Hungary's Structural Reform Programme

2011 – 2014

Based on the political thesis of the Széll Kálmán Plan

Ministry for National Economy

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Introduction

The fraction union of FIDESZ-KDNP, the presidencies of the ruling parties and the Government of Hungary made a political decision to launch the Structural Reform Programme. The programme is aimed at consolidating the Hungarian public sector by means of structural reforms, strengthening economic growth, encouraging the increase of employment and enhancing the competitiveness of Hungary's economy.

Political decision-making bodies of the country have assessed the current mid-term economic and financial situation due to the lack of structural reforms. They have established that fiscal targets for 2010 and 2011 could be reliably met due to one-off and extraordinary measures such as a tax on banks, crisis taxes, incorporating private pension funds payments and transferring a part of these assets of those to government-run pension fund which the Government did in 2010.

These measures will consolidate the Hungarian public sector partially in 2012 with additional moves to stabilize the government budget for 2012.

It has been established that, on the basis of economic and financial forecasts, mid-term general government deficit targets for 2013 and 2014 will involve significant risks. Therefore, to maintain secure fiscal positions in 2013 to 2014 and to create sustainable financial equilibrium on a mid-term basis, further measures are needed.

The fraction union of FIDESZ-KDNP, the presidencies of the ruling parties as well as the Government of Hungary have assessed three possible scenarios. Firstly, Hungary would undertake to run a general government deficit above 3 % of GDP each year in the period from 2012 to 2014. Political decision-making bodies have rejected this scenario due to Hungary's high sovereign debt, high national debt and especially due to an exceptionally high borrowing requirement even on international standards.

They have assessed the second scenario in which Hungary would undertake to maintain a general government deficit below 3 % of GDP in 2012, 2013 and 2014. Furthermore, in the wake of the European Commission's excessive deficit procedure, the country would provide for further structural deficit cuts by using the private pension funds' assets for this purpose. In this situation, private pension funds' assets would not finance the reduction of public debt but would provisionally cover a fiscal deficit course well above the structural deficit in the period of 2012 to 2014. The political decision-making bodies have rejected this scenario as well because it would not allow for the money market confidence to be regained and the EU excessive deficit procedure to be lifted. Also, it would postpone the commitment of creating sustainable financial equilibrium from a mid-term perspective to a period after 2014.

The political decision-making bodies have adopted the third scenario which is to complete the fiscal consolidation for 2012 through the 2011 structural reforms without the requirement that the deficit of the government-run pension fund should be lowered from the private pension funds' assets in 2012, thus consolidating the fiscal situation in full by 2013/2014. The decision also implies that the structural deficit of the general government will decrease year to year in the 2012-2014 period. From 1 January 2013, crisis taxes will be phased out. The tax on banks will be replaced by a harmonized EU tax imposed on the financial sector. Fiscal deficit will not be financed from the assets owned previously by the private pension funds anymore excluding the 2011 budget. Assets from the private pension funds as a whole will be used to slash the Hungarian public debt with the exceptions laid down in the 2011 budget law.

The political decision-making bodies have considered and adopted the proposal that the new Constitution expected to approved in 2011 should set out preventive measures to forestall an additional increase of public debt. They have established that structural reforms in 2011 would decrease Hungary's public debt to 65 to 70 %of GDP by the end of 2014. Based on their proposal, a public debt level of 50 %relative to GDP should be laid down in the new Constitution as a goal to be achieved. Accordingly, Hungary's public debt should be further cut in the period after 2014 as well.

I. Summary

On the basis of political decisions concerning structural reforms, a detailed action plan has been prepared with the relevant schedule and legislation to be amended as needed. The measures below are based on the political decisions made by the fraction union, FIDESZ-KDNP.

Hungary's high public debt bears the characteristics of advanced countries. The public debt increased to 21.791 bn HUF by 2010 exceeding 80 % of GDP. The average duration of this amount is some four and a half years and the calculated implicit interest rate is 5.8 %. Due to high public debt, Hungary is seen as risky on the money markets which results in investors' willingness to refinance the country's debt only with a premium. Interest expenses in Hungary shift between 1050 bn HUF and 1100 bn HUF a year raising the deficit by 1.5 to 2.0 % relative to GDP as compared to the EU-27 average.

In the European Union, a general government deficit below 3 %, in accordance with the Maastricht criteria, is not sufficient to lift the excessive deficit procedure against Hungary. The European Commission and the European Council are of the view that structural deficit cuts guarantee sustainable equilibrium and meeting fiscal targets undertaken by the Government of Hungary in the Convergence Programme to be met.

The Government will reduce the general government deficit in 2012, 2013 and 2014 to 2.5 per cent, 2.2 % and 1.9 per cent, respectively.

In addition to the updated macroeconomic growth course, which includes the measures already taken, adjustment needs will arise at around 500 bn HUF in 2012 and 900 bn HUF each year from 2013 to 2015. Beyond maintaining the deficit target, comprehensive moves should be made for job creation, promotion of economic growth and enhancing the competitiveness of the Hungarian economy. Public sector reforms are necessary particularly in the areas where government spending (or tax wedges) is high or where using available resources is of lower efficiency when compared internationally.

