MINISTRY
FOR NATIONAL ECONOMY

Report on the measures taken in response to Council recommendation of 7 July 2009 under Article 104(7) of the Treaty

November, 2010

Content

1. Introduction

According to Council Recommendation of 7 July 2009 within the framework of the excessive deficit procedure, in 2010 the general government deficit target should be 3.8% of the GDP, and in 2011 the excessive deficit should be corrected.

The Government, taking office at the end of May 2010, is committed to the achievement of these deficit targets. To this end, after taking up its duties, the Government announced two action plans, in which it adopted measures that were necessary to reach the deficit target set for year 2010. Furthermore, in planning the 2011 budget, these measures ensure that the next year's deficit will remain below the reference value.

In order to permanently reduce the high government debt accumulated in the previous years and to achieve a sustainable position in public finances, the structural problems of the Hungarian economy (low potential growth, low employment rate) need to be rectified. Therefore, while being dedicated to budget consolidation; several measures have been implemented with the aim of improving competitiveness and increasing employment and the growth potential. The Government’s goal is to reduce the expenditure level on a permanent basis. The budgetary plans for 2011 include the implementation of measures targeted at the reduction of government bureaucracy and the improvement of its efficiency.

The measures adopted with a view to stimulating growth are based partly on an overall reform of the tax system (personal income tax and corporate tax) and partly on the reduction of the administrative burdens of enterprises and the simplification of employment criteria. In addition, the system of vocational education will undergo a general transformation. In improving the conditions for growth priority is given to measures affecting the development opportunities of small and medium-sized enterprises (restructuring the use of EU funds in the framework of the new Széchenyi Plan, extending the Széchenyi Card Programme offering preferential credit facilities).

In the short run, the budgetary impacts of the structural reform of the tax system will be counterbalanced by the income from special taxes introduced on a temporary basis (special taxes payable by financial organisations and certain sectors), as well as the pension reform which aims at covering pension payments by pension related type revenues. The aim is to set up, in the medium term, a transparent old-age pension system which does not include social policy elements. Disabality pensions and other benefits of social policy character will be financed from the budget.

In the forthcoming years the long-term curtailment of government spending and the additional revenues derived from increasing employment and accelerated economic growth resulting from the measures supporting the improvement of competitiveness will make the accomplishment of medium term budgetary targets possible.

2. Macro-economic outlook 2010-2011

The convergence programme of January 2010 anticipated a further slight (-0.3%) shrink in Hungary's economic performance in 2010. Based on the economic developments of the period that has passed since then we expect a 0.8% increase in the gross domestic product of Hungary.

The growth forecast was revised basically owing to the far more positive change in external demand than what had been expected. As a result of the more rapidly rising external demand Hungary's export has also become more dynamic: the currently expected average growth rate (+12.6%) in 2010 may be more than twice as high as what was forecast at the beginning of this year (+5.5%).

Final consumption of households is likely to show a more unfavourable trend (-2.6%) than anticipated (-2.1%) earlier. At the same time, despite the weaker household consumption, the gross fixed capital formation and final consumption of government may rise higher than estimated in January 2010, so altogether internal demand – owing to the latter two factors - will probably drop at a lower rate (0.8%) this year (as opposed to the 1.5% decrease expected in January).

The annual average inflation rate may reach 4.7%, which is higher than the rate projected in January 2010 (+4.1%), which is mostly attributable to some external shocks (weaker HUF exchange rate, soaring energy and food prices).

In 2011, the economic performance of Hungary may be determined by the fading impacts of the crisis, as well as the positive trends both in domestic consumption and in foreign trade as a consequence of the growth-oriented economic policy. While 2010 has been primarily characterised by export growth driven by external demand, in 2011 domestic demand will also take off with the gross domestic product likely to increase at a rate of approximately 3%.

Internal demand

After the negative processes of 2010 household consumption is expected to improve to a significant degree in 2011 (+2.6%). The effect of factors exerting pressure on the income position of households will considerably decrease in the future, which enables consumption to grow. This is partly owing to an improvement in the labour market environment parallel with the upsurge in demand: the continuously increasing number of employees in the private sector and the modification of personal income tax will result in a real change in the income position of households. On the other hand, the lending activity of banks is forecast to advance, thus reducing the net loan repayment rate in the retail sector.

