MINISTRY
FOR NATIONAL ECONOMY

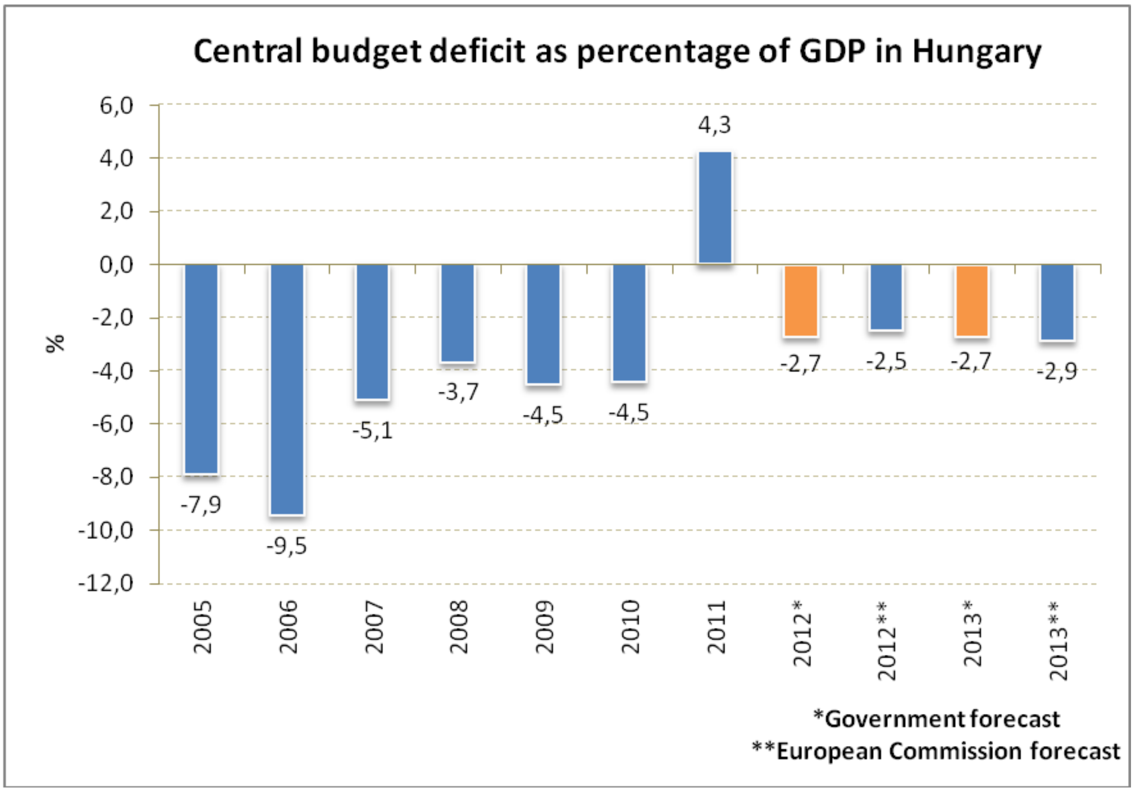
Comprehensive reforms in Hungary, 2012

In the third year after it had been elected the Hungarian Government has continued implementing wide-ranging reforms launched earlier. Hungary as a small country with an open economy has been severely affected by the crisis which has highlighted the fact that stable economic growth in the medium and long term can only be ensured by an adequately diversified economic structure. In other words, Hungary needed an economic trend reversal actively underpinned by economic policy. The Government has consolidated the budget and envisaged substantial reduction of general government debt. In order to secure financial stability the Government has requested banks and enterprises active in highly profitable sectors which have significant domestic market share to bear more of public burden. The Government has assisted the country via several measures over the course of the past year: unlike the previous government it managed to place the budget deficit and general government debt on a declining path; the taxation reform and the removal of its superfluous elements will result in improving economic conditions; the Job Protection Action Plan entering into effect as of next year aims to stimulate employment and may also have a positive effect on growth; while strategic cooperation agreements concluded with multinational corporations will aid Hungary's competitiveness. In addition to the aforementioned, there are several issues which are being currently addressed or about to be solved which the Government has been working on and intends to work on also in the future so that Hungary can continue with its economic strategy originally planned.

