# Péter Koroknai and Rita Lénárt-Odorán: The role of special purpose entities in the Hungarian economy and in statistics*,[1]

*The external debt and liability indicators which are important in terms of the external vulnerability of the Hungarian economy are significantly distorted if data on the so-called special purpose entities (SPEs) are taken into account. This is due to the fact that the gross external liabilities of SPEs amount to more than 100 per cent of GDP; taking these into account, the external liabilities of Hungary exceed 300 per cent. Accordingly, including SPEs results in a much less favourable picture of Hungary's external vulnerability. Clearly, data that exclude SPEs are appropriate for economically sensible analyses, as these entities do not engage in any real economic activity, but typically perform a financial intermediary function. They forward funds originating from abroad to foreign companies, attaining considerable tax savings for their group of companies (taking advantage of Hungarian tax regulations). By international comparison, including data on SPEs significantly exaggerates FDI inflows and changes in the intercompany loans of Hungarian companies. Recently, however, several events have occurred that may reduce the risks related to SPEs. First, as a result of efforts by the MNB, beginning in 2011 numerous organisations (e.g. ECB, Eurostat, OECD) consider as standard data that excludes SPEs. Secondly, several measures have been taken recently that reduce the tax advantage attainable by SPEs; these are also reflected in the decreasing domestic activity of SPEs. Regarding external vulnerability, the declining presence of SPEs in Hungary results in obvious advantages, as the external liabilities of Hungary are decreased, and the risk assessment of the country may improve.*

## INTRODUCTION

**Taking into account the financial operations of special purpose entities (SPEs) significantly distorts the gross external liability and debt indicators of the Hungarian economy.** External debt and liability indicators are key vulnerability indicators monitored by foreign investment banks, credit rating agencies and international financial institutions in their analyses. Data including SPEs significantly increase these indicators, thereby presenting a less favourable picture of the changes in the external liabilities of the Hungarian economy (the database of the IMF, which contains data including SPEs, was used for Chart 1; in order to demonstrate the magnitude of the distortion, data on Hungary excluding SPEs were also shown). These entities, however, do not engage in any real economy activity and typically perform a financial intermediary function – usually as arms of multinational groups of companies. Looking at their actual activity, however, money only flows through these firms, 'blowing up' both their financial assets and liabilities, and thus significantly distorting the statistics.

**The gross external liabilities of SPEs exceeded 100 per cent of GDP last year.** Excluding SPEs, the value of gross external liabilities as a proportion of GDP fluctuated around 200 per cent in this period. This is already high in terms of an international comparison, but including SPEs this indicator significantly exceeded 300 per cent (Chart 2). The external liabilities of these types of domestic entities are almost entirely non-debt type liabilities, mostly consisting of foreign direct investment (FDI). At the same time, the magnitude of inflows and outflows of their debt-type liabilities (e.g. loans, deposits, bonds) is negligible. Despite this, data on SPEs may distort not only liabilities but debt indicators as well, as many analyses – in contrast to our central bank analyses – calculate gross external debt with the inclusion of intercompany loans (loans extended by parent companies).[2] These types of gross liabilities of SPEs

* The views expressed in this article are those of the author(s) and do not necessarily reflect the offical view ot the Magyar Nemzeti Bank.

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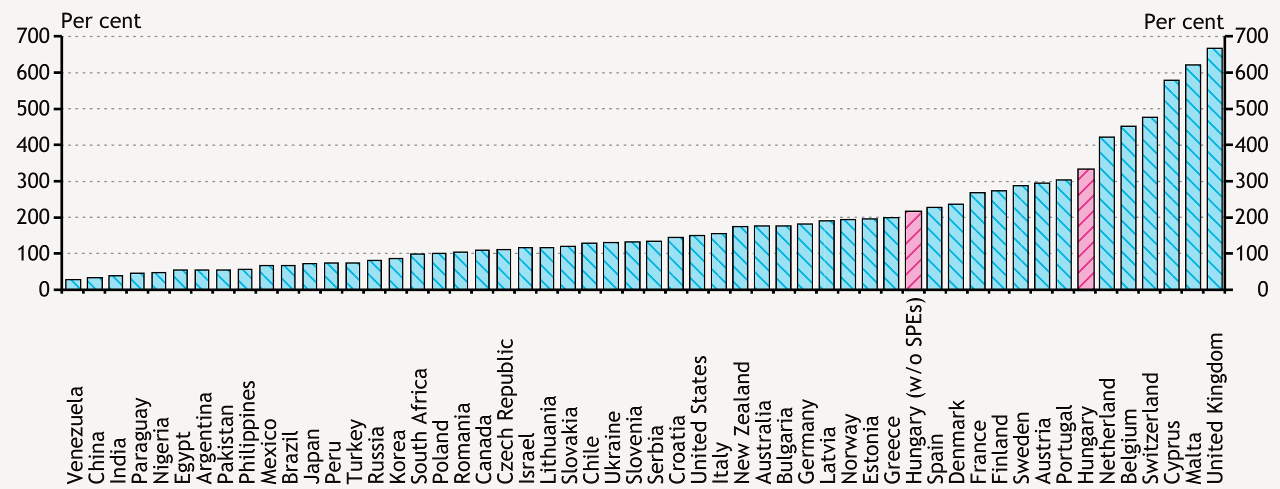
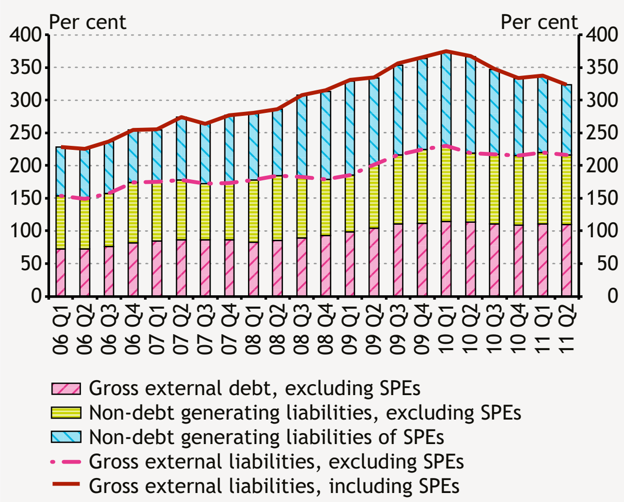
[2] Although based on the international statistical methodology intercompany loans within direct capital investment mean debt-type financing, due to economic considerations, in this article and in our central bank analyses they are treated as non-debt type liabilities. This is justified by the fact that parent companies are able to finance their affiliates through intercompany loans as well, similarly to equity capital. Based on our experience, passage between individual forms of financing is rather flexible. Our data indicate that equity capital-type liabilities and intercompany loans usually moved in opposite directions in recent years, and their common time series was much more stable.