As regards *investments* (+6.9%) a number of positive factors can be identified in 2011, which underpin the expected dynamic growth. Firstly, on the demand side, in addition to external demand the upswing in domestic consumption from 2011 is a remarkable positive factor. Secondly, on the supply side, the historically low capacity utilisation rate does not enable investments to grow to a significant degree this year with respect to the fact that in order to serve the export sector it seems to be sufficient for the moment to re-launch capacities that were disabled earlier. However, in 2011, the announced automotive investments will already have a strong impact. The effect of most government actions, primarily supporting the investments of the SME sector, will also be perceivable from 2011 (Széchenyi Card, rearrangement of EU funds towards the sector, preferential corporate tax rate, etc.).

In the private sector *employment* is expected to increase (+1.0%) in 2011 on account of the economic recovery, the government measures aimed at increasing employment and the positive change in headcount observed in the second half of 2010. On the other hand, employment is anticipated to decline (-3%) in the public sector as a consequence of the transformation of public employment and the staff reduction planned to be implemented at budgetary institutions.

External demand

While in 2010 the main element of growth of the Hungarian economy is net exports resulting from favourable external demand, next year the contribution of this factor may decrease. On the one hand, the exit strategies announced in developed countries in order to sustain the dynamics of sovereign debt will probably diminish the demand of our key export partners, which will deteriorate Hungary's export sales opportunities as well. On the other hand, the upsurge in internal consumption will continue to narrow the export-import gap still wide this year, leading to a substantial decline in the contribution of net exports to growth. At the same time, there seems to be a duality regarding the external demand of Asian countries. The dynamic growth of these countries is a significant driving force of the export sales of some European countries, also strengthening Hungary's foreign trade processes indirectly through the German economy, however, there have been signs which may cool down the economy of developing countries and reduce their external demand, thus eventually worsening Hungarian export prospects (2011: exports: +9%, imports +9.3%).[1]

Main macroeconomic indicators, 2009-2011

	2009	2010	2011
	Actual data	Forecast	
annual percentage change at constant prices			
Gross Domestic Product (GDP)	**-6.7**	**0.8**	**3.0**
Domestic use of GDP	-10.8	-0.8	2.8
Final consumption of households	-6.8	-2.6	2.6
of which: consumption expenditures	-8.1	-3.1	3.9
Gross fixed capital formation	-8.0	1.4	6.9
Exports (goods and services)	-9.6	12.6	9.0
Imports (goods and services)	-14.6	11.4	9.3
annual percentage change			
Gross average wage	0.5	2.4	2.6
Net average wage	1.7	7.1	4.9
Real wages, per employee	-2.4	2.2	1.3
Number of employees	-2.5	-0.1	-0.1
of which: private sector	-4.2	-1.2	1.0
public sector	2.7	2.8	-3.0
Unemployment rate (ILO), %	10.0	11.3	10.8
Consumer price index, annual average	4.2	4.7	3.5
in % of GDP			
Current account balance	-0.5	0.2	-0.2
External financing capacity (+) / need (-)	0.8	2.4	2.5

[1] The common root of these opposite effects is surrounded by great uncertainty; at present, the German *exit* appears to deteriorate Hungarian export prospects to a lesser degree than formerly assumed.

3. Budgetary developments

3.1. *Budgetary developments in 2009*

Based on preliminary cash data the convergence programme of January 2010 presumed the accomplishment of the deficit target set at 3.9% of GDP. However, the ESA95 data compiled by the Central Statistical Office (KSH) and submitted to Eurostat in March signalled a slightly higher deficit (4% of GDP), and the revised data disclosed in September registered an excess deficit of 0.5 percentage points over the target: the ESA95 general government deficit reached 4.4% of GDP in 2009.

