MINISTRY FOR
NATIONAL ECONOMY

REPORT ON THE MEASURES TAKEN IN RESPONSE TO COUNCIL RECOMMENDATION OF 7 JULY 2009 UNDER ARTICLE 126(7) OF THE TREATY

JULY 2011

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1. Introduction

In terms of the Council recommendation to Hungary with a view to bringing an end to the situation of an excessive government deficit, the Hungarian authorities submit a report twice a year to the Council and the European Commission. So far there have been 7 reports submitted, presenting the progress of the measures taken to correct the excessive deficit including the steps taken in the field of structural reforms.

The Council's recommendation set the deadline for the correction of the excessive deficit to 2011. Since following the pension reform 97% of the former private pension fund members returned to the state pension pillar, the transfer of their assets accumulated in the private pension funds results in a surplus in the general government balance in 2011.

The Government is committed to correcting the excessive deficit in a sustainable manner. In this context it announced a structural reform programme (the Széll Kálmán Plan) principally aimed at a growth-friendly transformation of public expenditures. In order to minimise implementation risks, the programme is accompanied by a codification schedule setting exact deadlines. The schedule presented in the Széll Kálmán Plan defined measures for the first half of 2011 related to employment and labour market, pension system, healthcare (pharmaceutical subsidies) as well as public and local government financing.

The goal of the interim report is to present

- the decisions and legislation in the fields defined by the Széll Kálmán Plan since the submission of the Convergence Programme in mid-April,
- the progress in additional measures presented in the Convergence Programme aimed at improving the balance and
- the Home Protection Action Plan aiming at easing the burden on households with mortgages in foreign currencies in order to reduce financial stability risks.

The measures scheduled for the second half of 2011 and later, as well as the further steps underpinning the deficit path set in the Convergence Programme will be presented in the next report to be prepared after submitting the 2012 Budget Bill to Parliament.

The Government discussed the Report on 25 July 2011, which was subsequently submitted to the European Commission and the Council.

2. MEASURES OF THE SZÉLL KÁLMÁN PLAN

EMPLOYMENT AND LABOUR MARKET

The Parliament adopted the act on public employment and on the amendment of acts related to public employment and other acts, including the modifications of unemployment benefits and certain social benefits.

STRICTER CONDITIONS FOR JOB SEARCH ALLOWANCE

As a result of the amendment, the eligibility period for the job search allowance and the granting period and size of the job search allowance are changed. The regulation retains the insurance-type characteristics of the benefit, i.e. the eligibility to the job search allowance and the granting period of the job search allowance continue to be dependent on the eligibility time acquired during a certain time period preceding the start of searching for a job. The upper limit of the granting period, however, decreases from the former 270 days to 90 days. For a granting time of 1 day, 10 days of eligibility time is required instead of the former 5 days. The upper limit of the amount of the allowance is reduced from 120 percent of the level of the lowest mandatory wage to the actual level of the lowest mandatory wage.

TERMINATION OF JOB SEARCH BENEFIT

As a result of the amendment, the job search benefit of those having already depleted the job search allowance, as well as the job search benefit of those having an eligibility time not reaching the minimum eligibility level of the job search allowance cease to exist. In the future, only those having become unemployed in the five year period preceding the reach of the old-age pension age limit will be eligible to such an allowance, since this is the age where it is generally very difficult for people to find jobs in the labour market.

PUBLIC WORK SCHEME

Participants in the public work schemes have insured legal status, with eligibility for benefits, and taxes and contributions paid similar to other forms of employment. Public work schemes may be organised for public projects, and in accordance with this, organisations performing public projects may become public employers. Public employees shall be over 16 of age. The status of participants in public work schemes differs nonetheless from other forms of employment in some aspects (additional obligations burdening the employer, special features of establishing and terminating the legal status, different wages). Participants receive public employment wages, the level of which is defined by a government decree.

The new regulation reduces labour costs associated with public employment by a nominal 30%, compared to the wages so far related to the minimum wage level.

Transformation of the wage substitute benefit

The wage substitute benefit ceases to exist and is replaced by the employment substitute benefit. The eligibility conditions for the benefit do not change fundamentally. The employment substitute benefit is eligible for economically active persons with working capacities, unable to get temporary job in the public work schemes. In case of a rejection of participating in a public work scheme without any justifiable reason, the employment substitute benefit is terminated.