In response to the global crisis that broke out in the autumn of 2008, Hungary took a lot of measures to improve fiscal balances while restraining domestic demand and economic growth. These measures were partly one-off moves (limited to the same year) while others were considered of a structural nature (with longer-term effects). All included in the table below:

Description	Effect, billion HUF		
	2009	2010	2011
Elimination of 13th month pension benefit	-	165	165
Change to pension indexation	0	76	91
Freezing minimum pension benefits	0	12	25
Postponement of the 2009 pension benefit correction to 2010	10	-	-
Cancellation of second instalment of the 13th pension benefit	82	-	-
Malus expansion for pensions (1 July 2010)	-	2	6
Cancellation of the reduced pension benefit correction in 2010	-	5	5
Reduction of the pension benefit correction due in 2010	0	35	36
Elimination of the 13th monthly wage in the public sector	90	181	181
Inflation-adjusted net wages in the public sector (increase only for low wages in gross)	-	70	70
Restricted disability pensions	10	20	20
Reduced or restricted housing subsidies (including social policy interest rate)	24	52	72
Blocking proceeds from Kyoto quote sales	20	-	-
Agricultural subsidy cuts (TOP UP and other)	35	35	35
Reduced natural gas and distance-heating compensations	20	40	40
Reduced prescription subsidies	30	30	30
Freezing of resources in ministries	60	60	60
Increasing the funds to the Research Fund	10	-	-
Freezing family allowances	0	12	25
Cancellation of the September 2009 family allowance increase	4	17	17
Entitlement to the family allowance reduced to 20 years of age from 23 years	-	9	9
General rate of sick-pay reduced from 70 % to 60 % (1 September 2009)	3	16	17
Local government subsidy cut	0	120	120
In total	**398**	**957**	**1024**

Source: Ministry for National Economy

Major structural measures are summarized in the following:

- The pension system change took place in several steps. First, the 13th month pension benefit was eliminated. Then, the indexation was modified (the so-called Swiss indexation was replaced by one that was exclusively inflation-adjusted below an economic growth lower than 3 per cent). Furthermore, the minimum pension benefit was frozen and the retirement age was increased to 65 years from 62.
- For public sector wages, the elimination of the 13th month salary and freezing nominal wages create the set of measures with the second largest effect.
- The housing subsidy system was modified with lower social policy grants and interest rate subsidies followed by the elimination of entire subsidy elements in several steps. Home-building subsidies were lowered by 25 %.
- General rate of sick-pay was reduced to 60 % from 70 %.
- Disability pension was restricted.
- Natural gas and distance-heating compensation payable on a means-tested basis from the central government budget were reduced to one-third.
- By restructuring prescription subsidies, 30 bn HUF was saved.

Furthermore, several measures of non-structural type were taken including freezing funds and improving balances. These remained in force for a longer time (e.g. expenditure cuts of ministries) while others did not prove to be effective in relation to the entire public sector (e.g. local government subsidy cuts resulted in higher local government borrowing).

The above measures only partially consolidated the Hungarian public sector, however, due to their one-off nature in part and their impact of reducing domestic demand, investments, employment and economic growth.

In mid-2010, the newly-elected Government of Hungary inherited a situation in which, instead of a deficit of 3.8 %as included in the budget law, 6 to 7 % of the deficit would have emerged at the end of the relevant year relative to GDP. To lower general government deficit to below 4 per cent, the Orbán-led government took unusual or unorthodox measures. The table below shows the measures taken in mid-2010 as a result of which the budgets for 2010 and 2011 were consolidated and the deficit target of below 3 % for 2012 could be partially achievable. At the same time, these measures are of a one-off nature or based on provisional crisis taxes. Therefore, to underpin fiscal sustainability appropriately in 2013 and 2014, further measures are needed.

Provisional, not structural, deficit reduction					
	2010	2011	2012	2013	2014
Bank tax	180	180	180	90*	90*
Crisis tax	161	161	161	-	-
Private pension fund payment	60	360**	-	-	-
Private pension fund asset	-	529	-	-	-
Budget freezing	220	250	-	-	-
Total	621	1480	681	430	430

* EU compliant Hungarian bank tax

Source: MNE

** 97% returned to the state pension system, 3% remained

Structural reforms are needed to achieve the full consolidation of the 2012 budget and in order to achieve the public deficit necessary to put Hungary on a structural deficit decreasing path in the medium term, as well.

II. No policy change

Before the introduction of the structural reform it is worth imagining the situation without any reorganization. After inauguration, the government would commit itself to constituting a sustainable budget management and thus decreasing the public deficit. However, the decisions made so far would not assure a permanently low public deficit and reduction of public debt. The expiration of the crises taxes, the tax reductions being made to increase the competitiveness of the economy (personal income tax, corporate tax) coupled with less favorable external macroeconomic processes would result in increasing public deficit after 2012.

Deficit-track in the case of unfavorable macroeconomic processes, without government action

(in % of GDP)

2012	2013	2014
-4.5	-5.2	-4.9

Source: MNE

These calculations assume slower economic growth and stagnation of competitiveness and employment which means a slight weakening of the forint exchange rate and a permanently high debt risk rating. Consequently, it would lead to an increasing public debt and the increasing burden of the financing of the public deficit. Moreover, according to their optimistic assumption, the patience of the market and the investors holding bonds would stand despite delayed structural reforms. Further downgrades would not occur neither would the European Commission issue a negative assessment for the non-fulfilment of the requirements of the excessive deficit procedure, so the Council could not withhold access to EU development funds. In addition, despite the deteriorating perceptions of risk, the budget and the financial situation, it would be assumed that we would be able to repay the IMF-loan according to the contract while decreasing the foreign currency deposit placed in the Hungarian National Bank.

The evolution of the deficit as described above, and the fulfilment of all the optimistic assumptions would lead to set the public debt on a downward path. One-off factors, notably the portfolio of the withdrawers from the private pension schemes would reduce or stabilize the debt in the short term but in later years this would be offset by the rising budget deficit which is annually 500-1000 bn HUF more than planned. Thus, the pension reform would be useless, because the previously set aside amounts would be consumed in a couple of years. Because of the increase of the budget deficit the public debt would start to rise again and in

2014 it would be several thousand bn HUF higher than with the implementation of the Structural Reform Programme.

The lack or delay of structural reforms would have serious consequences. The significant and unpredictable weakening of the forint exchange rate would be the most evident effect of the immediate market impacts. The weaker exchange rate and the increased costs of bank financing reflected in interest rates would lead to the increase of the population’s burden due to significantly increasing foreign currency loan repayment instalments. Even in the case of a 10 % exchange rate depreciation, the burden on households would increase by 70 bn HUF per year. If, in this case, a significant number of borrowers having payment difficulties could not continue to repay credit charges then the numerous defaults on home loans would make bank portfolios unmerchantable which could even lead to bank failures.