Placing the budget deficit on a downward path

Under the perilous conditions left behind by the previous administration the extraordinary measures of the Government headed by Viktor Orbán managed to bring down the budget deficit already in 2010 to a level more favourable than formerly anticipated. After that, **the central budget of Hungary ended the year of 2011 with a surplus of 4.3 percent – a unique performance in Europe.**

The deficit figure calculated by European Union methodology has included several one-off items, however, the 2.43 percent of GDP deficit figure adjusted for unplanned, extraordinary revenues was also much more favourable than expected.



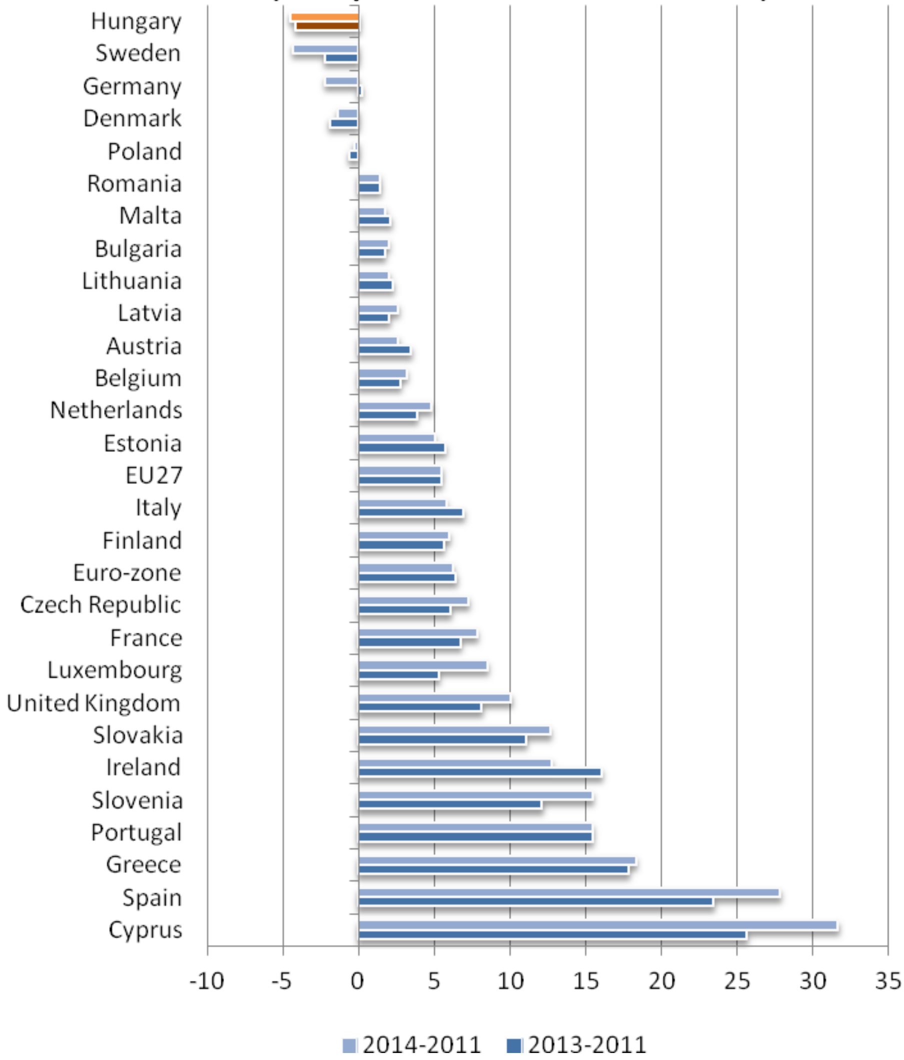
Source: NGM (Ministry for National Economy)

According to the autumn forecast of the European Commission and also in line with the intentions of the Government the ratio of central budget deficit as percentage of GDP will be below 3 percent in 2012 and also next year in Hungary. The aforementioned achievements are also attributable to the measures of the Government and the three fiscal adjustment programmes announced by the Minister for National Economy in October and November, which improve the budget balance by 397bn HUF and 367bn HUF, respectively, whereas the last of these schemes add 90bn HUF to the balance.