**Chart 1**
**Gross external liabilities as a proportion of GDP**
*(2009 values)*




*Note: The IMF data usually include the SPEs (for details, see footnote 8). In the case of Hungary, data excluding SPEs are shown for illustration.*
*Source: IFS.*

**Chart 2**
**External debt and liability indicators of the Hungarian economy as a proportion of GDP**




*Note: External liabilities related to financial derivatives and intercompany loans are included in non-debt type liabilities. Due to their negligible magnitude, the debt-type liabilities of the SPEs are not shown in the chart.*
*Source: MNB.*

reached 20 per cent of GDP at end-2010, and this measurement was added to the external debt indicator calculated with the inclusion of SPEs.

## WHAT ARE SPECIAL PURPOSE ENTITIES?

**The main feature of special purpose entities is that their relationship with the domestic economy is minimal; usually they only play a financial intermediary role in transactions, as part of the global tax optimisation activity of large international corporations.** SPEs are resident companies with foreign owners and foreign affiliates that are not engaged in any real economic activity in Hungary. These firms specialise in financing groups of companies, holding activities, dealing in royalties or asset leasing. According to our unofficial information, the most typical of the above activities is the financing of groups. The direction and amount of funds flowing through SPEs are regulated by their parent companies. Examination over a longer period of time reveals the net cash flow of SPEs to be nearly zero. Therefore, their activity does not significantly influence their respective financial positions, but the magnitude of their receivables and payables is considerably increased.

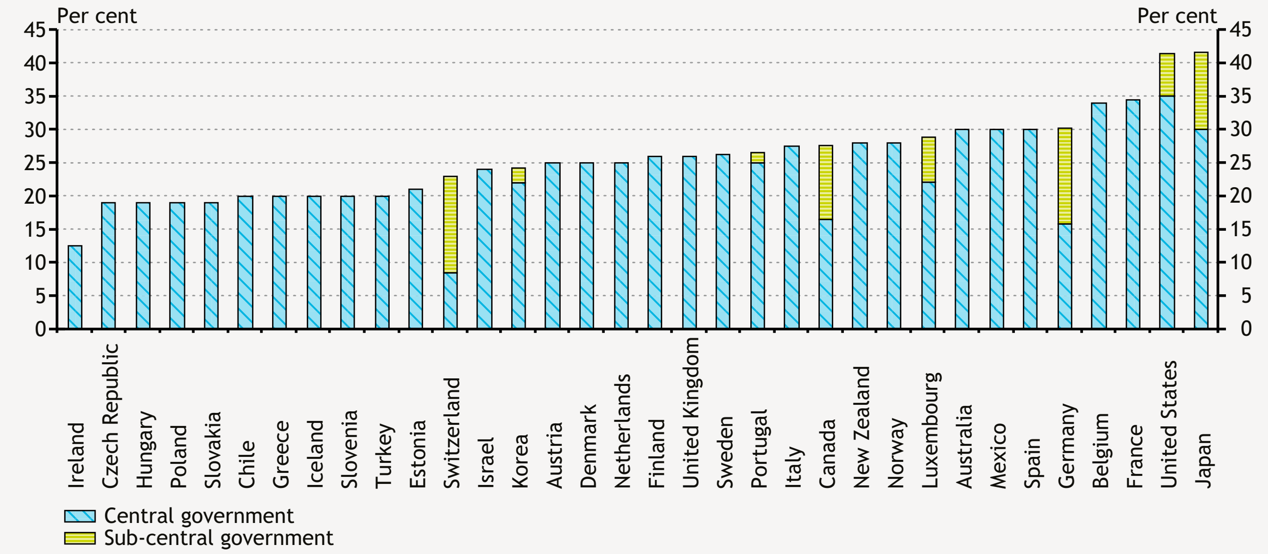
**The statistical filtering of special purpose entities is based on features that characterise their activity.** Currently, there is no internationally accepted, uniform standpoint in regard to what companies should be considered SPEs (IMF, 2009). However, despite this lack of a standard definition, there are commonly accepted criteria that allow individual countries to identify these companies. Based on the recommendations of the OECD handbook (OECD, 2008a, 2008b) which deals with the subject in a detailed manner, it is the convention of Hungarian statistics to separate SPEs within resident companies. The separation of SPEs within the corporate sector, starting in 2006, initially resulted in the identification of some 700 special purpose entities. Based on a more or less bi-annual revision, their number declined by 2011 to below 500 (i.e. 15 per cent of the foreign-owned companies included in the balance of payments). The system of rules developed jointly by the Magyar Nemzeti Bank and the Hungarian Central Statistical Office in 2005 (MNB, statistical methodology) contains the following main criteria for SPEs:

- They do not engage in real economy activity in Hungary.
- They have foreign ownership, with financial assets and liabilities that pertain to countries other than Hungary.
- In their balance sheets, the weight of real assets is negligible relative to that of their financial assets.
- Low number of staff (90–95 per cent of SPEs employ two people maximum).
- Negligible material costs.
- In some cases, the name of the enterprise indicates the special nature of the activity (e.g. group financing company, holding company).

**In terms of their operation, special purpose entities are similar to domestic off-shore companies (which ceased to exist in 2006), although the nature of their classification is not legal, but rather statistical.** Mainly due to benefiting from tax advantages, the activity of SPEs is similar to that of the earlier off-shore companies. Off-shore companies were identified by Act LXXXI of 1996 on Corporate Tax and Dividend Tax as companies performing activities abroad, subject to a significantly lower corporate tax rate. Accordingly, the off-shore classification was a legal category, subject to separate tax rules, whereas the special purpose entity is merely a statistical classification. SPEs are subject to the same tax regulations as other companies. In 2002, the Act on Corporate Tax changed in a way[3] such that, starting in 2006, it no longer distinguished off-shore companies in terms of corporate tax rate.

**Special purpose entities basically settled in Hungary in order to exploit taxation advantages.** In terms of international comparison, the Hungarian corporate tax level is considered low (Chart 3) and companies in Hungary pay taxes according to a relatively low rate. In addition, the effective corporate tax rate may have further been reduced by the various tax allowances prevailing in Hungary. From the point of view of SPEs, the most relevant rule was that until 2010 it was possible to deduct half of net interest income from the corporate tax base (Act LXXXI of 1996).[4] In the event that a group of companies financed a foreign company through a domestic SPE, it could attain considerable tax savings at a group level as a result of interest income being subject to a preferential tax in Hungary. It is also

**Chart 3**
**Corporate tax rates in 2011**




*Note: Excluding surtaxes and the business tax in the case of Hungary.*
*Source: OECD.*

[3] From January 2003 onwards, it was not permissible to set up an off-shore company. Previously existing ones lost their status by 31 December 2005 at the latest.

[4] Financial institutions (banks, insurance companies, investment funds) are not allowed to do this.

worth mentioning that exemption from local business tax exists in many settlements in Hungary. This may have attracted companies specialising in leasing; this exemption does not apply to group financing firms.

**A large proportion of domestic SPEs have US owners as their primary owners; accordingly, the significant difference between Hungarian and US corporate tax rates and the characteristics of their tax regulations played a major role in their establishment.** According to our information from market participants, the primary owners (and thus the decision-makers responsible for the allocation of funds) of these companies are often US residents. The difference between the 35 per cent corporate tax rate in the US and the much lower rate in Hungary was an important motive behind the foundation of these types of domestic enterprises (Chart 3). In addition, a determining factor in the creation of SPEs in Hungary may have been the convention signed in 1979 between the USA and Hungary on the avoidance of double taxation, which allowed a 0 per cent withholding tax (on income transferred abroad) on interest income inflows to Hungary from the USA (e.g. on loans extended from Hungary). In addition to the Hungary-specific tax advantages listed above, the domestic activity of SPEs may also have been facilitated by the fact that, in general, tax and accounting regulations were not globally harmonised. Thus, for example, funds are shown as capital or credit on the balance sheets of domestic companies; clearly, this is done on the basis of legal statements. As the authorities do not examine the underlying content, the liability shown abroad as an equity may also appear in the balance sheet of a Hungarian firm as a loan. Accordingly, dividend payments related to the equity may be accounted for as earning interest in Hungary, which may allow for a reduction of the tax payment obligation.

**In recent years, several measures have been taken in Hungary that may hinder the activity of special purpose entities here.** Tax revenues from SPEs in the budget may exceed HUF 10 billion.[5] Nevertheless, there have been several changes in the tax system recently, which may reduce the tax advantages of SPEs. EU directives and growing transparency (which may even lead to increased tax revenues through the improvement of general tax compliance) may have played a role. The main changes are as follows:

- In parallel with the renegotiation of similar treaties with other countries, the convention signed in 1979 between the United States and Hungary on the avoidance of double taxation was amended in 2010 (Act XXII of 2010). For example, an important change was the possibility of the 0 per cent withholding tax on interest incomes arriving in Hungary being tied to strict conditions (such as real economic presence). It is important to note that, taking capital flows as a basis, the weight of directly US-owned SPEs within all SPEs may be around 10 per cent (see below). In addition, however, it must also be mentioned that the reports of companies and statistics only reveal direct foreign owners and affiliates. The company on the top of the ownership structure of the companies is unknown, while the actual proportion of indirectly US-owned enterprises may be higher. Accordingly, the amendment to the US–Hungarian convention may have brought a material change in the activity of domestic SPEs; some changes are already reflected in the available data.