The increase in the value of foreign currency debt in HUF terms would hold back the households’ consumption demand, later it would reduce economic growth and due to the ensuing recession, the unemployment rate would rise again. In parallel, the increase in the country risk would limit foreign investment while the increase in interest on loans would negatively effect domestic investment.

The unsuccessful implementation of the Structural Reform Programme would cause the classification of Hungary's long-term foreign exchange debt be downgraded from the investment grade category by the three "major" credit rating agencies. Since many institutional investors could not keep in their portfolio securities which would not be recommended, the downgrade would result in a significant sale of government securities. This would cause a severe rundown of all these processes. The growing and increasingly more risky public debt would be more expensive to fund and would raise the interest expenses and, through this, the gross government debt as well.

If the Commission would establish that Hungary has not taken sufficient steps to correct the excessive deficit, the Council, based on the initiative of the European Commission, could also decide to suspend access to the EU's development resources.

This would ultimately risk the implementation of the Széchenyi Plan, which is based on the large-scale use of EU sources and consequently would risk losing the stimulation of the economy through job creation which would further deepen the real economic crisis. Until 2014 the public debt, instead of lowering the level to between 65-70 %, would rise to about 75-80 %.

Hungary would have to turn again to the IMF for financial assistance. This would mean that we would have to implement a package with conditions compiled by our creditors instead of a family and work-friendly, competitiveness-increasing structural reform programme, which was made by ourselves and for ourselves. This would include more severe steps in addition to heavy losses suffered during the crisis.

Overall, the presented scenario (no policy change) has a clear message: instead of being liberated from the debt and the burdens of paying the interests of the economy, we would remain in the debt trap's captivity for a long time.

III. Structural reforms (policy change)

The government accepted in the last months that an overall project will be finished and declared at the beginning of 2011, which:

- increases employment by creating jobs and starts the economic expansion;
- assures a balanced budget in the short and long term and the progressive improvement of its structural balance and the successive decrease of the national debt; and
- restores the international confidence of investors in the Hungarian economy and therefore, in addition to the concrete fiscal benefits, can stave off danger of possible sanctions of EU or of further downgrading.

The Structural Reform Programme contains concrete steps, the aim of which is to guarantee the fiscal balance in accordance with the increase of employment and the intensification of growth potential. The project also contains strategic directions, or reform conceptions, in which some critical areas (system of self-governments, pensions in kind, social services, affairs of public funds, community traffic) can serve the common good and the realisation of the government programme regarding aspects of the budget.

The measures will unburden the budget in 2012 with 549 bn HUF and from 2013, 900 bn HUF annually as compared to the unchanged state. In 2012, four fifths of the measures relate to expenses and one fifth to incomes but from 2013 three fourths of the measures will concentrate on expenses and only one fourth on the incomes.

	2011	2012	2013	2014
TOTAL	**12**	**550**	**902**	**902**
1. EMPLOYMENT and LABOUR MARKET	**0**	**195**	**213**	**213**
2. PENSION SYSTEM REFORM	**12**	**93**	**129**	**129**
3. PUBLIC TRANSPORT	**0**	**45**	**60**	**60**
4. HIGHER EDUCATION	**0**	**12**	**38**	**38**
5. PRESCRIPTION DRUG SUBSIDY SYSTEM	**0**	**83**	**120**	**120**
6. STATE and MUNICIPAL FUNDING	**0**	**32**	**122**	**122**
7. CONTRIBUTIONS TO THE FUND ESTABLISHED TO REDUCE PUBLIC DEBT	**0**	**90**	**220**	**220**

1. Employment and labour market

Currently the number of people with a job is much less (3.8 million) than the number of the able-bodied population of the country. The administration must take out loans to finance the shortfall of tax revenues and unemployment benefits.

In Hungary the number of people who are active in the labour market is very low. The Hungarian employment rate is the second lowest in the EU, at 56-57% we are only ahead of Malta at 55% and we are well behind the 65% employment of the Czech Republic and Slovenia. Relative to the EU average of 66%, we are lagging by 10 percentage points.

The shortfall which one can notice in the employment level among the population with low educational attainment, poses a grave problem for all four Visegrád countries. Another common phenomenon is the low youth employment level. As for the 55+ population, this age group contributes substantially to the shortfall in Hungary and in Poland. The difference of women of childbearing age in Hungary is minimal.

Basically, in Hungary the inactive groups which no longer seek jobs deepen most of the unemployment anomalies. Only 1-2% of the unemployed find the way back into the labour market.

The biggest gap between the employment rate of the EU and ours lies in the number of full-time and part-time jobs available for women. In Hungary the employment rate is very low and one of the greatest shortfalls is in case of women of childbearing age.

Within the working age population, in Hungary, the number of those who receive disability pensions is extremely high. In 2007 it was more than 12% whereas it was only 6.3% in Slovakia and the EU average was even less at 5.8%.

The amount of benefits related to disability is on par with the figures of the other EU member states but it is only about half a percentage point of GDP higher than in Poland, Slovakia and the Czech Republic.

In the most developed countries of the EU, the employment rate of handicapped people is 40% while here it is 12-15%

Objective

We must improve the balance of the national budget and stimulate employment by shortening the period when unemployment benefits are paid and in this way making the unemployed more interested in finding a job as soon as possible.

We must have an economic policy which can facilitate the creation of one million new and tax-paying jobs within a decade in Hungary.

The rate of employment must be increased by engaging more and more of the working age population.

We must encourage inactive groups (those who no longer seeking a job) to re-enter the labour market.

Part of the expenditures allocated to labour market instruments which are related to active employment and vocational training must be replaced with EU funds in order to improve the balance of the budget and increase the efficiency of interventions in connection with employment.

