Hungary

1. Economic situation

Hungary has faced considerable challenges to regain fiscal credibility. After almost a decade of persistent, high fiscal deficits and the building up of external imbalances, the financial turmoil in late 2008 forced Hungary to request financial help from the IMF and the EU (Figure 1B).

Real GDP plunged in 2008 and 2009 (Figure 1A), but economic growth resumed in 2010 fuelled by robust external demand. The authorities expected GDP to grow 1.6% in 2010, further picking up to 3.0% in 2011 and 3.5% and in 2012. However, declining revenues and debt burdens still weigh on public finances (Figure 1C).

Figure 1. **Key economic indicators**

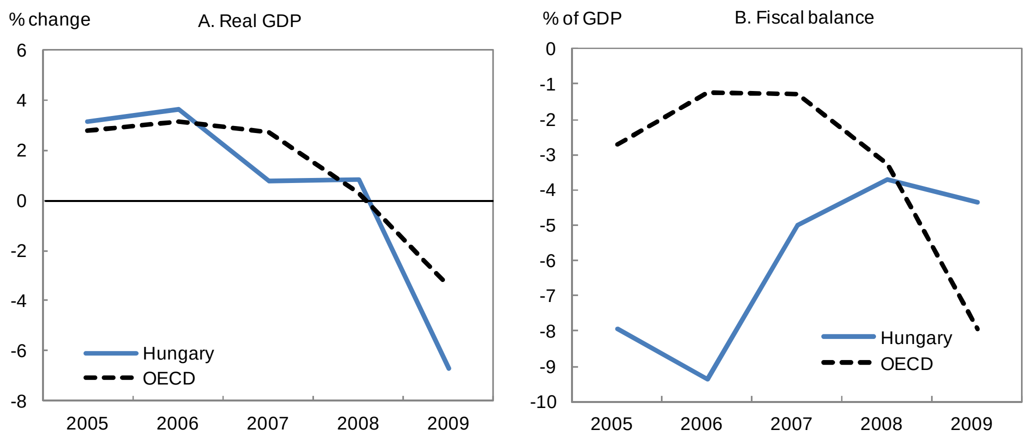
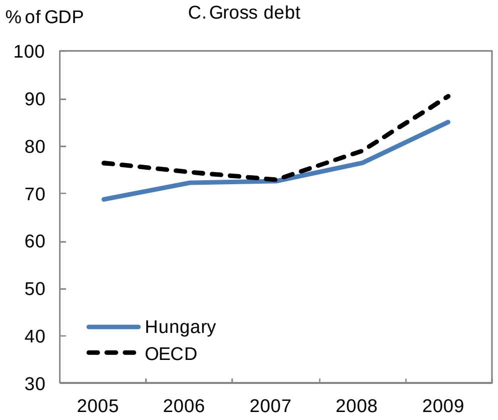


Figure 1. **Key economic indicators** *(cont'd)*



Note: Fiscal balance and gross debt are general government financial balance and gross financial liabilities as a per cent of nominal GDP.

Source: OECD (2010), "OECD Economic Outlook No. 88", *OECD Economic Outlook: Statistics and Projections* (database), doi: 10.1787/data-00533-en.