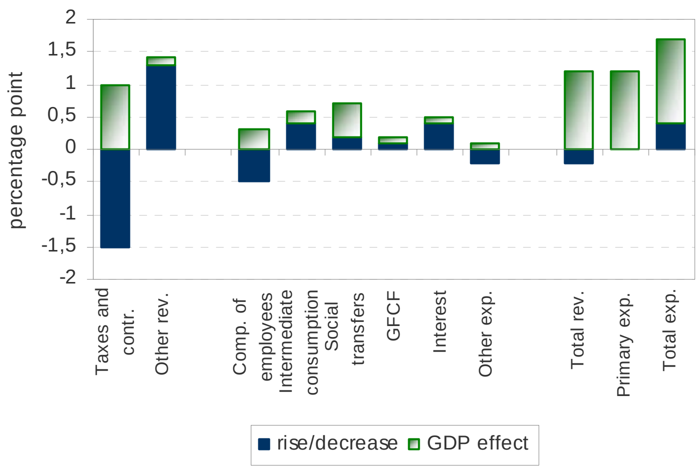
Changes of the 2009 balances in per cent of GDP

	Convergence programme (January 2010)	2010 Spring notification	2010 Autumn notification
Cash-based deficit of central subsystems	3.5	3.6	3.6
Cash-based deficit including local governments	-	3.9	3.9
ESA95 deficit of the general government	**3.9**	**4.0**	**4.4**
Primary balance of the general government	0.5	0.7	0.2

The balance worsened relative to the estimate made in January basically due to a change in accrual-based expenditure. Calculations relying on more accurate statistical data sources and the methodological adjustments have resulted in nearly 0.5 percentage points higher primary spending and 0.3 percentage points higher interest expenditure in terms of GDP, while revenues rose at a lower rate (by somewhat less than 0.2 percentage points of GDP).

Compared to the previous year, the general government deficit increased by 0.7 percentage points of GDP, and the primary balance declined by 0.2 percentage points in 2009. The economic recession led to a decrease in tax and contributions revenues of more than 400 billion Hungarian forints (1.5% of GDP), which could not be fully compensated by the increase in other revenues (EU transfers, in particular) either. Therefore, the primary balance became worse in spite of the fact that in nominal terms total primary spending remained at the previous year’s level. Nevertheless, the revenue and expenditure indicators relative to GDP have been subject to an intensive augmentation as a consequence of the over 2.5% (HUF 700 billion) shrinking of nominal GDP, parallel with the 6.7% decline in volumes.

Expenditure and revenue changes in 2009
(compared to 2008, in per cent of GDP)



3.2. *Budgetary developments in 2010*

The Government is committed to fulfilling the deficit target of 3.8% of GDP set for this year. Since on the basis of interim data it has become clear that the originally planned budget cannot be met and supplementary measures are required to meet the deficit target, the new Government announced two economic action plans. The key objectives of new measures are to strengthen economic competitiveness, to sustain budget consolidation while stimulating growth and employment, and to enhance the safe fulfilment of the deficit target.

According to he 2010 budget

- The wage scale in the public sector remained unchanged and the 13th month salary was abolished;
- For the expenditures of chapters financed from subsidies (i.e. not from own revenues or EU funds), the 2010 budget contained an almost 7% lower amount than the 2009 appropriation;
- Central budgetary transfers to the local governments were reduced. The budget forecast assumed that the local government subsystem would respond to this reduction partly by efficiency gains and partly by a higher deficit;
- The rules of pension indexation have changed as of 2010, thus the pension increase was in line with expected inflation. The 13th month pension was abolished;
- The family allowance and social benefits linked to the old-age pension minimum remained unchanged and the availability period of child care benefits and family allowance were shortened;
- The budget reckoned with the altered regulations resulting in an over 10% drop in sick pay expenditures;
- The appropriated amount of housing subsidies was reduced considerably, by about one quarter;
- Forecasted expenditures on means-tested gas and district heating subsidies dropped to about one third of the previous level. The sum of other price subsidies (pharmaceutical subsidy, consumer price subsidy) showed a minimal increase on a year-on-year basis;
- Due to the projects co-financed by the EU, the budget reckoned with a slight increase of investment expenditures;
- As a result of tax restructuring started in the second half of 2009 and completed in 2010, the budget forecasted modification of the structure of revenues (i.e. decrease of the weight of social contributions and taxes on income and increase of the ratio of taxes on consumption).

The interim data have made it increasingly probable that without the supplementary measures the excess deficit resulting from the shortfall in tax and contributions revenues would exceed 1% of GDP. In addition, the outgoing Government held of from adopting necessary additional saving measures on the expenditure side. Some originally budgeted savings targets (expenditures of budget chapters, local government and public transport subsidies) did not prove to be accomplishable in the first half of the year. Despite the expected lower interest expenditures facilitated by a more favourable yield environment and the balance improving impact of the revenues related to the return of private pension fund members into the pay-as-you-go pillar, the risk of a higher deficit appeared already at the beginning of the year. Therefore, the previous Government decided on freezing of the stability reserve amounting to 0.4% of GDP (under Government decision the stability reserve can be used only if revenue appropriations are expected to be achieved at a rate of over 102%). Since this measure was not sufficient to meet the deficit target, the Government projected the revision or freezing certain expenditure appropriations, however, these savings did not materialize until election. Thus the necessary adjustment measures had to be implemented by the new Government immediately after taking office.