As far as the handicapped are concerned, we have set three priorities:

- Increasing employment
- Streamlining
- Cost cutting

We must replace the nonsensical and non-transparent laws which are currently valid with a transparent, simple, comprehensible regulatory background which will define the job requirements to obtain benefits.

We must revise the social support system which has been run in a lavish and non-transparent way for years. A maximum allowance will be introduced which will be lower than the current minimum wage and will cover each type of support, from those received as inalienable rights to the many others which are financed from the central budget.

As a result of the economic growth and the changes in labour market regulation, according to our expectations, less people will receive wage supplement support and the number of the unemployed will be reduced by 100.000 in 2012, 200.000 in 2013 and 300.000 in 2014.

2. Pension system reform

Currently in Hungary the pension fund is not balanced. Every third forint paid out as pension has been financed from credits and has created a system which can no longer be maintained. The interest liabilities of the national debt which had been accumulated in this way are exhausting the resources which we receive from economic growth and which could be spent on increasing pensions.

The proportion of pension expenditures as percentage of GDP is high and has been on the rise in international comparison. The proportion of pension expenditures (old age, disability, family-related, early retirement) rose from 8.5% of GDP in 2000 to 10.9% in 2008.

The proportion of the 65+ population increased relative to the entire population in Hungary, the Visegrád countries and the EU-27 between 2000 and 2008. In Hungary this figure rose during the last 9 years from 15% in 2000 to 16.4% by 2009 and in the meantime it was always above the rate of the Visegrád countries.

According to the estimates of Eurostat, in Hungary the old age dependency rate will rise from 24.2% in 2010 to 57.6% by 2060. There have been parallel tendencies in the other Visegrád countries and in most of the EU's current member states.

Objective

The objective of the transformation of the pension system is to secure its financing. We will establish a system based on the principle of evenly shared responsibilities that will create security and calculable solidarity preserving the value of the pensions. At the same time, we will implement a standardized pension calculation mechanism.

The money of the pensioners, which will be collected from the contributions of the employed population, will only be spent on pension benefits. The pension will be an allowance that only those who have reached the retirement age will be entitled to.

We must reform the state (publicly financed) pension pillar and create a balanced pension fund in order to secure the pension benefits for everyone in the pay-as-you-go system. The calculation of pension benefits must be transparent and distinguishable between risk profiles and which will be logical as far as its coverage is concerned.

The services provided by the system and the insurance, solidarity and social elements within the individual risk profiles must be identified and, when possible, separated. The allowances which are only partly or not at all covered by an insurance policy must be gradually transformed into social benefits.

3. Public transport

Hungary enjoys considable economic advantages by having a dense transport network in comparison with Europe. Transport provides the 7-9% of the Hungarian GDP. The financing of public transport, however, is often described as a bottomless well.

In Hungary public transport has been in a crisis in most sectors as the companies have been run haphazardly and they have been carrying superfluous burdens. Therefore, their funding has been based on credits. Currently public transport services are scattered across a number of companies: MÁV (Hungarian State Railways), Volán (bus company) and BKV (Transport Company of Budapest). Their operation, which has been basically uneconomical, is weighed further down by enormous burdens and incurred losses resulting in the negative impact on public debt. In the 2011 budget Hungary allocated 430 bn HUF for public transport.

MÁV is a special case from the viewpoint of public debt, as it provides a number of social services which have not been covered by its own budget. Between 2000 and 2010 MÁV received 183 bn HUF annually from the budget. 208 bn HUF are allocated for it in the budget of 2011. By 2010, the group has accumulated debts of 289bn HUF of which 189bn HUF are covered by state grants. The entire group is made up of 24 companies. The number of employees exceeds 40 000.

The Volán group received 27bn HUF from the budget in 2011. Volán is a group of companies made up by 59 companies which also has 12 units that carry out freight forwarding and logistical tasks. Thirty six companies are responsible for scheduled local and domestic public transportation. They carry more than 3.9 million passengers on a daily basis on 77 000 vehicles. Two-thirds of the passengers can reach their places of work, another settlement or a doctor, etc., only by coach.

In 2011 BKV will receive 32bn HUF as normative support and Budapest has been requesting an extra 16bn HUF from 2011 on. The transport company owes 75bn HUF in debts to the banks. The current financial shortfall is estimated to be 25-30 bn HUF. 600-800 bn HUF of shortfall is the result of the lack of amortization compensation and its postponement. 51% of income is made up by state subsidies. Almost half of the operational costs are attributable to wage payments.

Hungary has been suffering losses because transit freight transport carried out by foreign trucks which utilize the motorway network do not pay sufficiently for it.

Objective

Such a funding system must be worked out which can secure the high-quality and efficient operation of the transport companies in the long term by the optimal utilization of budgetary resources. Parallel services between the public transport companies must be abolished by establishing a holding, the National Transport Company.

The benefit system which provides free transport for the family members of the transport employees on the basis of unalienable rights is unjustified and must be abolished. With the exception of free transport for the 65+ population, securing other benefits will be the responsibility of the new transport holding company.

We must develop environmentally friendly sectors from EU funds and increase their proportion within the transport industry.

4. Higher education

The Hungarian education system is far from meeting the actual demands set by the economy and the labour market. We have been financing an education system with significant public resources that does not serve the interests of the economy, does not create value and, as a whole, increases public debt.

At enormous cost the higher education system issues such diplomas to young people which do not help them find a job. The students who graduate in areas which would be crucial for the Hungarian labour market often leave the country and the knowledge they obtained bears fruits in another country.

Due to normative financing, the institutions of higher education were interested in maintaining or increasing the number of students which brought about the launching of unnecessary degree subjects.

In Hungary 5.1% of students in higher education study sciences while this figure in the EU is more than double at 12%. As the international comparison which analyzed the proportion of graduates with a degree in sciences or in technological studies and which was carried out among 20-29 year olds indicate, the number of such degree courses must be increased in Hungary.

As the structure of the higher education system does not fulfil the expectations of the labour market, the Hungarian government has been wasting tens of billions of HUF each year. In the private sector there is an increased demand for technological degrees, yet arts departments have been gaining ground in higher education. Applicants to higher education courses decide on their field of study without considering their future on the labour markets.

