MINISTRY
FOR NATIONAL ECONOMY

UPDATE

on

THE STABLE PUBLIC FINANCES OF HUNGARY

SZÉLL KÁLMÁN PLAN

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The Hungarian government is determined to **respond to the new challenges** posed by a volatile economic environment as promptly as possible. It is of paramount **importance to counter factors which could endanger the budget deficit target**, and Hungary is committed to pursue the course it has established of a steadily and predictably declining deficit. Properly undertaken this plan will **lead to the reduction** of public debt.

In this Update we report **on the key measures of recent weeks**.

The measures necessary for upholding the budget deficit target for 2011

In an unfavourable global economic environment, Hungarian **growth factors may also be jeopardized**. In the light of the signs of global slowdown, the **growth target of the government for this year needs to be revised.** The Hungarian economy grew by 1.5% in the second quarter, lower than the 2% rate which had been projected. This is also the result of base effects (after the crisis, there was for the first time positive growth in the corresponding period of last year) and the lower than expected performance of the export-oriented industrial sector. In addition, the **slowing of the economy has an adverse effect on the tax revenue** projections of the budget. **In order to achieve the deficit target**, the government announced measures aimed at amending the budget position by **100bn HUF**. These measures focus on **four key fields**. Due to the abuse of VAT regulations, the state loses an estimated 600bn HUF inn tax revenues each year. The Hungarian national tax authority is committed **to boosting the focused**

collection of VAT liabilities from concealed incomes that will improve the balance of the budget by 40bn HUF. The government will save another **40bn HUF by speeding up the reform of public administration and by limiting public sector procurements**. The government can ensure extra revenues by **raising the excise tax on some goods and the tax on gambling**. The budget will also benefit **from dividends from foreign equities** of the portfolio of private pension funds, and that will also contribute to improving the balance.

Field	Measure	Expected revenues
VAT	Improving efficiency of tax collection	40bn HUF
State administration	Speeding up reform, limiting public procurements	40bn HUF
Excise tax	• Raising tax on gambling by 50%	1bn HUF
	• Raising tax on tobacco by 7%	5bn HUF
	• Raising the excise tax of alcohol by 5%	1bn HUF
	• Raising the tax of flavored alcoholic beverages by 50%	
	• Raising the excise tax on gasoline from 97 HUF to 110 HUF per liter	3bn HUF
Dividends from shares	Dividends received from foreign equities by the private pension fund reform	10bn HUF

VAT

The governments which were in office in 2004-2010 **failed to carry out tax harmonization regarding the regulation on the refund of VAT** as required by EU guidelines. As a consequence, the European Commission took legal action against Hungary in March 2007. In their verdict of 28 July 2011, the European Court of Justice declared that the provision of VAT Act (2007/CXXVII/186§/2nd Paragraph), which prohibits the refund of VAT for unsettled bills, is contrary to community law. As the Court reasoned, as a consequence of this provision, certain taxpayers, who routinely register negative tax liabilities in their tax declarations, may be obliged to declare it in the next taxation periods. **After the verdict had been announced, the Ministry for National Economy began to elaborate a Bill for the government in order to amend the law to allow for repealing the paragraphs which the Court had referred to**. In addition, the Ministry has been working on a special legislative procedure which would make it possible for the taxpayers concerned to exercise their right for the refund of VAT which, due to the disputed provision, had so far been unrequested. **The objective of the government is that those concerned should receive the refund of VAT, totaling 250bn HUF already this year**. The transaction will be funded from state assets instead of the state budget.

Public debt reduction

It has been a priority of the government **to reduce the indebtedness of Hungary** and handle the problems in connection with public debt. At **the end of 2010, public debt was 80.2% of GDP**. The objective of the convergence programme published in April 2011 is to bring the debt rate **down to 75.5% by the end of 2011 and 72.1% by the end of 2012**. In order to achieve this, in June 2011 the government carried out a **debt-cutting project of 1 345bn HUF**, the highest on record, by taking over the state bond assets of private pension fund portfolios. As a result, the **debt-to-GDP ratio of the country was decreased to 77%**. In September 2011, **the government announced another package of debt-cutting measures which will reduce the debt rate by another 4 percentage points to 73%** in October and November. The reduction of 4bn EUR is financed from national foreign currency reserves (3bn EUR) and from the sale of part of the foreign equity package which the state owns after the pension reform (1bn EUR). In order to maintain the reduction of debt on a sustainable course, the **Hungarian government is committed to achieving the below 3% budget deficit target and the 50% debt-to-GDP ratio stipulated by the new Constitutional Law**.