Maximisation of social and family support transfers available under several titles

In order to ensuring that the amount of subsidies available in the social benefit system does not create disincentives for working, an upper limit of 90% of the public employment wage level is defined for the total sum of financial benefits (employment substitute benefit replacing the wage substitute benefit and regular social allowance) available to families with unemployed persons in their active ages without the income necessary for the bare living. There are two types of limits. On one hand, an upper limit for the case when the family only has persons receiving regular social allowance, on the other hand, for the case when the family has persons eligible for regular social allowance and employment substitute benefit as well. In this case, it is reasonable to consider the total sum of the two benefits when defining the maximum for the amount of benefits available for a single family.

The regulation for regular social allowance is modified in several aspects due to the reform of the allowance system of economically active persons and the introduction conditions in case of benefits. Local governments can define in resolutions – in line with the principle of benefits subject to conditions – the rules for persons receiving regular social allowance related to ensuring order in their environment.

Due to the rise of the retirement age, the limit for the eligibility for regular social allowance will be altered from the age of 55 to 5 years prior to the retirement age relevant for the individual. In this context persons above 55 are considered as employable, creating better conditions for their reintegration to the labour market.

Financing of active labour market policies and vocational trainings from EU funds

The replacement of expenditures planned by the Labour Market Fund for 2012 with EU funds is possible under the scope of the SROP 1., 2., 5., the SIOP 1., 3., and the EDOP 2., 3. priorities.

Transformation of the sick pay benefit system

As of 1 May 2011, the upper limit of sick pay benefit was reduced from four times the minimum wage to twice the minimum wage.

The possibility for the so-called passive sick pay benefit available for 30 days, after the termination of the insured legal status in case of (extant) inability to work (or beginning till the third day from the termination), ceased to exist from 1 July 2011.

FIXING THE NOMINAL LEVEL OF FAMILY ALLOWANCE

The regulations for family allowance are included in the act on family subsidies, that does not include any rules for raising the level of subsidies.

THE PENSION SYSTEM

The changes were enabled by the amendment of the Constitution, stating that any pension granted before reaching the retirement age may be reduced and transformed into a social benefit according to the provisions of the law, or even terminated in case of the ability to work.

REVIEW OF DISABILITY PENSIONS, REFORM OF BENEFITS

The concept of reviewing the disability pension system was discussed by the Government.

According to the review, the range of persons suggested for consideration regarding rehabilitation in 2012 includes persons reaching the relevant retirement age in more than five years, with health impairment levels between 40-69% according to the current qualification system. Their number is, based on January 2011 data, 220 thousand. Out of this, there are 111 thousand so-called Group III disability pensioners, 84 thousand persons receive regular social allowance, and 25 thousand persons receive rehabilitation benefits. Following the complex review of the involved range of people, an estimated number of 120 thousand persons are recommended for employment or employment rehabilitation.

REVIEW AND REFORM OF EARLY RETIREMENT SCHEMES

The Government decided, in order to establish the balance of the pension system, to eliminate the legal titles providing the possibility of retirement before reaching the retirement age, providing the opportunity for establishing a clean system. The development of the details of the reform is under progress, a final decision is expected in the second half of the year.

HEALTHCARE (PHARMACEUTICAL SUBSIDY SYSTEM)

The Parliament adopted the bill on the amendment of the different acts on healthcare, including the following changes enacted in 2011:

MEASURES RELATED TO REVENUES:

- The payment obligation of pharmaceutical manufacturers increased from 12% of the National Security subsidy as per the producer's price according to their subsidised turnover to 20% from the 1st of July 2011.
- In order to repress the marketing activity, the amount of the medical representatives' annual fee increases from the former HUF 5 million to HUF 10 million from 1 July 2011.

Further measures affecting the year 2011 (the decree is under public administration negotiations):

- Renewing expired support volume contracts with an appr. 10% lower limit may help containing expenditures on pharmaceutical subsidies, which is translated into an increase of the manufacturer's payments.

MEASURES RELATED TO EXPENDITURES:

- Generic programme, preferred reference price band system, generic incentive.
  Following the entry of generic products to the market, the reference product established after fixing does not currently achieve any market advantages. It is necessary to establish a system that would make, beyond the patients, the other players of the market also interested in the reinforcement of the status of the reference product. The system establishes a preferred situation for the reference medicine as well as the medicines with up to 5% (fixed group based on the identical active agent) or 10% (fixed group based on therapeutic similarity) higher daily therapy costs and any medicines cheaper than this. From 1 July 2011, only medicines included in the preferred reference band, out of those containing active agents receiving fixed amounts of subsidy, may be ordered for patients eligible for public healthcare.
- In the coming years, the patents of several large-volume products will expire, therefore the inclusion of the generic products may result in substantial savings. It is of utmost importance that this affects the distinguished 100% subsidy category requiring indication at several points.
- Emergence of first generics
  The generic product entering the market after the expiry of the patent shall be converted into a reference product after 3 months instead of 6 months.
- Revision of certain fields of therapy
  Beyond the establishment of financing protocols with the widest possible scope, a revision of the amount of subsidies is necessary in certain fields. The goal is to have financing protocols prepared in all fields.
- Therapeutic outcome oriented financing
  For high-value therapies, the state/insurer provides subsidy based on, instead of results achieved in clinical experiments, real results for the given group of patients; if these lack, the manufacturer shall reimburse.
- Revision of combination products
  Based on the regulations in effect since 1 January 2011, the subsidy of products containing more active agents is fixed to the subsidy of mono-components.
- Revision of subsidies of cholesterol-level reducers

The detailed preparation of the measures suggested for the year 2012 is expected to take place in September 2011, based on the decision of the Government, and that of the measures for 2013 is expected in September 2012. The suggested changes for the subsidy policies are the following:

- New regulations to pharmaceuticals available in the framework special pharmaceutical public subsidy system.
- Subsidy system for bio-similar products. Although for biotechnologically manufactured protein-based products it is not recommended to use subsidising methods identical to chemicals (active agent-based and partially therapy-based fixing), it is necessary to make use of the lower price of bio-similar products.
- Improvement of patient cooperation. Currently, medicines are not able to provide the required success rate in many cases due to the inadequate patient cooperation in the field of chronic diseases. It is suggested that subsidy rules take also into account patient cooperation, in certain groups of diseases.
- Reclassification (change of financing method), reclassification of certain products to hospital financing. The financing of certain high-value (e.g. oncological) products by effective public procurement methods monitored via hospitals according to traced workflows may result in substantial savings.
- Overhaul of the principles applied for equity consideration in individual cases.

PUBLIC AND LOCAL GOVERNMENT FINANCING

A NEW PUBLIC PROCUREMENT ACT

The Parliament adopted the new public procurement act.

The complicated detailed rules of the former public procurement act were unable to manage the procurement process adequately. The hardly applicable legal environment had a negative effect on the participants of public procurement procedures. The new structure and clear rules of the new act allow for easier use of the legal regulation. Some of the most important novelties of the act as compared to the former regulation:

- One of the main goals was to establish a transparent structure. The act includes the rules to be followed in all procedure types in the form of general provisions instead of defining them in the rules of each type of procedure.
- By means of its transparency, it serves the fundamental goals of public procurement better: to ensure transparency of spending public money and fairness of competition. The act contains numerous provisions aimed at reducing abuse and corruption, and the clearer regulations for each procedure type help in achieving easier application and predictability of the regulation.
- The act increases the role of basic principles in the legal applications. It provides for more effective measures against corrupt behaviour and also provides better solutions for questions arising during the proceeding, providing fundamental principles an increased role instead of over-regulation. Accordingly, the principle of using public money with efficiency and responsibility is also laid down along with the proper application of law.

- The new act's further aim is to fight against economy wide arrears as well as to help small and medium size enterprises to participate in public procurement.

Principles in the Fundamental Law on fiscal responsibility and provisions on the introduction of a debt brake rule

Hungary's new Fundamental Law was adopted on 25 April 2011. The Fundamental Law will entry into force on 1 January 2012; most important provisions of its public finances chapter are the following:

Hungary implements the principle of balanced, transparent and sustainable fiscal policy, with primary responsibility of the Parliament and the Government, while other public bodies and local governments are also obliged to respect it.

The Fundamental Law defines the upper limit for the public debt, in line with responsible fiscal policy, of half of the gross national product, significantly lower than the limit set in EU rules. The current level of the public debt exceeds 50% of GDP, therefore the Fundamental Law requires the reduction of the public debt until it reaches the reference level. The Government may disregard from these provisions only in the case of extraordinary circumstances, and to a commensurate extent. Separate legal regulation is required to clearly define the concepts of public debt and gross national product, as well as the steps towards reaching the reference level of public debt as specified by the Fundamental Law. This regulation is currently under construction, it is expected to be submitted to Parliament in autumn.

According to the Fundamental Law another law may require the consent of the Government in case of borrowing or assuming any obligation by a local government in an amount defined by the law. This regulation, in parallel to the renewal of the act on local governments, is currently under construction, and will be discussed by the Parliament in the autumn session.