Objective

Higher education must be attuned to the needs of the economy and the labour market. The number of participants in the various courses must match the expectations of the labour market, in other words, there should be no under or oversupply in certain professions.

The disproportionate tuition and institutional system of higher education must be modernized. The efficiency of the role which the state plays must be increased by modifying the internal structure of the system which defines the number of state-sponsored students.

One of the main tasks for the government is to create the frameworks and the basic infrastructure. Another main task for the government is to act as proprietor for higher education together with municipalities and representatives of businesses and to define precisely the demand in the number of people, their field and quality of profession as well as the fields where research work is necessary.

5. Prescription drug subsidy system

In Hungary health care focuses on the illness instead of concentrating on prevention. Regarding expenditure on health care in a European comparison (EU-27: 6.9 % as of GDP) Hungary spends below the average (4.9 % of GDP) but within this system the expenditure on medicine is high (EU-27: 1.1%, Hungary: 1.4 %). The high proportion of expenditure on medicine in proportion means that the total amount spent on medicine relative to the total of health care expenditure and the curative-prevention budget is excessively high. Due to the consumption boost arising from conflicting interests of pharmaceuticals and medicine distributors and the lavish expenditures on medicine, Hungary takes on loans to cover the expenses of medicine. As a result, the government debt arising from this has to be paid back by Hungarian tax payers.

This situation, in fact, contrasts with the financing practice of European hospitals regarding the financing of several bn forint worth of medicine from pharmaceutical subsidies that generates 20% of the total medicine budget that subsidises the price of medicine and it results from the relatively high demand of patients for preventative or non-immediate therapies. The 2012 budget of the Health Care Fund counts on their being a deficit of approximately 100 bn HUF and assets of 630 bn HUF transferred from the central budget (as contributions) under unchanged conditions. It would show an increasing deficit in the forthcoming years so the long-term financing of the expenditures of the Fund could only be ensured by an increasing role played by the central budget.

Objective

The system of subsidising medicine should be transformed.

Within the medicine budget of 343.5 bn HUF in 2011 the objective is to reach a savings of 120 bn HUF within three years’ time.

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6. State and local government finance

The tax system affects the competitiveness of a country in many areas including:

- the measure of tax liability,
- the composition of tax liability,
- the efficiency of tax administration,
- the complexity of tax legislation,
- the cost of tax administration,
- the stability and computability of the tax system.

The competitiveness of the Hungarian tax system significantly declined in all of these areas over the past few years. In an analysis of the tax system of a country from the viewpoint of growth, it must be noted what proportion of the GDP public finances exhaust from the budget.

The creation of the National Tax and Customs Authority and their investigative powers created the organizational conditions for determined governmental behaviour against tax avoidance and the black economy.

The local government system is a crucial factor of the Hungarian economy. The local governments are the primary employers in education and public health. Their public services affect the employment both supply and demand directly and indirectly through long-term mechanisms. The local government system takes part of the circulation of the Hungarian economy not only with its public services and consumption, but in the last few years also as debtor. The total debt of the local governments between 2006 and 2009 doubled, increasing to 3.9% of the GDP. On average small sizes and fragmentation describes the local government system due to the large number of small independent settlement local governments. Compared with other European systems, the Hungarian local government system is one of the least concentrated systems according to the average number of inhabitants per local government. The local government system struggles with serious problems due to the lack of accord between the task structure and the resource structure, the chronic lack of resources, large territorial differences and lack of efficiency.

Objective

Hungary should tax less, but collect revenues more efficiently. It is necessary to strengthen the national tax authority and increase its efficiency in order to reduce tax avoidance and increase the efficiency of tax collection. Besides the reduction of administration it has been proposed to create a means to simplify and speed up the tax procedure, increase the efficiency of tax collection, and to encourage the law-abiding behaviour incentive scheme in order to increase tax moral.

However, decreasing tax avoidance efficiently requires legislation changes. The support of law-abiding behaviour, the reduction of administrative costs and the decrease of red-tape obstructions to law-abiding taxpayers, are aims of the tax process. It is necessity to act quickly and more efficiently and implement serious legislation against the tax avoidance or tax dodging behaviour.

The main aims of local government reform are to increase the efficiency of local governments and decrease their debt level, in other words, to create financial stability in the local government system. In addition to organizational and operational development, reducing fragmentation would have also an important role in increasing efficiency. A local government can only take out a credit if that was authorized by the Ministry for National Economy. The municipal offices of small settlements must be radically centralized.

The prohibition of unnecessary expenditures of the central institution system and the reduction of public services for the assurance of qualitative, effective and economically optimized public services must be established. We must abolish the subcontracts which are in connection with tasks carried out via the government or central administrative staff as part of the administrative bodies. We can achieve savings by modifying the public procurement's regulations.

Maintaining family supports (family allowances, maternity benefits, child-care allowances, etc.) at a nominal level can create budget savings. The desire to have a child, compared with other countries, still has a strong stimulus regardless of the tax system allowance.

7. The revenues of the Government Debt Reduction Fund

The Structural Reform Programme with its structural reforms could reduce Hungary's public debt to 65-70 % of Gross Domestic Product by the end of 2014. Restructuring the country would result in higher economic growth, increased employment, improved competitiveness and a financial balance that could be maintained in the medium term.

A budget that could be sustained for the period between 2013 and 2014 would predominantly derive from restricting the lavish nature of state expenditure. However, part of what makes the reduction of government debt possible is through decisions that bring new revenue, such as electronic tolls, and means extra revenues as compared to the budget revenues calculated so far.

The outlook chapter of the 2011 budget was calculated using only with half of tax on banks that had been introduced previously but according to the decision to reduce government debt in 2012 only the collection of the tax on banks for 2010-2013 will take place which will help reduce government debt by 90 bn HUF.