By the end of June the cash deficit of the central government had reached 119% of the initial appropriation for the year, increasing by more than 200 billion forints (nearly 30%) as compared to the previous year. The

ESA95 deficit of the general government increased to 5.4% of the (seasonally adjusted) GDP in the first half of the year, reflecting a decline by 1 percentage point in an annual comparison. The accrual-based tax and contributions revenues have dropped by 4.1% (by 210 billion forints), while government spending has grown relative to the previous year, although only at a moderate rate (1.1%). As a result of the processes of the first half of the year the deficit became higher even on the basis of the cumulated data of the four quarters, amounting to 4.9% of GDP in the year ending with the second quarter of 2010.

Quarterly balances
(ESA95, in per cent of GDP)

For this reason, on the one hand, the action plans have introduced rigorous savings measures to curb expenditures and, on the other hand, they contain temporary revenue-increasing steps in addition to the tax measures aimed at increasing competitiveness and those promoting small and medium-sized enterprises.

The measures directly affecting the 2010 budget are as follows:

- freezing budgetary institutions' appropriations for expenditure, eliminating a part of the unused appropriations carried over from previous years, increasing the contribution of budgetary institutions to be paid into the central budget,
- banning bonus payments, completely reviewing external contracts and the outsourcing of tasks, restricting asset acquisitions,
- introducing the monthly gross wage ceiling of HUF 2 million in the public sector and imposing a tax on severance payments over 60 days and other extra benefits at a rate of 98%,
- improving the balance of extra-budgetary funds and the state asset chapter,
- reducing the budgetary support of political parties,
- reducing the number of representatives in local authorities,
- increasing the credit line of the so-called Széchenyi Card Programme offering preferential credit facilities to SMEs to HUF 50 million and extending the opportunities for its use,
- radically rearranging EU funds for the benefit of small and medium-sized enterprises,
- cancelling certain so-called small taxes in order to simplify the tax system, rationalising the rules of simplified employment, and introducing the term "non-taxable income" in the case of household work,
- making grant-giving a VAT-exempt activity,
- making the production of home-made fruit spirits tax-free up to a limited quantity,
- cancelling inheritance and gift tax in the case of direct relatives,
- from the second half of the year, decreasing the rate of corporate tax from 19% to 10% up to HUF 500 million annual profit so as to boost business activities and increase competitiveness,
- introducing the special tax of financial organisations from 2010 on a temporary basis in order to ensure a more even distribution of the burdens of budget adjustments than earlier,

- introducing the so-called crisis tax from 2010 on a temporary basis, for a period of 3 years, payable by telecommunications companies, retail chain stores and the energy sector in order to distribute public burdens more proportionately,
- redirecting private pension fund contributions to the state pension pillar from November 2010 to December 2011 and launching the pension reform.

On the whole, these measures will improve the general government balance by 1.6% of GDP, including 1.2% of GDP improvement on the revenue side and 0.4% of GDP through cutting back on spending This large-scale correction is sufficient for offsetting the loss of tax receipts not affected by the measures and the higher payments expected in the case of certain expenditure items (e.g. extra expenditure due to natural disasters or the extra costs of the "Pathway to Work Programme"), and ensures the fulfilment of the 3.8% deficit target.

The cash data of the third quarter already reflect the positive achievements of the action plans. In each month of the quarter the cash balance of the central government has been closed with better results than last year, and as opposed to the downturn characterising the previous months, tax and contributions receipts were higher in September than a year before. The adjustment is apparent also in respect of the net expenditure[2] of budgetary institutions and chapter-administered appropriations; the deficit of the third quarter attributable to chapters diminished by more than 32 billion forints year-on-year. In the last quarter, the strict control of expenditures of budgetary chapters, the tax receipts normally increasing at the end of the year, as well as the revenues from special taxes will result in a significant surplus, which will enable the targeted balances to be achieved.