<u>Reducing general government debt</u>

Over the past year positive trends have also appeared in Hungary regarding general government debt. On the basis of the European Commission forecast general government debt could be reduced significantly from 81.4 percent as of GDP in 2011: this figure is expected to moderate to 79 percent this year. The prognosis projects further decrease in 2013 and 2014, predicting the indicator to decline to about 77 percent.

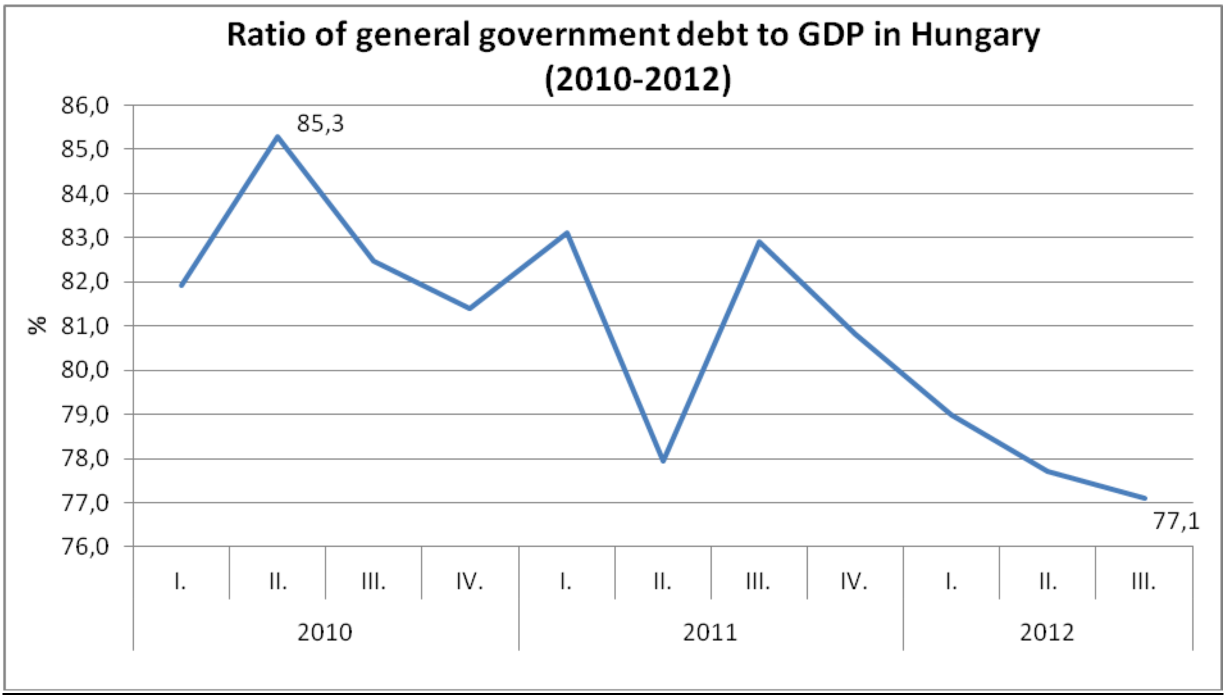
Estimated change in the ratio of general government debt to GDP as of 2011 (European Commission forecast)



Source: European Commission, NGM (Ministry for National Economy)

According to the **European Commission forecast**, only five countries out of the EU 27 member states will be capable of reducing their **general government debt**. Among these countries (Poland, Denmark, Germany, Sweden, Hungary) **it is Hungary which will achieve the largest percentage decline in 2013 and 2014 compared to the level of 2011.**

According to data of the National Bank of Hungary, general government debt as percentage of GDP decreased to 77.1 percent by the third quarter of 2012 after declining by 8.2 percentage points from the peak of 85.3 percent in Q2 2010.