In 2010 there was a breakthrough in the tax system although, according to the original plans, by 2013 the 19% rate of corporate tax would have been abolished and the 10% rate would have become general. However, according to the political decision on Structural Reform Programme, in 2013-2014 the general rate of corporate tax will not be reduced from 19% to 10% yet the 10% tax rate up to the profit level of 500 million HUF will be kept. This will contribute to the programme of reducing government debt by 120 bn HUF.

The three items that would increase the budget revenues will be incorporated in the Government Debt Reduction Fund that is to be established on 1 January 2012, which will create extra revenues of 90 bn HUF in 2012 and 200-220 bn HUF in 2013-2014 and in both years the incoming amounts could reduce the government debt of Hungary.

IV. ADMINISTRATION CUTS

574 bn HUF: this is the amount each year enterprises spend on bookkeeping in Hungary. Using the data from 2008, this amount equals 2.17% of GDP. In Denmark the costs of 5279 reporting requirements make up 2.2% of GDP. The difference between the two figures is not only attributable to the fact that Denmark's GDP is twice as much as Hungary's.

The sum total of the costs of the 152 administrative demands (IO) which were surveyed was 608bn HUF. Extrapolating this figure and considering the aforementioned representation rate, the compound amount of administrative costs for the national economy can be put at about 800bn HUF which adds up to 3.1% of GDP. (The equivalent to the figure in the above example is 1.9% in Denmark, 1.6% in the UK and 2.3% in the Netherlands. Although these are but random examples, we can assume with great certainty that the proportion of administrative costs is significantly lower in each country which was surveyed.)

Reducing these burdens often require far-reaching reforms, the curbing of reporting requirements demanded by the administration, genuine political commitment and priorities as well as the creation of a central operational framework which regards enterprises as partners. For the authorities, which have been functioning for decades by the same internal procedures, even a tiny regulatory modification such as electronic data logging, which other authorities already have in place, can make 30-40% of the apparatus redundant in certain offices which currently handle paper-based administration.

In December 2008 Hungary joined the EU member states that publicly announced target figures and a deadline in connection with reducing administrative burdens which stem from national regulations. According to them, by 2012 costs must be cut by 25%. (The EU will likely reach the 25% target and most of the member states will similarly accomplish the goal. Belgium, for example, has already completed the Kafka Programme which delivered the 25% cut and the Netherlands has already launched its second project aimed at reducing costs by 25%.

In order to accomplish this government priority, during 2011 we will present the following predictable and transparent initiatives in three steps:

1. To devise the 'First Strike' meausures which will be quick and which will represent the government's commitment,
2. To devise an Action Plan aimed at reducing administrative costs across the board,
3. To develop the government's regulatory policy which will secure our commitment to monitoring administrative costs and the changes of these burdens.

THE ‘FIRST STRIKE’ MEAUSURES

The ’First Strike’ meausures aimed at cutting burdens in nine prioritised areas by more than 100bn HUF devised in cooperation with a wide range of entrepreneurs and which will be implemented in the first half of 2011 contains the following proposals:

- The management of complimentary reporting requirements and registries which facilitate decision-making of the government,
- The reduction of the administrative burdens related to employment and the facilitation of job creation,
- The rationalization of tax accounts and transfers,
- The revision of the frequency of returns on certain mini taxes,
- The reduction of the irritation of enterprises caused by product charges,
- The correction of the overlap of data requirements between the National Tax and Customs Office and the bodies of the social insurance system,
- The streamlining of the HACCP regulations,
- The revision of the mandatory obligations of an auditor,
- The rationalization of the mandate of authorities to control and impose fines.

GOVERNMENT ACTION PLAN

The Government Action Plan assigns the following tasks to 2011-2012:

- Defining specific legislation amendment demands for certain ministries;
- Determining principles and expectations for the development of administrative burden-cut proposals for assignments of regulatory areas;
- Setting extensive tasks for the ministries and authorities for the facilitation of the terms of legal implementation, horizontal tasks for the electronic completion of datasheets used in certain procedures, rationalization of the requirements in connection with continuing activities and improvement of information for business.

The main aim of the action plan is the simplification of the supply of data in connection with business operations. Partly examine commitment-groups, which were estimated in previous measurements but weren’t involved in the previous work, and partly to revise the regulations that weren’t involved. Possible main areas for simplification are for example the abolition of the overlaps between corporation tax and the obligations of financial reporting, the radical simplification of accounting, the modernization of environmental regulation that is responsible for creating about 180 bn HUF of administrative costs, rationalization of health regulation that generates a 24 bn HUF expenditure for entrepreneurs, the simplification of the transfers from the state in connection with funding sources and tax rebates, and reviewing the regulation for pettycash. Overall, horizontal tasks, such as the review of regulation about document preservation, the harmonization of the deadlines for the supply of data, the review of the sectorial administrative obligations particularly focusing on sectors with high employment potential and the creation of practical information surface for the areas of entrepreneurial activity across the spectrum can also serve the simplification.

- We will review every regulation that has an adverse effect on the growth of enterprises: number of employees, net income, supply of data or other legal requirement linked to earnings limit. A cutback of these can contribute to the size category change of the market players with growth potential.

- We intend to create an extremely important role for the indicators that were examined in the World Bank's Doing Business analysis, which can make procedures easier and minimize costs for enterprises including new entrants. The effect of the Stability and Growth Program will be tangible for everyone with the abolition of the formal elements of the foundation of a business (making it possible to found a business with one form and the verification of the founder's identity), the radical simplification of paying taxes for new or micro enterprises and making it possible to pay presumptive tax and decreasing administrative expenditures in connection with the persecution of a right.

- Our aim is to have a transparent regulatory environment which not only creates fair business activity but also creates the desire to continue this work among the population. Within this framework:

    - Fulfilling the 25% burden-cut obligations or achieving an even bigger burden-cut would create at least 100-150 bn forint savings for enterprises. Reducing the administrative costs by at least 300 bn HUF by decreasing of the risks of regulations and revising of the transparency would also be beneficial.