- Since 2010, half of net interest income cannot be deducted from the corporate tax base (Act LXXXI of 1996; Adózóna, 2010). An important reason for this decision may have been that this kind of tax allowance is unprecedented in the EU, for which reason an infringement investigation was conducted against Hungary (Brückner, 2009).

- In 2010, a rule was introduced stipulating that domestic enterprises must pay 30 per cent withholding tax on interest, royalties, consulting or agency services paid to foreign companies if no double taxation agreement is in place (RSM–DTM, 2011; Act LXXXI of 1996). However, Hungary has signed agreements of this type with more than 70 countries. This obligation ceased to exist by 2011, but its introduction may have driven some SPEs to relocate their respective registered offices to other countries.

## DOMESTIC STATISTICS

**For the purpose of Hungarian statistics, special purpose entities belong to the sector of non-financial corporations.** It is typical of SPEs that they do not generally participate in production, but only forward funds originating from foreign companies to other foreign companies. The financial intermediation of SPEs is considered in a statistical sense to be a financial service provided within a closed circle, meaning that these companies must be classified as non-financial sector

[5] According to the income declarations, for example, some 500 companies took advantage of the tax allowance related to interest income in 2010, which entailed a tax payment obligation of HUF 15 billion (F. Szabó, 2011a).

companies. Another argument for their classification in the sector of non-financial corporations is that in domestic statistics the classification of enterprises according to activity is based on self-assessment, according to which SPEs are registered as non-financial corporations. The underlying reason is that the majority of companies presumably declare the activity of their respective mother companies, and thus these companies usually distort the statistics of the sector of non-financial corporations.[6] Due to the increasing impact of SPEs, new international statistical methodologies deal with the accounting rules related to SPEs in more detail. Based on the new national accounts methodology (SNA 2008 and within the EU ESA 2010), within financial corporations SPEs need to be classified in a newly created sub-sector (captive financial corporations), which is expected to be applied by the EU countries from 2014 onwards.

**Data on special purpose entities affect the financial accounts of non-financial corporations and the balance of payments statistics.** Until end-2005 (i.e. as long as off-shore status existed), data on off-shore companies appeared in net terms in the *balance of payments;* therefore, they did not influence the statistics. The balance of payments statistics of SPEs are available from 2006 onwards, and the high volume of external assets and liabilities significantly affects the gross amounts. Data on SPE-type companies appear in financial accounts not only following the termination of the off-shore status. Because the statistics – by excluding companies that meet the statistical criteria typical of SPEs – attempted to trace data all the way back to the beginning of financial accounts in order to have a uniform, unbroken time series. Data on SPEs exist (on an annual basis) starting from 1990, but the operation of SPEs has materially influenced developments since 1999. Accordingly, data on the scope of companies excluding SPEs and including SPEs are available separately in the case of both statistics and are accessible on the website of the central bank of Hungary. At the same time, in line with methodological standards, the MNB forwards balance of payments and financial account data including SPEs, as well as international investment positions, to several international institutions (MNB).

**The MNB makes efforts to ensure that international institutions also regard data excluding SPEs which are closer to economic changes are perceived as the standard.** In earlier years, the MNB strived to ensure that international organisations were able to receive data including and excluding SPEs in their databases. Clearly, for economically sensible data releases and analyses, data excluding SPEs are appropriate; for the compilation and comparison of mirror statistics, however, users also need data calculated with the inclusion of SPEs. As a development of recent months, the MNB has achieved that many organisations (ECB, Eurostat and OECD) use data excluding SPEs for their country analyses, data releases and scoreboards containing the external imbalance indicators of individual countries. At the same time, data including SPEs are contained in the statistics of several institutions (IMF, World Bank).