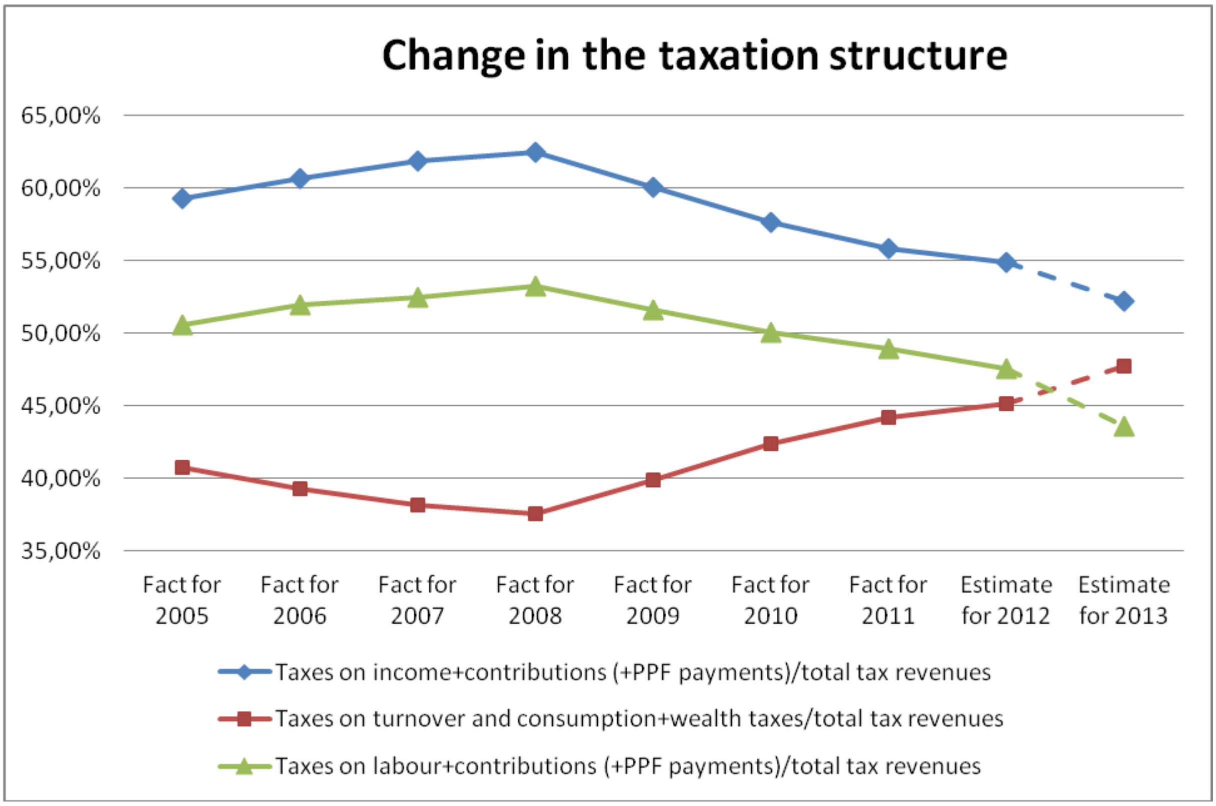
Source: MNB (National Bank of Hungary)

<u>**Taxation system reform**</u>

Overhauling the taxation system has been a pivotal element of the Government's reforms. **Since taking office, the Government has been consistently pursuing the implementation of the tax policy it had predefined: it has submitted such measures to the Parliament that gradually shift the emphasis of income taxes towards levies on consumption and turnover, or on negative externalities (from the aspect of environmental protection or healthcare). The reduction of income taxes has practically been implemented and the introduction of levies on consumption and negative externalities is also about to be finalized. Consequently, the taxation reform will soon be concluded.**