    - Increasing the satisfaction of the players: by 2013 no regulation requiring the supply of data or business operations can be enacted, which causes new information supply requirements for an enterprise only because of its growth. However, during the simplification of the regulation we have to emphasize not only the growth of small businesses, but also expanding medium businesses. Any additional administration costs should not significantly impact the business profits.

    - The regulation should help the operation and the recourses of the enterprises should not focus on the adaptation but reducing the risks which make the enterprise diverge from optimal behavior, administration of the business, and weaken its fiduciary relationship to the state.

    - The administrative burden level per employee should be decreased by the end of 2012 for micro and small enterprises from the current 18 times higher than large companies to 6 times , then by 2020 to only 4 times higher. (In the EU the administrative burden level per employee is 1 euro for big companies, 4 euros for medium enterprises, and about 10 euros for small enterprises. These rates in Hungary are higher: for the small enterprises it can be 18 times higher.)

- By 2012, there should not be any obligation for micro enterprises to require an outside expert due to any administrative instrument except a computer due to risks or regulatory red tape.

THE FRAMEWORK OF THE SYSTEMATIC ADMINISTRATIVE BURDEN CUT

The third step of the initiatives to reduce the administrative burden and the determination of the framework for the systematic burden reduction contains the following:

- Creating the methodology and a practical guide for public administration which makes it possible to measure the administrative burden of draft legislation;
- Preparation of a decision-making and monitoring system which prevents net administrative burden growth;
- Organizational recommendations for regulatory, law-enforcement processes with preliminary risk analysis arising from the law enforcer;
- development of information platforms, communication of the results, change and computability management;
- Creation of an organizational system which makes possible the monitoring of fulfillment and the quality assurance.

The opportunities, which were collected from entrepreneurs' proposals and the best practices of successful burden-cutting countries, complement and support Action Plan. Most of these are propositions that aim at forming the operating approach of the government and agencies. These propositions are in connection with the Small Business Act of the EU are attached to commission proposals made for improving certain directives' efficiency. These areprimarily:

- The enhancement of the payment discipline of the state and the financial security of enterprises;
- The creation of a system of annual legislation changes and the date of their enactment;
- The preliminary calculation of the administrative burden of draft legislation and the prevention of the national economy's burden-level (net) growth;
- The creation of external and internal cooperation in connection with the administrative burden-cut.

These steps will likely improve business climate and they will create the base for growth and employment. We do not calculate with direct savings in the budget.

Appendix I.

The Action Plan of the Structural Reform Programme

1. As soon as the amendment enters into effect, the holiday time for ministers will be reduced from forty to twenty days per year.

2. From 1 April 2011 the Ministry of National Resources and the Ministry for National Economy will conduct consultations with the relevant parties about a new, more efficient funding system for prescription drugs.

3. By 1 July 2011 the Ministry for National Development and the Ministry of Interior will work out the details of the regulation which will facilitate the freezing of utility costs.

4. By 1 July 2011 the Parliament will have voted on the new public procurement law.

5. National Employment Programme, 1 July 2011

6. By 1 July we will have completed the very work-intesive, new roadmap about public employment and the new Acts which will serve as the framework for the public employment system and which will be jointly worked out by the Ministry of the Interior, the Ministry for National Economy and the Ministry of Rural Development.

7. By 1 July 2011 those Acts and institutions will have been established by the coordination of the Ministry of National Resources which will constitute the base of the new certification and registry system about disabled persons.

8. By 1 July together with the relevant departments, the Ministry of National Resources will have revised the system of early retirement schemes and they will propose amendments in this regard.

9. By 1 july 2011 the Ministry of Justice and Public Administration together with the Ministry of the Interior, the Ministry of Defence and the Ministry of National Resources will have worked out the new career models for public sector employees.

10. By 1 July the Ministry of National Resources and the Ministry for National Economy will have revised the regulations on sick pay transfers and will make proposals for amendments.

11. By 1 July 2011 the Ministry of National Resources and the Ministry for National Economy will have worked out the Acts which will be necessary for the operation of the new prescription drug subsidy system.

12. By 1 July 2011 the Ministry of Justice and Public Administration will have examined whether the current criminal justice regulation is sufficient enough to prevent sick pay fraud.

13. By September 2011 we will have voted upon the new Acts which regulate public and higher education.

14. New Labour Code, September 2011

15. By 31 December 2011 we will have worked out those Acts which are necessary for the operation of the new pension system.

16. By 31 December 2011 the Ministry for National Economy will have implemented those further measures which will result in a further reduction in the tax liabilities of enterprises.

17. By 31 December the Ministry for National Development will have completed the plan aimed at the debt restructuring and reorganization of the MÁV.

18. By 31 December 2011 the Ministry of Justice and Public Administration will have worked out those Acts which will reduce the burdens of the enterprises by making foreclosure and liquidation procedures faster and more transparent.

19. By 1 January 2012 we will have revised the former classifications in the framework of the new, transparent system for the certification and registry of disabled persons in a fair and systematic way.

20. By 1 January 2012 the National Transport Holding Company will be established and the structural consolidation of public transport will begin.

21. By 1 January we will have launched the new system of public employment.

22. On 1 January the new, sustainable pension system will be launched.

23. The amount of political parties' nominal funding will be frozen at the level of 2011.

24. As soon as the new Institution enters into force, we will implement a system aimed at tax reduction.

25. On 1 September 2012 the new Act on public education will enter into force.

26. From 1 September 2012 the new system of higher eduction will be launched.

27. On 1 January 2013 the new electronic toll system which will be based on road utilization will be launched.

28. From 2014 we will vote a 200-strong National Assembly.

Appendix II.