3.3. *The 2011 budget*

The Government aims at maintaining the budgetary discipline and reducing the deficit to below 3% of GDP in 2011. In planning budgetary expenditure the principle of economy is strictly observed, while the measures targeted at the strengthening of employment and competitiveness will also feed through.

In the framework of the structural reform and simplification of the tax system

- The progressive tax system applied in the case of personal income tax is replaced with a 16% flat rate tax system, which will facilitate the whitening of incomes and stimulate labour supply through the reduction of the extremely high former marginal tax wedge; Furthermore, the lower tax wedge will have a positive impact also on labour demand, and may contribute to an increase in employment rates;
- The flat rate also applies to incomes that used to be separately taxable, the tax rates of in-kind benefits will be modified, coupled with the first step of the gradual phasing-out of tax credits;
- A substantial family tax base allowance will be introduced, which aims at increasing the number of births and thus improving long-term sustainability;
- In the case of corporate tax the 10% preferential tax rate will be applicable up to a tax base limit of HUF 500 million for the whole year to stimulate growth and strengthen competitiveness;
- A targeted reduction in contributions will be implemented in order to improve the employment of women, in particular: in the case of part-time (4-hour) employment, the 27% employer's contribution will fall to 20%;
- The taxation of self-employment will be simplified;
- Due to the EU obligation regarding the approximation of legislation the excise tax of tobacco products will increase.

[2] Balance of expenditures, revenues, and payments to the central budget.

In order to offset the revenue impact of changes in taxation and fulfil the deficit target

- The special tax (so-called Robin Hood tax) of energy companies will be maintained also in 2011;
- The budget expects the same amount of revenue from the special tax of financial organizations and the so-called crisis tax payable by telecommunications companies, retail chain stores and the energy sector as in 2010;
- Within the framework of the pension reform, members of private pension funds will pay pension contribution to the state pension pillar instead of the membership fee and will have the opportunity to return to the state pension scheme.

To ensure a more efficient and safe achievement of estimated revenues the organisational integration of the tax and customs administration will be implemented. The newly established organisation will be able to provide full control and protection of the state's tax receipts and other fiscal revenues in a more effective and cost-efficient manner than before.

Regarding the expenditure side, the Government aims at cutting back on bureaucracy and strictly enforcing the principle of economy with respect to the budget. To this end

- the impact of freezing and other withdrawals, as well as the absence of one-off tasks will be permanently incorporated into the expenditure appropriations of budget chapters;
- The number of public sector employees will be reduced. The posts made available as a result of the organisational measures will be abolished and, in addition, the staff of administrative and administrative-type budgetary institutions will be reduced by 5% and that of background institutions by 10%. No bonuses can be planned in central budgetary institutions, fringe benefits will be subject to an upper limit and the allotment on external assignments will be cut by 20% on average, compared to the 2010 appropriations. The one-off additional expenditure resulting from staff reductions must be financed from the realised savings, the wage bill cannot increase;
- Service contracts will be reviewed;
- The conditions of the "Pathway to Work" programme will be modified;
- In the central budget chapters the expenditures on purchase of goods and services will be diminished by an average of 5% as compared to the 2010 appropriation modified by freezing;
- In order to avoid parallelism, neither the chapter-administered appropriations, nor the central investments may include any new tasks, programmes or investment projects purely financed from national sources that are supported also by the European Union.
- The Government will set up a Re-structuring fund (amounting to HUF 8 billion) in order to transform the organisations which are inefficient, or do not deliver adequate quality or are not in line with the public interest in performing public tasks;
- The implemented PPP development projects will be revised;
- The reduction of bureaucracy will affect the development policy and the tender system as well: the number of organisations taking part in the evaluation of tenders will decrease and the administrative burdens of enterprises will be lessened;
- At the same time, the Széchenyi Card Programme will be extended also to agriculture and the provision of working capital loans;
- Pensions will increase in accordance with the laws, while the total amount of social cash benefits relative to GDP will be lower than in the previous year;
- The system of pharmaceutical subsidies and health care provisions will be reviewed.

