



MINISTRY FOR
NATIONAL ECONOMY

MEASURES
TO ATTAIN THE SUSTAINABLE REDUCTION OF PUBLIC DEBT

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INTRODUCTION

After it took office in May **2010**, the new government faced several unexpected challenges. Serious measures had to be undertaken to control the slippage in the 2010 budget. Without prompt fiscal adjustment, general government deficit would have increased close to 7% of GDP. The two action plans announced in the second half of last year introduced rigorous saving measures on the expenditure side (freezing of appropriations, elimination of bonuses, revision of outsourced activities, reduction of purchase of goods and services). On the other hand, the action plans contained temporary revenue-increasing steps (temporary crisis taxes, the re-direction of private pension fund contributions to the state pension pillar from November 2010) in addition to tax measures aimed at increasing competitiveness and promoting small and medium-sized enterprises. Owing to the measures, the accrual-based deficit dropped by 50% between the first and the second half of the year and finally it was 4.2 % of GDP in 2010.

In **2011**, the general government balance will be in surplus, influenced by significant one-off items. Nevertheless, the government is committed to achieving the original budgetary target, i.e. a deficit of 2.9% of GDP net of the bulk of the one-off items¹. In the course of the year, several steps have been made in order to keep the underlying budgetary processes on track. Revenue shortfalls due to lower than expected GDP growth were compensated first of all by the abolishment of the stability reserve amounting to HUF 250 billion (around 1% of GDP), predominantly affecting the appropriations of budgetary chapters. The excise duty in case of the bioethanol component of the E85 fuel was increased and a new tax on unhealthy foods with high sugar or salt content also was introduced.

In light of the deterioration of the international macroeconomic environment and the growth outlook, in early September the Government decided on additional measures of HUF 100 billion (freezing of further HUF 37 billion in appropriations of budgetary chapters, stop on purchase of goods and services, rising gambling tax and excise duty of alcohol and gasoline products, enhancing efficiency of the tax collection).

The autumn notification on general government balance and debt sent to Eurostat included an estimate of a surplus of 3.9% of GDP, calculating with revenues from the private pension fund assets and with one-off VAT refunds related to the July 2011 European Court decision,

¹ The 2011 Budget deficit target of 2.9% was based on the assumption that in the context of the pension reform only revenues of 2% of GDP would be realised from the assets of individuals returning from the private pension funds into the state pension pillar and a further 1% in 2012. However, the number of people opting for return was significantly higher than expected and the process closed already at the beginning of 2011. Thus, the whole amount of assets transferred to the Pension Reform and Debt Reduction Fund exceeding 9% of GDP improved the 2011 budget balance.

while in the absence of exact details of the implementation, this figure did not contain the impact of a possible take over of public transport companies' debt and the buyout of certain PPP projects².

In **2012**, the safe attainment of the deficit target of 2.5% of GDP will be ensured by the following items included in the Budget Bill (see Annex 1):

- Growth supporting measures of the structural reform programme announced in March 2011 (Széll Kálmán Plan) which will reshuffle and decrease public expenditures,
- Additional budget improving measures included in the Convergence Programme,
- Further adjustment in view of the deterioration of the macroeconomic outlook (see Annex 2) and of the need to build increased reserves in the Budget Bill to tackle the impact of possibly adverse global macro-economic and financial developments.

The total adjustment exceeds HUF 1400 billion (4.9% of GDP), almost 60% of which will be realised on the expenditure side.

Owing to the structural measures with permanent effects, the cyclically adjusted deficit net of one-off measures drops by more than 2 percentage points in 2012. Given the deterioration of the cyclical conditions and the unchanged headline deficit target in 2012, the structural deficit will be smaller than projected in the Convergence Programme of April 2011.

General government balance

in per cent of GDP

	2011		2012	
	CP	2012 Budget Bill	CP	2012 Budget Bill
Balance	2.0	3.9	-2.5	-2.5
Structural balance	-4.7	-4.5	-2.6	-2.4

A preliminary review of the indicators to be used in the new European macroeconomic surveillance framework of excessive imbalances – to be applicable from the beginning of next year – confirms that the key vulnerabilities of Hungary are the high levels of public debt and of external debt (an issue explicitly addressed in the Structural Reform Programme), while the indicators related to the real economy (like competitiveness) are rather favourable (see Annex 3). The Government realised these vulnerabilities and made the reduction of public debt the core objective of its economic policy. The attainment of the deficit targets

² The Convergence Programme of April 2011 indicated a surplus of 2% of GDP, based on the assumption that a considerable portion of the public transport companies' (MÁV and BKV) debt would be taken over by the budget and that certain PPP projects would be bought back.

and of the structural reform objectives set out in the Structural Reform Programme and Convergence Programme is thus crucial to reduce these vulnerabilities.