Legislation Programme 2011-2014

Acts to be amended
1. **Act XCVIII of 2006** on the General Provisions Relating to the Reliable and Economically Feasible Supply of Medicinal Products and Medical Aids and on the Distribution of Medicinal Products
2. **Act CLXXXIII of 2005** on Railway Transport
3. **Act I of 1988** on Public Road Transport
4. **Act III of 1993** on Social Governance and Social Benefits
5. **Act LXXXIV of 1998** on Family Support
6. **Act XXXI of 1997** on the Protection of Children and Guardianship Administration
7. **Act LXIII of 1992** on the Protection of Personal Data and the Disclosure of Information of Public Interest
8. **Act CLXIX of 2010** on the 2011 Budget of the Republic of Hungary
9. **Act LXV of 1990** on Local Self-Governments
10. **Act XX of 1949** The Constitution of the Republic of Hungary
11. **Act CXXVI of 2010** on Metropolitan and County-level Government Offices and Legislative Amendments Pertaining to the Establishment of Metropolitan and County-level Government Offices and to Territorial Integration
12. **Act L of 2010** on Election of Local Municipal Government Representatives and Mayors
13. **Act LXIV of 1994** on the Election of Mayors and the Fees of Local Municipal Government Representatives
14. **Act XXXI of 1997** on the Protection of Children and Guardianship Administration

15. **Act LXXIX of 1993** on Public Education
16. **Act CLIV of 1997** on Health
17. **Act CXXI of 2006** on the Development of the Health Care System
18. **Act LXV of 1990** on Local Self-Governments
19. **Act CXXXIX of 2005** on Higher Education
20. **Act IV of 1991** on Job Assistance and Unemployment Benefits
21. **Act LXXXVI of 2003** on Vocational Training Contributions and Assistance for the Improvement of Vocational Training Programs
22. **Act CI of 2001** on Adult Education
23. **Act LXXXI of 1997** on Social Security Pension Benefits,
24. **Act XLIII of 1996** on the Service of Professional Members of the Armed Forces
25. **Act XCV of 2001** on the Legal Status of Career and Contractual Soldiers of the Hungarian Armed Forces
26. **Act LXXXIII of 1997** on the Services of the Compulsory Health Insurance System
27. **Act LXXXIV of 1998** on Family Support

1. **Government Decree 223/1998 (XII. 30.)** on the Implementation of Act LXXXIV of 1998 on Family Support
2. **Government Decree 149/1997 (IX. 10.)** on Orphans' Court Divisions and the Protection of Children and Guardianship Administration
3. **Government Decree 217/1997 (XII. 1.)** Korm. on the Implementation of Act LXXXIII of 1997 on the Services of the Compulsory Health Insurance System
4. **Government Decree 86/2006 (IV. 12.)** on the Student Loan Scheme and the Student Loan Centre
5. **Government Decree 51/2007 (III. 26.)** on Allocations to Students in Higher Education and Payments to be Made by them
6. **Government Decree 168/1997 (X. 6.)** on implementation of Act LXXXI of 1997 on Social Security Pension Benefits
7. **Government Decree 181/1996 (XII. 6.)** on Pension Benefits with Age Allowance
8. **Government Decree 283/2009 (XII. 11.)** on the Prolongation of Pension Benefits with

Age Allowance
9. **Council of Ministers Decree 83/1987 (XII. 27.)** on Disability Annuities
10. **Government Decree 387/2007 (XII. 23.)** on the Social Annuities of Disabled Persons
11. **Government Decree 23/1991 (II. 9.)** on the Social Security Allowances of Miners

1. Decree of the Minister of Health, Social and Family Affairs **32/2004 (IV.26.)** on the Criteria for Inclusion of Registered Pharmaceuticals and Foods Satisfying Particular Dietary Requirements into Social Insurance Coverage, and on Altering Coverage or Reimbursement Status.

Acts and Decrees to be amended
1. **Act CXVII of 1995** on Personal Income Tax
2. **Act LXXXII of 1991** on the Motor Vehicle Tax
3. **Act C of 1990** on Local Taxes
4. **Act I of 1988** on Public Road Transport
5. **Act CXXVII of 2007** on Value Added Tax
6**. Act CXXVII of 2003** on Excise Taxes and Special Regulations on the Distribution of Excise Goods
7. **Act CLXXXV of 2010** on Media Services and Mass Media
8. **Act CLXIX of 2010** on the 2011 Budget of the Republic of Hungary
9. **Act LIX of 2006** on the Introduction of Special Tax and Bankers' contribution Intended to Improve the Balance of Public Finances
10. **Act XCIV of 2010** on Special Taxes on Certain Sectors
11. **Act LX of 2003** on Insurance Institutions and the Insurance Business
12. **Act LXII of 2009** on Insurance Against Civil Liability Regarding the Use of Motor Vehicles BUT: It would be justified to incorporate the accident insurance fee in to separate Act (as the extra taxes are included in the Act XCIV of 2010 about the extra taxes levied on certain sectors.)
13. **Act XCII of 2003** on the Rules of Taxation

14. **Act XCIII of 1990** on Duties
15. **Act IV of 1978** on the Criminal Code
16.**Act XLIX of 1991** on Bankruptcy Proceedings, Liquidation Proceedings
17. **Act V of 2006** on Public Company Information, Company Registration and Winding-up Proceedings

1. Government Decree **273/2010 (XII. 9.)** on the Organisational Structure of the National Tax and Customs Authority
2. Government Decree **122/1997 (VII. 17.)** on the Collection of Device Operational Fees

1. Decree of the Ministry of Economy and Transport **36/2007 (III. 26.)** on the Motorways, Motor Roads and Other Main Roads Usage
2. Decree of the Ministry of Economy and Transport **37/2007 (III. 26.)** on the Tolls for Motorways, Motor Roads and Other Main Roads
3. Decree of the Ministry of Economy and Transport **47/2007 (IV. 17.)** on Electronic Toll Systems on Domestic Public Roads
4. Decree of the Ministry of Finance **40/2006 (XII. 25)** on the Filing, Tariff, Setting and Accounting of Duties

Total (revenues – expenditures): **42 Acts**

13 Goverment Decrees

5 Ministerial Decrees