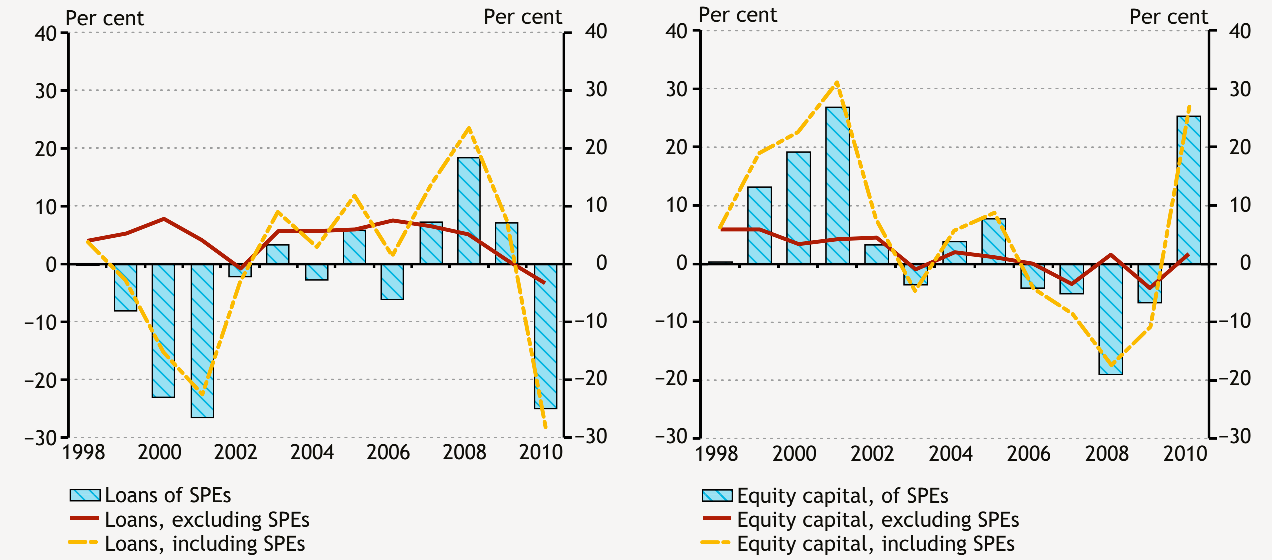
## a) Financial accounts

**As international statistics address the corporate sector that includes special purpose entities, data in financial accounts significantly exaggerate the picture of changes in the loans of the Hungarian corporate sector during the crisis.** Considering that intercompany loans belong to loan type liabilities in financial accounts, in terms of an international comparison, changes in the loans of Hungarian companies may be considerably affected by the activity of SPEs. Based on the data, changes in net borrowing and net obtaining of equity capital by SPEs were contrary to one another for the whole period (Chart 4). In the years before the outbreak of the crisis, it was typical for SPEs to raise equity capital in foreign companies by using intercompany loans originating from abroad. Starting from 2009, in parallel with the narrowing of financing possibilities, loans to SPEs also declined considerably. In 2009, this was still offset by the even greater fall in loans extended, and thus net borrowing remained positive. In 2010, however, SPEs reduced their equity type receivables to an extent equalling 25 per cent of GDP (consequently, their net equity type liabilities increased sharply), which was partly spent on the repayment of earlier received intercompany loans and partly on increasing of lending (which resulted in a decrease in their net borrowing – see Chart 4). It is important to note that on the basis of the information available, SPEs only have external liabilities and assets (i.e. they are not exposed to the domestic banking sector). Accordingly, their operation or eventual liquidation does not pose any financing risk to the domestic banking sector and, by extension, to Hungary.[7]

[6] The Dutch statistics also contain separate data release concerning special financial corporations. The Dutch distinguish this circle of companies that perform special tasks (special financial institutions, SFIs) on the basis of considerations similar to the Hungarian ones, and according to the methodological description they classify them among the non-financial corporations (De Nederlandsche Bank, 2005).

[7] While of course SPEs also may have bank accounts, in most cases the transactions performed by an SPE do not entail any real monetary movements; they are only book entries or, as far as we know, if there are monetary movements, they entail intraday transactions. SPEs need bank transactions only for technical reasons, not for the purpose of investment.

**Chart 4**
**Net borrowing and net transactions in equity capital type liabilities of the non-financial corporate sector, as a proportion of GDP**