4. Structural measures

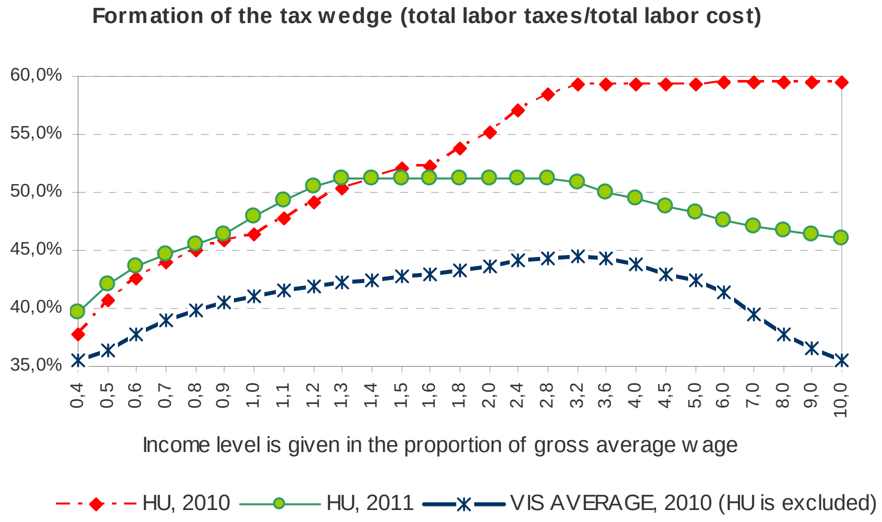
4.1. *Measures increasing competitiveness*

To build a new economic system, the Government already prepared its first economic action plan in the middle of 2010. In this context, in addition to reducing corporate tax, several simplifications have been introduced: ten small taxes were abolished, including the tourist tax on buildings, the communal tax of entrepreneurs, the tax on high performance vehicles, watercraft and aircraft, the TV set operation fee, the contribution of water management associations based on their interest involved, the spirit tax on contract distilling, as well as the inheritance and gift tax in the case of direct line inheritance. These measures will significantly reduce not only the tax burdens of enterprises, but other administrative burdens as well, which will have a positive impact on the whitening of their activities, that is to pursue their economic activity within a legal framework, and will also influence the enterprises' willingness to invest in a favourable direction.

The Government introduced the term "non-taxable income" with respect to household work, furthermore, the criteria of occasional work have been simplified and – primarily in view of helping victims of natural disasters – donation has become VAT-exempt.

In the framework of modifications to the tax and contributions laws the Government proposes structural changes in the system of personal income taxation to take effect from 2011. Based on this, the former progressive tax system will be replaced by the system of proportional taxation operated with a flat rate of 16%, while the institution of “super grossing” will have been gradually abolished by 2013. At the same time, the rate and limit of tax credit will be modified, and so will the taxation of non-wage benefits. The rate of separately taxed income (the flat rate tax of private entrepreneurs and small-scale farmers, income from dividend, life annuity, capital gain, sale of real estate property or moveable assets, the renting of real estate, as well as income subject to other withholding taxes) will also be modified to 16%. As a new element, the family tax base allowance will be integrated into the scheme, which will provide a more extended aid to families with children having taxable income than the former family tax allowance.

The new tax system has considerable direct and indirect positive macroeconomic impacts. Households with a higher income, which have higher credit as a result of their increased borrowing capacity, will have improved repayment ability due to the additional income they gain from the reduction of taxes. This eases the portfolio deterioration of the financial system, thus reducing financial stability risks. The marginal tax wedge, which is outstanding among high-income taxpayers as compared to other countries of the region, will be lower as a result of the reforms, and will therefore have a favourable effect on the whitening of the income, that is, on the total amount of declared income. In fact, experience shows that the impact of the marginal tax wedge on declared income is the most significant in the case of high-income taxpayers.



The new family tax base allowance directly influences consumption and employment in a positive direction. On the one hand, since the allowance is available only for families with taxable income this encourages parents to work. On the other hand, it increases the disposable income of families, which can be spent on consumption or loan repayment purposes, as mentioned above.

According to the schedule of the tax reform, in the case of the minimum wage it is not necessary to increase real wages in excess of productivity. Abolishing the institution of tax credit over a period of three years will allow a gradual increase in the tax burden on the minimum wage.