2. The government's fiscal strategy

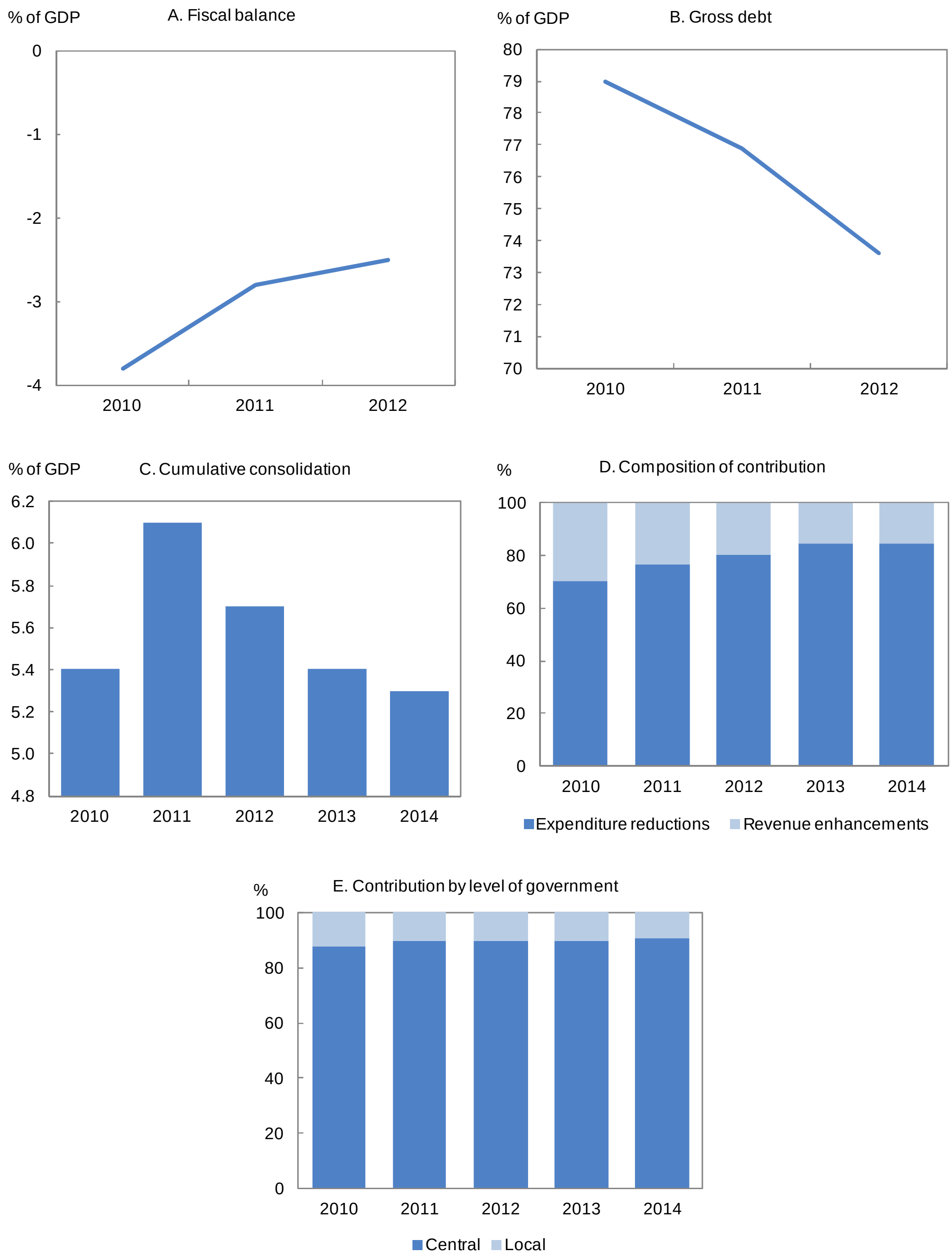
The economic crisis forced Hungary to adopt an early and front-loaded consolidation. The great majority of planned consolidation measures over the medium term was therefore either decided or already adopted in 2009. A fiscal deficit of 3.8 % of GDP was foreseen in 2010 by the authorities. Hungary is committed to reduce the deficit to 3% of GDP in 2011. The new government, which took office in June 2010, has let the IMF/EU-led support programme lapse.

Key features of the consolidation plan are rescheduling the tax burden from labour to consumption in 2010, notably by a significant cut in personal income tax rates from 2011. In order to achieve a deficit target below 3% in 2011 and lower future debt ratios, the government has introduced levies on financial institutions and adopted temporary sector taxes, the nationalisation of private pension contributions into the budget and reformed the pension scheme to lead more employees into the state pension pillar. In addition, a significant simplification of the taxation system itself is envisaged. In 2011 central government institutions' wage bill and operational expenditures will be decreased again by HUF 70 billion.

The government cuts taxes for growth promotion. It especially focused on small and medium-sized enterprises (SME) which are considered to be the source of job creation. The guarantee and interest rate subsidies for SMEs have been broadened significantly. Another main direction is to lower the number of taxes (those that bring a relatively small amount of revenues at high operational costs).

Over the medium term through 2014, continued consolidation peaking of 6% of GDP in 2011, decreasing to 5.3% of GDP in 2014 is envisaged, most of which will be based on expenditure reductions (Figure 2C and 2D). The consolidation plan gradually improves the fiscal balances and is set to put the debt to GDP ratio on a downward path (Figure 2A and 2B). The central government budget will stand for the bulk of the consolidation over the five-year period, with a contribution of almost 90% (Figure 2E).

Figure 2. **The government's planned fiscal adjustments**



Notes: Fiscal balance and gross debt are general government financial balance and gross financial liabilities on a Maastricht basis as a per cent of nominal GDP. Fiscal consolidation is cumulative consolidation as a per cent of GDP. The composition of the contribution to fiscal consolidation is expenditure reductions and revenue enhancements (total = 100%). OECD calculations.

Source: "OECD Fiscal Consolidation Survey 2010".

3. Major fiscal consolidation measures

The government has presented a detailed consolidation programme for 2010-14. In the first part of the period, structural reforms will have a greater weight in the expenditure reduction package underlying the budget. Operational measures are substantial (1.3% of GDP in 2010), e.g. the freezing of public wages and reducing public consumption, but programme measures contribute more over the period, in particular the decision to *de facto* nationalise the mandatory private pension pillar leading to additional revenues for the state pillar (around 1.4% of GDP in 2014). On the revenue side, the VAT increase (1.4% of GDP in 2011) contributes significantly as does a new banking tax (0.7% of GDP per year in 2010 and 2011) and temporary taxes on energy, telecoms and commercial chain companies in 2010 and 2011 (0.6% of GDP per year in 2010 and 2011).