As of 2013 the transformation of the taxation system will continue on the basis of these guidelines. One of the most important amendments is that from the beginning of next year super-grossing will be abolished and thus a **proportionate, flat-rate personal income taxation** system will be introduced: the rate of tax will be **uniformly and transparently 16 percent** on every type of a private person's income. The ceiling for pension contributions will also be phased out, and thus each taxpayer shall contribute to the same extent to the pension insurance system. The introduction of free enterprise zones and relevant taxation incentives as well as stimulating the R&D activities of enterprises via tax allowances will also assist the development and growth of enterprises. The introduction of small enterprise tax and the lump-sum tax for micro enterprises will make taxation easier and more transparent for small taxpayers and small enterprises along with reducing their tax liabilities. In addition, the Government reduced the corporate income tax rate to 10 percent, abolished 10 minor taxes, among them the communal tax for enterprises. The new Labour Code and the announced Job Protection Action Plan made employment more flexible and eased its burden for enterprises.

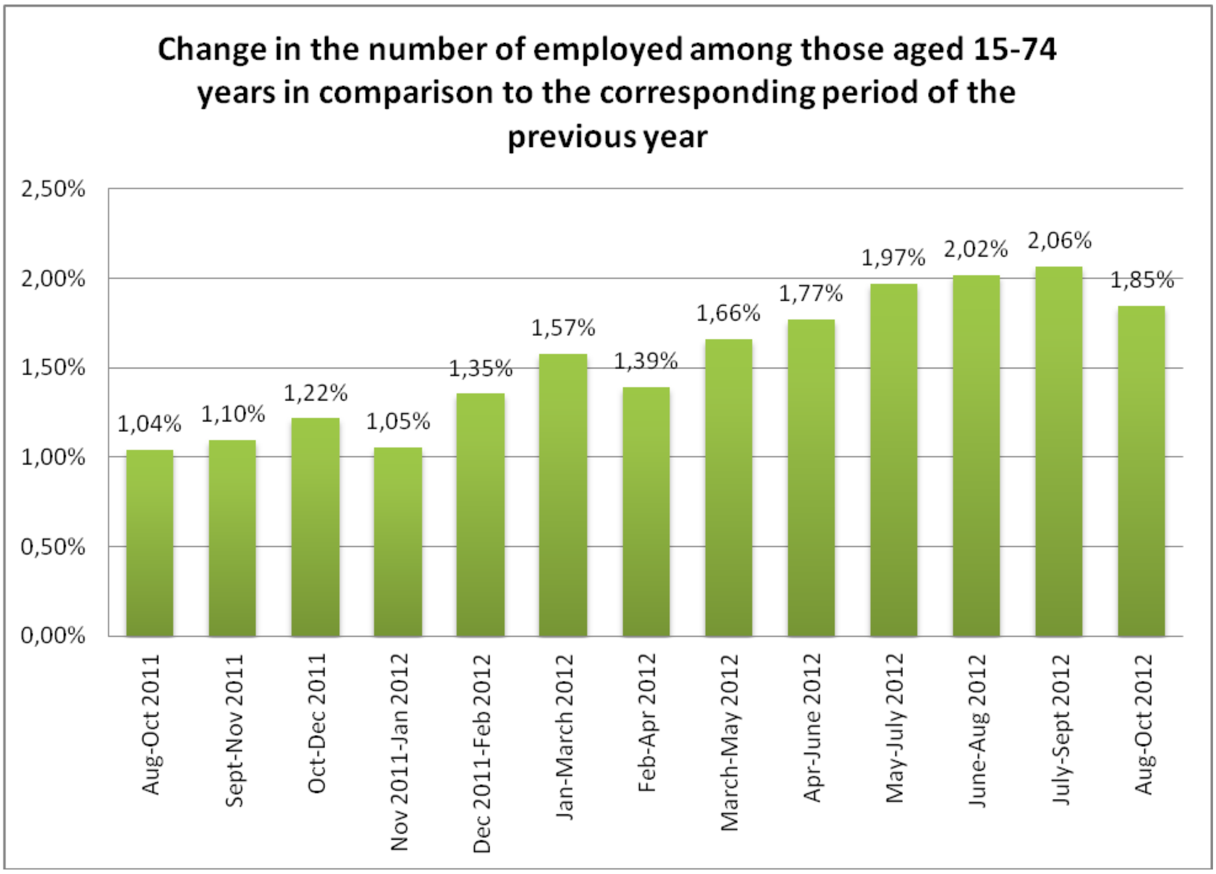
Until 2008 revenues from income-type taxes and contributions had risen year after year. In 2009 tax burdens shifted towards taxes on consumption which process continued after 2010. By 2013 the share of taxes and contributions payable on labour within total tax revenues is expected to get below the ratio of revenues from levies on sales and consumption as well as wealth taxes.