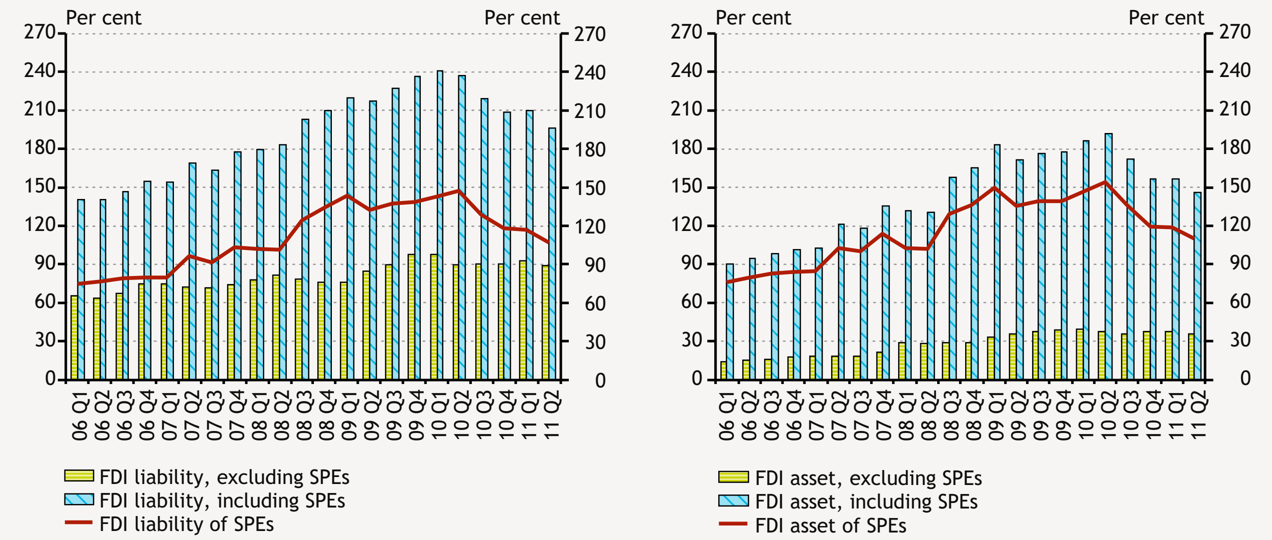



*Source: MNB.*

## b) Balance of payments

**The presence of special purpose entities on the financing side of balance of payments statistics distorts foreign direct investments considerably.** The financial intermediary role of SPEs is well reflected by the identical sizes of their direct investments in Hungary and abroad and by their co-movement (Chart 5). Based on corporate reports and accounts, equity-type liabilities account for the major portion of foreign direct investments. At end-2010, total direct investment liabilities of SPEs (and related assets) were around EUR 120 billion, of which equity-type external liabilities amounted to EUR 100 billion. Compared to that, the amount of total non-equity type liabilities (typically intercompany loans) is low, but transactions of liabilities of this kind may be significant. It is important to call attention to the fact that as circulation between the two forms of financing (equity and loans within the group

**Chart 5**
**Foreign direct investment (FDI), end-of-period stocks as a proportion of GDP**




*Source: MNB.*

of companies) is very frequent, it is worth dealing with the two together.

**Loans of special purpose entities within a group of companies also cause problems in the calculation of gross debt indicators which take these loans into account.** In many analyses, external debt indicators are calculated with the inclusion of intercompany loans. Intercompany loans of non-SPEs increased gross debt indicators by 30 per cent of GDP at end-2010. This may be further increased by taking into account the types of liabilities of SPEs, amounting to some 20 per cent of GDP. Accordingly, calculating gross external debt in this way results in 160 per cent of GDP last year. By contrast, the debt indicator that ignores intercompany liabilities was around 110 per cent of GDP.

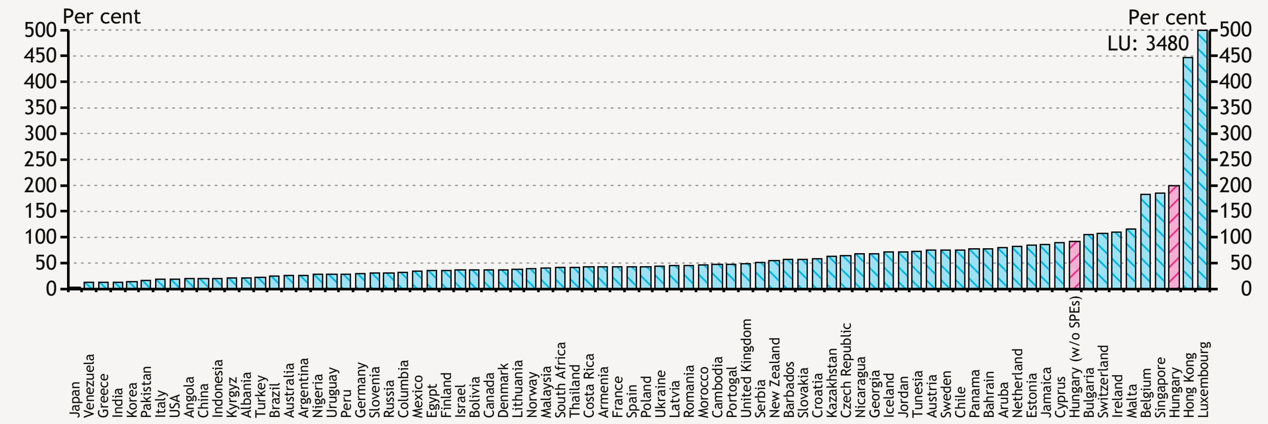
**During 2010, a decline was observed in the domestic and foreign direct investments of special purpose entities.** FDI stock declined to 120 per cent by end-2010 from the level of 130 per cent which was typically seen earlier. The primary reason underlying this phenomenon may be the narrowing of the scope of tax allowances discussed in detail above. In addition, as a result of losses due to the crisis and falls in profits, tax optimisation efforts may already have declined, also contributing to the capital outflows of SPEs.

**The presence of special purpose entities entails significant gross income flows vis-à-vis the rest of the world, without having any material effect on the income balance and the picture of external financing capacity.** It follows from the lack of real economy activity of SPEs and their statistical classification that they do not engage in investment activity or participate in foreign trade turnover (including the exports and imports of services). At the same time, considerable income flows are related to the foreign affiliates and parent companies of SPEs. In the balance of payments, they have a material effect on the gross values of income balance. However, their net effect is insignificant.