Table 1. **Major consolidation measures**[1]

Billions HUF (% of GDP[2])

		2010	2011	2012	2013	2014
Expenditure		**(4.06)**	**(5.19)**	**(5.08)**	**(5.31)**	**(5.40)**
1. Operational measures		339.5 (1.27)	324.7 (1.16)	324.7 (1.09)	324.7 (1.04)	324.7 (1.00)
– Public consumption	Freezing ministries budgets	60.0 (0.22)	60.0 (0.21)	60.0 (0.20)	60.0 (0.19)	60.0 (0.19)
– Wages	Improving Labour Market Fund balance	23.0 (0.09)	23.0 (0.08)	23.0 (0.08)	23.0 (0.07)	23.0 (0.07)
	Freezing gross wage bill and reducing earning compensation in the public sector	129.0 (0.48)	129.0 (0.46)	129.0 (0.43)	129.0 (0.41)	129.0 (0.40)
	Stopping all bonuses, review of contracts and procurements and abolishing bonuses and wage compensations for low earners	19.0 (0.07)	72.2 (0.26)	72.2 (0.24)	72.2 (0.23)	72.2 (0.22)
– Public consumption	Freezing budgets, carryover withdrawal, asset management and budgetary savings	108.5 (0.41)	40.5 (0.14)	40.5 (0.14)	40.5 (0.13)	40.5 (0.13)
2. Programme measures		747 (2.79)	1 127 (4.03)	1 187 (3.99)	1 331 (4.27)	1 425 (4.40)
– Housing	Elimination of housing subsidy	52.0 (0.19)	70.0 (0.25)	81.4 (0.27)	98.2 (0.31)	106.9 (0.33)
– Agriculture	Reduction of farm subsidies	37.0 (0.14)	37.0 (0.13)	37.0 (0.12)	37.0 (0.12)	37.0 (0.11)
– Energy	Reduction of natural gas and heating benefits	40.0 (0.15)	40.0 (0.14)	40.0 (0.13)	40.0 (0.13)	40.0 (0.12)
	Elimination of natural gas and distance heating compensation in 2010	19.0 (0.07)	25.0 (0.09)	25.0 (0.08)	25.0 (0.08)	25.0 (0.08)
– Health care	Reduction of healthcare expenditure	30.0 (0.11)	30.0 (0.11)	30.0 (0.10)	30.0 (0.10)	30.0 (0.09)
	Decrease in sick pay by 10 percentage points	16.0 (0.06)	17.0 (0.06)	18.1 (0.06)	19.7 (0.06)	21.4 (0.07)
– Pensions	Cancellation of 2010 pension correction	40.0 (0.15)	41.0 (0.15)	42.3 (0.14)	43.8 (0.14)	45.4 (0.14)
	Change in pension indexation system	76.0 (0.28)	91.0 (0.33)	99.9 (0.39)	171.6 (0.55)	209.6 (0.65)
	Elimination of 13th pension	170.0 (0.64)	175.0 (0.63)	180.8 (0.61)	186.9 (0.60)	193.6 (0.60)
	Tightening disability pension, freezing pension minimum, early retirement changes	34.0 (0.13)	51.0 (0.18)	51.3 (0.17)	51.6 (0.17)	52.0 (0.16)
	Private pension pillar into the state	62.1 (0.23)	360.0 (1.29)	384.2 (1.29)	417.0 (1.34)	452.9 (1.40)

Table 1. **Major consolidation measures**[1] *(cont'd)*

Billions HUF (% of GDP[2])