Source :NGM

Improving employment

One prioritized goal of the Government has been to increase the rate of employment. Recently the Government has implemented several labour market measures to this end, and by observing trends of the past two years it can be concluded that despite negative foreign market environment labour market tendencies have been constantly favourable. According to the latest data, in the third quarter of this year the number of employed increased by almost 80 thousand in comparison to the corresponding period of the previous year and **thus the employment rate among those aged 15-74 years increased to 51.4 percent. This has been the best figure of the past ten years** and it was to a large extent attributable to the labour market measures of the Government, among them to organizing public work schemes.



Forrás: KSH

<u>**Job Protection Action Plan for underpinning the improvement of employment**</u>

The Job Protection Action Plan of the Government announced in 2012 and seen to commence next year will further stimulate employment. The programme which consists of clear-cut and plain initiatives includes incentives which can safeguard 1.5 million jobs and enable the creation of several hundreds of thousands of new jobs. The success of the initiative is secured by an unprecedented reduction in tax liabilities which leaves almost 300bn forints at enterprises which do and offer work.

The measures of the action plan can be divided into three major categories. The first category is made up by measures aimed at the targeted reduction of employer tax liabilities: the programmes provide incentives in those sectors where the rate of employment is substantially lower in comparison to European Union statistics. Thus, social contribution allowance and vocational training allowance are applicable for employees below the age of 25 years or above the age of 55 years as well as for unskilled employees, while taxes will also be lower for the long-term unemployed and employees with small children. **The simpler and more optimal taxation requirements elaborated for enterprises constitute the second category.** In order to improve taxation conditions of SMEs, increase employment and cut red tape two new optional taxes were introduced: the lump-sum tax for micro enterprises and the small enterprise tax. **Measures assisting company financing and other accounting issues are in the third group of the action plan.** These are aimed at, on the one hand, helping enterprises weighed down by foreign currency debt losses and at simplifying petty cash regulations and introducing cash-base accounting in taxation on the other.

Strategic partnership agreements for establishing a competitive Hungary

The Hungarian government is convinced that in the next decade only those countries will be successful which are capable of establishing strategic partnerships and long-term cooperation with large multinational corporations. **Therefore the Government has begun establishing a net of alliances by concluding strategic partnership agreements with corporations with global reach** which have long-term plans in Hungary and are committed to contribute to the development and growth of the Hungarian economy. These corporations acting as strategic partners will significantly boost Hungarian added value and exports, they will also rely on Hungarian suppliers, have a keen interest in research, development and innovation and are active in the field of vocational training. The Government aspires to sign **altogether 40 strategic agreements**. **In the past couple of months such a contract could be concluded with 10 large corporations already:** Coca-Cola HBC Hungary, Richter Gedeon Nyrt., Alcoa-Köfém Kft., Daimler AG, Suzuki Hungary Zrt., Hankook Tyre Kft., Microsoft Hungary Kft., GE Hungary Kft., Stadler Trains Hungary Kft. and Tesco-Global Stores Zrt. All these strategic cooperation agreements signal that the Hungarian Government and these corporations are prepared to act together for the development of the Hungarian economy, they are capable of defining common objectives and work together to achieve them.