The Fundamental Law includes, furthermore, the most important tasks, scopes of responsibility and rules for electing members of the Magyar Nemzeti Bank, the State Audit Office and - as opposed to the current Constitution - the Fiscal Council as well. According to the Fundamental Law, the president of the Fiscal Council (nominated by the President of the Republic), the president of the Magyar Nemzeti Bank and the president of the State Audit Office are members of the Fiscal Council. The Fiscal Council examines the budget bill for the given year and its harmony with the fiscal rules defined in the Fundamental Law, and in this regard, the Fiscal Council's preliminary consent is required to the adoption of the budget, i.e., it has the power of veto. The preparation of the act on the Fiscal Council's operation is under progress, it is expected to be discussed by the Parliament in the autumn session.

3. Further balance improving measures of the Convergence Program

Elimination of the stability reserve

At the beginning of February the Government made a decision to establish a stability reserve with an amount of about HUF 250 billion, approaching 1% of the GDP in order to ensure a disciplined and cost-effective state financial management - reacting to emerging risks.

The largest item of the stability reserve consisted of the freezing of a total of HUF 187 billion part of the expenditure allocations of the chapters under the Government's control. Furthermore, the government resolution requires a payment obligation, financed from their own revenues, from the central budget organs under the Government's control (Land Registration Offices of the Capital and Country Government Offices, the Hungarian National Transport Authority and the Hungarian Office for Mining and Geology) and took measures for expenditure savings at the Labour Market Fund.

Furthermore, the amendment of the act on the budget of 2011 provided instructions for establishing reserves in the so-called constitutional chapters (i.e. those not under the control of the Government, e.g. State Audit Office, the Courts, Hungarian Academy of Sciences) and the Media Service Support and Asset Management Fund, and required additional contributions from the institutions financed fully from their own revenues.

After the review of economic developments during the year, the Government made a decision in June 2011 to prepare an amendment proposal to the 2011 budget act for the final elimination of the freezes. The amendment was passed by the Parliament.

With the continued careful and conservative revenue projections (primarily company tax and value added tax revenues) tax revenues may still lag behind the planned levels, therefore the modification affects both the revenue and expenditure sides of the budget with the same amount, that is, does not influence the balance of the central government budget. It is to be emphasized that expenditure allocations - with named exceptions - constitute obvious upper limits according to the act on the state budget, while tax revenues may automatically exceed plans. Therefore, the reduction of the expenditures supported by legal limits and the levels of revenues may result in a budgetary position better than approved.

Measures to increase revenues

Raise of the excise taxes

The Parliament passed the modification bill on excise taxes. For the bioethanol component of the E85 fuel, a tax rate of 40 HUF/litre was introduced as opposed to the earlier tax-exemption. This measure may strongly limit the increasing shift of fuel purchases towards cheaper E85 fuel (with lower tax rates) that would have resulted in a HUF 6-7 billion reduction of excise tax revenues in the state budget if this trend persists.

The raise of excise tax rates on tobacco products will be presented to the Parliament in the scope of the autumn tax package after the establishment of the long-term concept of taxing tobacco products.

INTRODUCTION OF THE TAX ON PUBLIC HEALTHCARE PRODUCTS

The Parliament passed the bill on the tax on public healthcare products. The new tax is levied on the sales of products whose consumption is proved to bear risks of damage to health. In this respect, a risk factor to health is borne by the high sugar or salt content of products, and the coffein content of certain products with high sugar content.

The expected effect of the introduction of this measure on the budget is HUF 15-22 billion.

REDUCTION OF GOVERNMENT DEBT

The gross consolidated debt of the government sector calculated at a nominal value (according to the Maastricht definition) was HUF 21749 billion at the end of 2010 (80.2% of GDP). By the end of the first quarter of 2011, the gross debt was HUF 22458 billion (81.9% of the GDP of the year closing with the first quarter of 2011). In the second quarter, government bonds with the total nominal value of HUF 1345 billion were withdrawn after the transfer of the funds of former private pension fund members, and this improved the debt ratio by almost 5 percentage points in a single step.

4. THE HOME PROTECTION ACTION PLAN

In order to reduce the social, real estate market and financial stability risks originating from the large-scale indebtedness of households in foreign currencies having occurred in recent years, the Government established a Home Protection Action Plan consisting of five pillars. The elements of this are the following:

- introduction of exchange rate protection to secure monthly instalments,
- an interest rate subsidy system,
- establishment of the National Asset Management Company,
- release of the eviction moratorium with a quota system
- and enabling foreign currency-based mortgage loans again.

When preparing the Action Plan, distinguished attention was paid to the joint assumption of obligations by the interested parties (debtor, bank, state), the effective resolving of the problem and considering the capacities of the state budget, too.