		2010	2011	2012	2013	2014
– Child and family benefits	Child-care fee, maternity aid from 3 months to 2 years of age and family allowance from 23 months to 20 years of age	3.0 (0.01)	12.0 (0.04)	18.6 (0.06)	32.0 (0.10)	33.0 (0.10)
	Elimination/freezing family allowance	29.0 (0.11)	32.0 (0.11)	32.0 (0.11)	32.0 (0.10)	32.0 (0.10)
– Transport	Reduction of subsidy to MÁV Start	17.6 (0.07)	17.6 (0.06)	17.6 (0.06)	17.6 (0.06)	17.6 (0.05)
– Local government	Reduction of local government subsidies and representatives in local governments	121.4 (0.45)	128.4 (0.46)	128.4 (0.43)	128.4 (0.41)	128.4 (0.40)
Revenues		**1 171 (4.38)**	**1 229 (4.40**	**1 202 (4.04)**	**1 203 (3.86)**	**1 290 (3.98)**
– Health	Health care contribution increases from 11% to 27%	18.0 (0.07)	18.8 (0.07)	20.1 (0.07)	21.8 (0.07)	23.7 (0.07)
	Increase of rehabilitation contribution (five times higher)	35.0 (0.13)	36.6 (0.13)	39.1 (0.13)	42.4 (0.14)	46.0 (0.14)
– Personal income	Some tax-free benefits become taxable	110.0 (0.41)	115.0 (0.41)	122.8 (0.41)	133.2 (0.43)	144.7 (0.45)
– Capital taxes	Broadening the corporate income tax base	65.0 (0.24)	69.2 (0.25)	74.5 (0.25)	80.7 (0.26)	87.5 (0.27)
	Eliminating tax reduction on intra-group interest difference	25.0 (0.09)	26.6 (0.10)	28.7 (0.10)	31.0 (0.10)	33.7 (0.10)
	Increasing the corporate income tax rate to 19%, from 2010	97.0 (0.36)	103.2 (0.37)	111.2 (0.37)	120.4 (0.39)	130.6 (0.40)
	Increasing the tax rate of the simplified business tax from 25% to 30%	18.0 (0.07)	19.2 (0.07)	20.6 (0.07)	22.3 (0.07)	24.2 (0.07)
	Banking tax	187.0 (0.70)	187.0 (0.67)	93.5 (0.31)	93.5 (0.30)	93.5 (0.29)
	Energy company income tax	70.0 (0.26)	70.0 (0.25)			
	Telecom company income tax	61.0 (0.23)	61.0 (0.22)	166.0 (0.56)	85.5 (0.27)	86.5 (0.27)
	Commercial chain income tax	30.0 (0.11)	30.0 (0.11)			
– VAT	As from 1 July 2009, the general VAT rate increased by 5 percentage points	358.0 (1.34)	385.7 (1.38)	411.3 (1.38)	447.6 (1.44)	484.7 (1.50)
	Excises increased from 1 July 2009	40.0 (0.15)	43.1 (0.15)	46.0 (0.15)	50.0 (0.16)	54.2 (0.17)
	Excises increased from 1 January 2010	48.0 (0.18)	51.7 (0.18)	55.1 (0.19)	60.0 (0.19)	65.0 (0.20)
– Wealth	Tax on wealth	1.7 (0.01)	3.5 (0.01)	3.8 (0.01)	4.1 (0.01)	4.4 (0.01)
	Increase of the taxes on cars	8.0 (0.03)	8.6 (0.03)	9.2 (0.03)	10.0 (0.03)	10.8 (0.03)

1. Tax reliefs and new spending items are not included.

2. OECD calculations using OECD forecasts of nominal GDP for 2010-15.

Source: "OECD Fiscal Consolidation Survey 2010".

Pension reform

According to the authorities, long-term sustainability has been improved by recent pension reforms. However a new measure will be adopted to lower the retirement age for women who have at least 40 years of working experience. Other pension measures are described in Section 2 and 3.

4. Institutional reforms

Hungary has introduced a Fiscal Responsibility Law, which sets a new fiscal rule for the central government and establishes a new independent fiscal institution (the Fiscal Council) to assess the government's fiscal policies. The new fiscal rule entered into force in January 2010. From 2011, the Fiscal Council, as set up in the Fiscal Responsibility Law and assisted by a technical staff of about 40, is closed and replaced by a new council with three members. The new Fiscal Council may recommend that the President of the republic refers the law establishing the budget of the republic of Hungary to the parliament for reconsideration.

The Fiscal Responsibility Law introduces the so-called real debt rule, which requires that the medium-term budget balance must be specified for two years in advance ensuring the real value of government debt does not increase. It entails a simplification of the former classification of some general government sub-sectors. From 2010 onwards, social security funds and other extra-budgetary funds are presented in aggregate together with the central government budget. The new budgetary structure differentiates between mandatory and discretionary expenditure.

Table 2. **The government's fiscal consolidation plan**

% of GDP

Fiscal consolidation	2010	2011	2012	2013	2014
Consolidation volume (cumulative)	5.4%	6.1%	5.7%	5.4%	5.3%
Total deficit(-)/ surplus(+)	-3.8%	-2.8%	-2.5%		
Total level of debt	79.0%	76.9%	73.6%		
Fiscal consolidation by expenditure reductions and revenue enhancements (total = 100%)					
Expenditure reductions	70.4%	76.8%	80.0%	84.3%	84.4%
Revenue enhancements	29.6%	23.2%	20.0%	15.7%	15.6%
Contribution to fiscal consolidation by levels of government (total = 100%)					
Central	87.8%	89.5%	89.5%	89.9%	90.5%
Regional					
Local	12.2%	10.5%	10.5%	10.1%	9.5%

Source: "OECD Fiscal Consolidation Survey 2010".