From August 2010 the system of corporate taxation has also changed in a way that the amount limit of the tax base entitled to the preferential tax rate has been increased from HUF 50 million to HUF 500 million. Since the modification of the law entered into force during the year, enterprises will need to divide their annual tax base to calculate the corporate tax for 2010: while for the first half of 2010 the preferential 10% tax rate is applicable according to the former system, that is, up to a limit of HUF 50 million, for the second half of the year the modified and prorated limit of HUF 250 million must be taken into account. From 2011, the tax base limit for which the preferential rate can be applied increases to HUF 500 million, since the new system will be effective for the whole year, and from 2013 a flat rate of 10% will be generally applied to corporate tax.

In order to boost employment the Government will launch the German-type dual vocational training scheme, which better meets corporate requirements. Part-time employment will also be supported – particularly for women – by introducing a reduced social security contribution rate for part-time work. In addition, the taxation of self-employment will be simplified, and there will be less bureaucracy in development policy. This latter step will reduce the time of tender evaluation and the administrative burden of tendering, and will result in a faster and more favourable utilisation of development funds in the future.

4.2. *Labour market*

In addition to the comprehensive tax reform, government measures to improve the efficiency of the labour market are also planned in order to facilitate job creation and reduce unemployment. In this context, the active employment policy instruments of the Labour Market Fund will be reviewed with the aim of increasing the share of support for job creation, transforming the subsidy schemes and phasing-in measures which promote self-employment and labour mobility. The possible amendment of labour legislation is examined and the unemployment benefit system will be reviewed. Demand driven vocational training is promoted through the development of the vocational training system. The Government intends to apply a co-ordinated approach among all relevant public policy areas in order to increase the employment rate significantly.

4.3. *Central administration*

Modification of regulations relating to the legal status and financial management of budgetary agencies

The Government aims at renewing the system of public finances and the central budget so as to ensure grounded, transparent and controlled operation, and, at the same time, at improving the quality of public services and public administrative work. Therefore, priority is given to cutting back on the excessive administration characterising the operation and financial management of budgetary agencies. Another key goal is to make sure that while planning will be more detailed and soundly based, the budget adopted by the legislature will not have to be rewritten in the course of its implementation, therefore, the Government will introduce a set of tools and rules designed to ensure compliance with the budget, and guarantees for protecting public property and combating corruption will be integrated into the process of public spending. A more substantial and comprehensive modification of the system of public finances will be implemented only after thorough preparation, during 2011, however, its foundations were already laid down in the modified Public Finance Act adopted in August 2010.

Based on experience regarding their introduction, the budget lines set out in the act pertaining to the legal status and financial management of budgetary agencies (the so-called “status act”) did not provide an adequate background for operating the budgetary agencies according to public interest. For that reason, upon modifying the act, the Parliament repealed the status act and many of its provisions (including, for example, the institution of the organisation unit operating as a legal person, the option of shared management of budgetary agencies, the advance and liquidity credit, the purchase of securities, as well as the other special entitlements of contracting public bodies, such as own property).

At the same time, in the course of formulating the modification of the act in August 2010, regulations relating to the legal status of budgetary agencies, which complied with the above goals, such as the rules pertaining to the "life path" of the budgetary agency (foundation, registration, transformation, termination), its control (supervision) and its managing body (board of supervisors and founders), have been used and now form an integral part of the Public Finance Act.

This way the modified Public Finance Act already contains measures aimed at the protection and dedicated use of public funds, although the review of the public finance system on the merits and its modernisation as per the above is a priority task of the Government requiring serious professional preparation in the forthcoming years. Regulations relating to the use of additional interim revenues will be modified (in the future, as a general rule, their use will be subject to authorisation), and the rules pertaining to long-term commitments, the use of residual funds, and the financial assistance of social organisations and (public) foundations will be stricter.

Establishment of the budget inspectorate system

The modified act set up a legislative framework for the establishment of the budget inspectorate system. The purpose of this new scheme – in line with international practice – is to exercise continuous control over commitments undertaken under Government-administered central budget chapters with respect to the chapter, the budgetary agencies under its control and supervision, and the separate state funds. The need for the further development of the system arose while analysing the positive and negative experiences of the recently introduced treasury system. The reason for this does not only lie in the fiscal situation of the country itself, but also in the fact that only this way can the use of public funds based on standard principles be assured on the government level and commitments adverse to public interest be filtered out. This way the required level of supervision is exercised in time, already at the beginning of the spending process, which will significantly reduce potential control risks that may arise later. Pursuant to the rules the Government decides the number of inspectors to be delegated to the specific chapters, and the Minister for National Economy appoints and delegates the persons accordingly. It is an important novelty that the inspectors will perform their work as full-time government officials. The regulations prescribe - as the basic task of the inspectors - what the approval obligation regarding the commitments and rules covers. The detailed rules are set forth in implementing decrees.

