fixed ('pegged') exchange rates
  - but adjustable if fundamental disequilibrium
- Controls permitted on international capital flows; gradual phase out;
- 'Scarce currency' clause: import controls against countries with persistent payments surpluses
- New institutions: International Monetary Fund (IMF), to monitor economic policy and provide short-term financial aid

BWS IN PRACTICE

- Currency rate adjustments applied too rarely
- IMF resources insufficient; no 'super bank'
- IMF had no teeth in controlling national economic policy
- But: capital controls worked well in 1950s; key to success of early BWS; eased pressure on governments to adjust currency rates;
- Once capital controls were lifted: inevitable collapse of BW?

Comparison of IMF and IBRD

Aspects	IMF	IBRD
Corporate's goal	Maintain the stability of the international financial system	Encourage the recovery of economy of member countries
Debtor of outstanding loans	State (National Bank)	Corporates (co-operating with local banks)
Purpose of loan	Free	Fixed (by tender)
Conditions	Stand-by (to macroeconomic conditions)	Stand-by (to microeconomic conditions)
Constraints	Linked to the quota	Linked to the equity
Maturity of loan	Generally short and medium (1-3 years)	Generally long (over 5 years)

Collapse of Bretton Woods

- Greater capital mobility undermines fixed exchange rates
- Inflationary policy in US: undermines central role of US currency and gold peg
- Devaluation of US$ needed, but politically controversial
- Nixon Administration: forced devaluation in 1971; end to BWS in 1973
- Key factors:
  - Design faults of BWS
  - Lack of political support in key states (USA, Europe)

After Bretton Woods

- Move towards flexible exchange rates
- Major advantage: allows countries to prioritise domestic policy objectives (e.g. inflation; employment)
- But: fluctuations and greater instability
- Europeans favour fixed rates (higher trade dependency): move towards European monetary system (EMS), later European monetary union (EMU)

Milestones of the European Monetary Union

- 1958 - convertibility in export and import (in frame of Bretton-Woods system)
- 58 – 68 – matching the fiscal policy (mainly indirect taxes)
- 68-78 – matching the exchange rates
- 69 – Werner-plan – towards to monetary union – failure
- 1971 – 1975 Currency snake - pegged in ± 2,25%
- 1975 – basket currency – ecu
- 1979 – European Monetary System – every currency pegged in ± 2.25 against ecu; European Monetary Cooperation Fund
- 1989 – Delors-plan
- 1992 – Maastricht-treaty
- 1994 – full convertibility
- 1999 – introduction of euro as bank money
- 2002 – introduction of euro as bank note

Consultation