## INTERNATIONAL COMPARISON

**By international standards, the FDI stock of Hungarian companies is extremely high (Chart 6).** Official statistics available in international databases usually contain the corporate sector including SPEs.[8] On this basis, the total FDI stock invested in the receiving country amounts to nearly twice as much as GDP in Hungary, which is the third highest value following Luxemburg and Hong Kong. As such, it is, inter alia, greater than that of Switzerland, Ireland or Cyprus, which are considered to be favourable target countries in terms of FDI. It is also important to note that the approximately 100 per cent value of GDP-proportionate FDI stock excluding SPEs is also considered to be very high. In addition to early privatisation and the central role of Hungary in the region[9], another underlying reason may be

**Chart 6**
**Foreign direct investment in 2009, international comparison, as a proportion of GDP**




** 2008 data.*
*Note: The IMF data usually include the SPEs (for details, see footnote 8). In the case of Hungary, data excluding SPEs are shown for illustration.*
*Source: IFS.*

[8] The MNB has succeeded in convincing the ECB, Eurostat and the OECD that they should also receive balance of payments data excluding SPEs, and make them available for users as country data in their databases. The MNB has already indicated to Eurostat and the ECB that it would like to shift to a similar practice in the case of financial accounts as well. It is as a result of these kinds of efforts of individual countries that in spite of the theoretically uniform database, in IMF statistics the Dutch data do not include special financial institutions (SFIs); the FDI stock including the latter exceeds 400% of GDP.

that data excluding SPEs may also contain capital flows that are not related to production but to financial services (see the box for details on arguments supporting this). This latter point is also confirmed by the level of FDI outflows that are considered high in the region (Czech, Polish and Slovak economies).

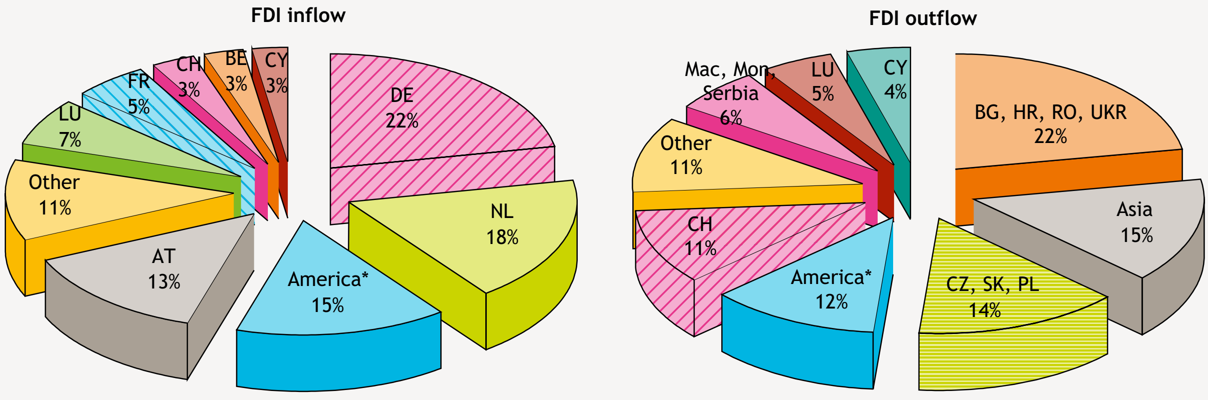
## Are the data excluding SPEs also distorted?

**Several factors indicate that although the exclusion of SPEs considerably reduces distortion of data, adjusted data may continue to overestimate actual FDI inflows related to the real economy.** This is indicated by the fact that even FDI stock excluding SPEs exceeds the data of several countries where the role of SPEs may be significant.

**First, the operation of cash-pools performing financial settlements of groups of companies that operate in several countries and also deal with production significantly distorts the data.** The cash-pool is a cash management technique, the objective of which is the combined management of liquid assets of a group of companies (for example, in order to attain more favourable bank conditions). At the same time, a cash-pool may also serve for financing of the activities of the companies, as lending is possible from this source within the group of companies (group financing). In 2009 Q1, for example, the domestic affiliate of a foreign-owned company engaged mainly in production had a cash-pool liability in excess of EUR 3 billion, although it simultaneously extended a loan of a similar magnitude abroad. Accordingly, this transaction added considerably to the gross amount of the receivables and payables of the corporate sector without having any effect on domestic economic developments.

**Secondly, examining the FDI stock of the corporate sector excluding SPEs, one finds that a significant portion of these investments originates from (and goes to) countries where SPEs typically operate.** Of course, most of FDI flows originate from Western European countries (e.g. Germany, the Netherlands and Austria) intending to invest in Hungary or go to countries in the region (e.g. Visegrád countries, Bulgaria, Romania, Croatia, member states of former Yugoslavia). Nevertheless, even in the case of the corporate sector excluding SPEs, approximately one third of FDI outflows are aimed at countries that are presumably not targets of Hungarian companies' expansion abroad (e.g. United States, Switzerland, Luxemburg, Cyprus). This indicates that data excluding SPEs also contain capital flows that are independent of fundamental economic changes (Chart 7).[10] However, as mentioned above, the statistics only mention the primary foreign owners and affiliates. Only knowing the highest-level company would allow an establishment of where money flows actually started and whom they financed.

### Chart 7
### FDI flows of domestic companies excluding SPEs in 2009




** 30-40 per cent North America, 60-70 per cent Central America.*
*Source: MNB.*

[9] For example, the Deutsche Telekom and the Bayerische Landesbank also continue their regional expansions through their respective affiliates located in Hungary.

[10] At the international level, within the framework of examining the effects of globalisation, this phenomenon is being treated as a separate research subject by the OECD working group that elaborates the methodology of foreign direct investments. In connection with this work, the MNB Statistics Department plans to examine the weight of the economic activity of multinational companies operating in Hungary by separating their data within the FDI statistics.