Integration of the government offices of Budapest and the counties

In order to increase the efficiency of public administration, regional administrative tasks will be performed in a more coordinated, controlled and cost-efficient manner. Therefore, the Government recommends that the currently disintegrated regional administrative bodies should be integrated.

The government offices of counties and Budapest will be established as a result of the transformation of the public administrative bodies of Budapest and the counties, and the specific regional administration bodies will be integrated into these as special administrative agencies. In the newly created government offices of Budapest and the counties the performance of functional tasks will be centralised (e.g. procurement, maintenance, reconstruction), leaving the professional autonomy and sectoral management of the integrated bodies intact.

Integrated duty performance also means that there will be integrated customer service bureaus operating within the framework of the government offices of counties and Budapest, in which it will be possible to handle various official procedures in a one-stop shop system:

- submission of applications relating to a wide range of official procedures,
- payment of fees and charges with respect to a variety of procedures,
- one-stop shop for activities requiring permission from several authorities,
- one-stop-shop notification of changes in clients' data recorded by several authorities,
- access to the electronic information service or electronic communication system of other authorities, making copies of data included in official records, data disclosure, as well as the performance of comprehensive information and - even electronic – customer assistance tasks.

4.4. *Public employment*

By transforming the community service programmes currently financed in the framework of the local governmental sub-system and the public employment programmes financed tby the central budget an integrated public employment system will be established. To this end, in the present system local governments allocate funds exclusively for those entitled to social aid (people dependent on social benefits and those incapacitated), while for those of working age and recipients of availability support jobs will be created in the framework of the designated public employment programme.

4.5. *Pension reform*

Recording contribution payments

The Government will provide an opportunity and incentives for those taking part in the multi-pillar pension system to re-enter the state pension scheme. In the Pay-As-You-Go pillar the option of recording contribution payments on individual accounts will be available within the Pension Insurance Fund. The maintenance of individual accounts can rely partly on the contribution returns (database of the Hungarian Tax and Financial Control Administration and analytics) and partly on the insurance certificates ("NYENYI" records). The system of individual accounts can be made suitable for ensuring the traceability of the performance of individual contribution payment obligations and the process of accumulation of insurance coverage for all insured persons. The new system will certainly ensure transparency and security. Furthermore, it will enable the preliminary calculation of pension entitlements and strengthen the relation between the payment of contributions and the provision of services.

Service pension

In the framework of the service pension scheme every year thousands of people retire on more favourable conditions than those laid down in the social security regulations. In light of this fact, it seems reasonable to approximate the current preferences to the social security regulations.

Early retirement pension

The list of jobs eligible for early retirement will lose effect as at 31 December 2010. The scopes of activities included in the list require revision.

4.6. *Pharmaceutical subsidies*

The introduction of international reference pricing serves to reduce expenditure on pharmaceutical subsidies. Under this measure the National Health Insurance Fund (OEP) reviews pharmaceutical products already adopted into social security subsidisation but generating a substantial outflow of subsidies at least once a year. In the case of pharmaceuticals that are far more expensive than the five lowest average producer prices of EU and EEC Member States OEP initiates a price reduction, in the absence of which the pharmaceuticals will be excluded from the subsidisation system.

4.7. *Social benefits*

Pursuant to the relevant provisions of the Family Support Act (Cst.) effective as from 30 August 2010 the family allowance is the collective name for two types of aid: the child-raising support and the education support. The child-raising support is available for children under school age and for persons of legal age with a permanent illness or serious disability, who do not attend a public educational institution, and the education support is disbursed for children attending school up to the age of 20 or up to the age of 23 for students with special educational needs but not eligible for disability allowance.

4.8. *Public transportation*

In order to facilitate a more efficient and economical operation of the main public transport enterprises, a new holding will be set up comprising the state railway company (MÁV) and the various branches of the public bus transport companies (VOLÁN). This will enable the elimination of unjustified duplications of service on certain railway and road transport lines. Furthermore, the expenditure and revenue structure of the public transport companies will be reviewed.