The exchange rate protection pillar has no direct influence on the budget, however, the provision of state guarantee means an implicit obligation for the budget, i.e. future budget expenditures may emerge, if the state guarantee is called. The state provides a hundred percent full surety for the duration of the exchange rate fixing, and for the following period a twenty-five percent queue-holding surety on the balance of the special account.[1] The possible expenditures originating from the calling in of the surety may be, at the same time, counterbalanced by the collateral fee to be paid by the banks. It is not possible to determine the exact level of expenditure in advance, because it is impossible to predict the ratio of non-payers, and it is currently unknown how many banks will require the guarantee[2], and how many debtors would participate in the program, and also the trends of the HUF exchange rate will strongly influence the basis of the guarantee. In total, however, a maximum of HUF 5 billion budget expenditure is expected by the end of 2014 in relation to the exchange rate protection, considering that the revenues from the guarantee charge provide, in an optimal case, coverage for the expenditures arising from the possible calling in of the guarantee.

The National Asset Management Company will purchase the real estates of a total of 5000 debtors - selected on the basis of social considerations - on a substantial discount price. The purchase of the five thousand assets[3] may incur a total expenditure of HUF 20.5 billion by the end of 2014.

The burden on the budget from building social homes may amount to HUF 15 billion, the majority of which would incur in 2012.

The influence of the interest rate subsidy on the budget is regulated by a government resolution, based on which the annual permissible effect on the budget is a maximum of HUF 1.5 billion. This way, the maximum expenditure of the program is HUF 6 billion during the four years.

In total, the effect of the Home Protection Action Plan on the budget between 2011 and 2014 may be HUF 40-45 billion, the largest part of which – about HUF 20 billion – is expected to incur in 2012.

[1] For full suretyship, the creditor may claim compensation directly from the guarantor, while for queue-holding suretyship, the creditor shall attempt to collect claims through the debtor first.
[2] Using a state suretyship is not mandatory for banks.
[3] Assuming an average real estate price of 8.2 million HUF and 50% of it as the purchase price.

ANNEX

PIECES OF LEGISLATION RELATED TO THE MEASURES PRESENTED IN THIS REPORT

(in time sequence)

Act XXXI of 2011 on the modification of Act XXXVIII of 1992 on public finances

Promulgated: 25.03.2011.

Reference point: reduction of the upper limit of sick-allowance by modifying Act LXXXIII of 1997 on the benefits provided by the mandatory health insurance system

Hungary's Constitution

Promulgated: 25.04.2011.

Reference point: government debt

Act LXI of 2011 on the modification of Act XX of 1949 on the Constitution of the Hungarian Republic in order to establish certain temporary provisions related to the Constitution

Promulgated: 14.06.2011.

Reference point: pensions granted below the old-age pension age limit

Act LXIII of 2011 on the modification of Act IV of 1978 on the Criminal Code and certain Acts in relation to financial criminal acts

Promulgated: 17.06.2011.

Reference point: budget infringements, misuse of social security, social or other welfare benefits

Act LXXV of 2011 on the fixing of the repayment exchange rate of foreign currency loans and the order of forced repossession of homes

Promulgated: 28.06.2011.

Reference point: Home Protection Action Plan

Act LXXXI of 2011 on the modification of certain Acts on healthcare

Promulgated: 30.06.2011.

Reference point: modification of Act XCVIII of 2006 on the general rules of safe and effective supply of pharmaceuticals and healthcare aidances and the distribution of pharmaceuticals

Reference point: cessation of passive sick-allowance by modifying Act LXXXIII of 1997 on the benefits provided by the mandatory health insurance system

Act XCVI of 2011 on the modification of certain Acts on economy

Promulgated: 14.07.2011.

Reference point: modification of Act CXXVII of 2003 on the special rules of excise tax and selling of excise products

Bill no. T/3636 on the modification of Act CLXIX of 2010 on the 2011 budget of the Hungarian Republic

Passed: 11.07.2011.

Reference point: elimination of stability reserve

Act CVI of 2011 on the modification of the Acts on public employment and related to public employment and other Acts

Promulgated: 19.07.2011.

Reference point: new regulation on public employment

Reference point: reform of job search benefits by the modification of Act IV of 1991 on the support of employment and benefits to the unemployed

Reference point: setting a maximum limit for the sum of social and family support transfers eligible under different legal titles by the modification of Act III of 1993 on social administration and social benefits

Act CIII of 2011 on the tax on public healthcare products

Promulgated: 19.07.2011.

Act CVIII of 2011 on public procurement

Promulgated: 20.07.2011.