**Table 1**
**FDI inflows of selected countries**
*(transactions as a proportion of GDP)*

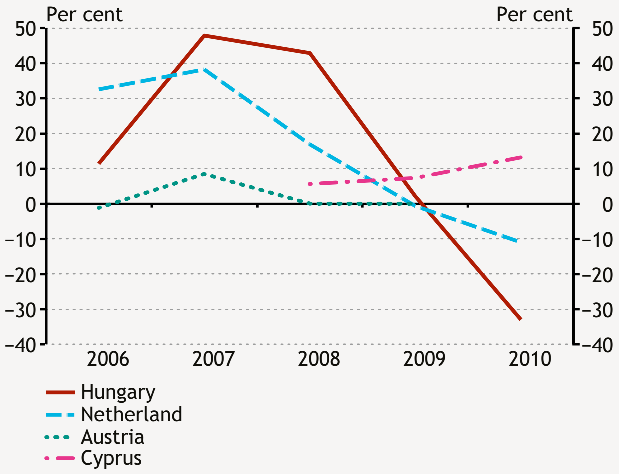
| | | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Excluding SPEs | Netherland | 2.1 | 15.3 | 0.4 | 4.3 | –2.1 |
| | Cyprus | 10.0 | 10.2 | 10.4 | 17.0 | 7.8 |
| | Austria | 2.5 | 8.4 | 1.7 | 2.3 | |
| | Hungary | 6.1 | 2.8 | 3.9 | 1.2 | 1.4 |
| Including SPEs | Netherland | 34.6 | 53.6 | 17.3 | 3.7 | –13.1 |
| | Cyprus | | | 16.0 | 24.3 | 21.0 |
| | Austria | 1.3 | 16.8 | 1.6 | 2.3 | |
| | Hungary | 17.5 | 50.6 | 46.8 | 3.3 | –31.7 |

*Sources: Websites of central banks of selected countries.*

**In Hungary, the FDI flows of the corporate sector including special purpose entities are considered high in terms of an international comparison.** Although it is known about several countries that their statistics are considerably distorted by capital movements related to SPEs, as a result of our lengthy investigation, Hungarian data can be compared against the officially released breakdowns of the Netherlands, Austria and Cyprus. Accordingly, while the data on GDP-proportionate capital inflows to Hungary excluding SPEs are not much different from those experienced in other countries, the FDI inflow including SPEs was very high prior to the crisis, and the magnitude of the fall in the years following the crisis was also greater (Table 1).

**Prior to the crisis, FDI inflows related to special purpose entities were close to 50 per cent of GDP in Hungary, significantly exceeding the value seen in countries that gave a breakdown regarding SPEs (Chart 8).** FDI inflows to SPEs amounted to around 10 per cent of GDP in Austria and Cyprus. While this size of inflow continued following the crisis as well in Cyprus, the data indicate outflows of funds in the case of Hungary and the Netherlands. This may mean that an affiliate – in connection with the fall in demand for loans as a result of the crisis – repaid a loan received earlier, but in the case of Hungary the tax changes that took place in the meantime may also have played a role in the outflow of funds.

**Chart 8**
**FDI inflows of SPEs**
*(transactions as a proportion of GDP)*




*Sources: National central banks.*

## SUMMARY

The external debt and liability indicators that are important in terms of the external vulnerability of the Hungarian economy are significantly distorted if data on the so-called special purpose entities (SPEs) are taken into account. Although the MNB publishes the balance of payments statistics with the exclusion of SPEs as well, and this version is also considered economically sensible, in the past international organisations typically took into account the statistics including SPEs. As the presence of SPEs is not typical in countries that constitute a relevant basis for comparison for Hungary (newly joined Central and Eastern European Member States), indicators that also take SPEs into account depict a less favourable picture of Hungary in terms of its external vulnerability.

SPEs are companies that do not engage in any real economy activity, but typically perform a financial intermediary function: they forward funds originating from abroad to foreign companies, while (taking advantage of the Hungarian tax regulations) they attain considerable tax savings for a group of companies. The external liabilities (and assets) of SPEs, which belong to the sector of non-financial corporations, amount to more than 100 per cent of GDP; considering these, the external liabilities of Hungary exceed 300 per cent. In an international comparison that usually includes SPEs, changes in loan disbursements to Hungarian companies are exaggerated by the presence of SPEs: namely, prior to the crisis they received significant amounts of intercompany loans, whereas following the crisis their external loans fell. In addition, the presence of the SPEs on the financing side of balance of payments distorts the FDI data considerably. At the same time, the SPEs have not borrowed from domestic banks (i.e. their eventual liquidation does not pose any financing risk).

Recently, however, there have been several events that may reduce the risks related to SPEs. First, as a result of efforts by the MNB, starting in 2011 numerous organisations (ECB, Eurostat, OECD) consider data excluding SPEs to be standard. Secondly, several measures that reduce the tax advantage attainable by SPEs have been taken recently, which are also reflected in the declining domestic activity of the SPEs. Regarding external vulnerabilities, the declining presence of SPEs in Hungary entails obvious advantages. As the external liabilities of Hungary fall, the risk assessment of the country may improve.

## REFERENCES

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