THE IMPACT OF THE SZÉLL KÁLMÁN PLAN ON THE 2012 BUDGET

EMPLOYMENT AND LABOUR MARKET

- The Act CVI of 2011 on the modification of the acts on public employment and related to public employment and other acts amended the Act IV of 1991 on job assistance and unemployment benefits. Stricter conditions have been determined for job search allowance, as the upper limit has been decreased from 120% of the minimum wage to the exact amount of the minimum wage and the maximum eligibility period has also been decreased from 270 to 90 days. The impact of the measures is in line with former estimations, or even exceed them somewhat, and expenditures on passive benefits of the Labour Market Fund decrease to around half of the 2011 level.
- Concerning the financing of active labour market policies and vocational training, the Budget Bill contains savings in line with the Széll Kálmán Plan, as these expenditures may only increase in line with amounts received from EU funds.
- As a result of the amendment of the Act LXXXIII of 1997 on the services of the compulsory health insurance system, the upper limit of sick pay benefit was reduced from four times the minimum wage to twice the minimum wage and the possibility for the so-called passive sick pay benefit ceased to exist as from 1 July 2011. Savings have so far been in line with the Széll Kálmán Plan.
- The Act CVI of 2011 on the modification of the acts on public employment and related to public employment and also other acts amended the Act III of 1993 on social administration and social benefits, and maximised the overall amount of social support transfers and wage substituting benefits available for families. Additional savings of HUF 10 billion in the Budget Bill stem from the abolishment of certain benefits provided by local governments, or rather from the accordingly decreased contribution from the central government. This serves as an incentive for local governments to provide support only for those in need.
- In the framework of the new Start-Job programme, the number of participants in public work schemes will increase substantially, expenditures on this item will be doubled compared to 2011. Reflecting differing specificities of the public work schemes from normal employment, public employment wages are lower than the minimum wage. Active persons with working capacities who are unable to get a temporary job in the public work schemes will be eligible to employment substitute benefit instead of the former wage substitute benefit. The Budget Bill assumes that no savings will be achieved

from the transformation of the wage substitute benefit, since the macroeconomic environment is significantly less favourable than expected at the time of the announcement of the Széll Kálmán Plan, thus the number of recipients is expected to be larger. In this area, the need for savings necessitates further measures.

- There is no indexation of family subsidies determined by law, therefore the Budget Bill calculates with unchanged nominal level of family allowance in line with the Széll Kálmán Plan.

PENSION SYSTEM

- Since real GDP growth in 2012 is expected to be below 3%, pensions increase by the inflation rate in line with the legislation in force (Act LXXXI of 1997 on social security pension benefits). The Bill T/4656 submitted to Parliament on the modification of certain acts underlying the Budget stipulates the changes in indexation: pensions continue to increase in line with the expected inflation.
- The Government submitted to Parliament the Bill T/4663 on the abolishment of early retirement schemes, early pensions and service dues. According to the Bill pensions in early retirement schemes are transformed to early retirement benefits, in case of armed forces, the pensions have been replaced by service dues. Following the review of the early retirement list and the abolishment of the early retirement schemes, as of 2012 no new rights to these entitlements can be gained. Entitlements of Members of Parliament and members of armed forces will be decreased by the amount of the personal income tax. The budgetary impact of the measure is in line with the Széll Kálmán Plan.
- The Budget Bill includes prudent assumptions regarding the review of disability pensions: the savings estimated may be achieved during several years; only about 30% is expected to be achieved in 2012.

PUBLIC TRANSPORT

On the basis of the Bill T/4656 on the modification of certain acts underlying the Budget, subsidies on travel discounts decrease (consumer price subsidies). The restriction of the discount system is expected to yield HUF 16 billion, while a more efficient fulfilment of functions and the termination of redundant schedules are expected to bring savings of around HUF 10 billion.

HIGHER EDUCATION

The Budget Bill assumes that regulation will ensure savings included in the Széll Kálmán Plan.

HEALTH CARE

The 1226/2011 Government decree stipulates the transformation of the pharmaceutical subsidy system in line with the Széll Kálmán Plan. The July 2011 amendment of the Act XCVIII of 2006 on the general provisions related to the reliable and economically feasible supply of medicinal products and medical aid and on the distribution of medicinal products, as well as the resolutions already in force or entering into force by 1 January 2012 that are underlying the measures, are expected to ensure the planned savings at the pharmaceutical subsidies. Pharmaceutical subsidies decrease by more than 25% compared to 2011.

PUBLIC AND LOCAL GOVERNMENT FINANCING

- In the framework of the rationalisation of the central public administration, headcount is reduced by around 7,000. This is expected to imply savings of HUF 29 billion, which is 2.5 times of what was originally planned.
- The appropriation of expenditures to local governments contains the planned savings.

DEBT REDUCTION FUND

In line with the Széll Kálmán Plan, the level of the bank levy remains unchanged in 2012.

Overall, 83% of the savings planned in March is included in the 2012 Budget:

The impact of the Structural Reform Programme on the 2012 Budget Bill

	Billion HUF	In per cent of GDP
Employment and labour market	158	0.54
Pension system	42	0.14
Public transport	26	0.09
Higher education	12	0.04
Health	83	0.29
Public and local government financing	44	0.15
Contribution to the Debt Reduction Fund	90	0.31
Total	455	1.56

MEASURES INCLUDED IN THE CONVERGENCE PROGRAMME AND FURTHER BALANCE IMPROVING MEASURES

Further to the important structural reforms that mainly bring benefits in the medium to longer term, appropriations in the Budget Bill were determined in line with the prudent planning described in the Convergence Programme:

- Nominal wages have been frozen in the public sector. The wage supplement compensating for the abolishment of tax credits for low earners remains in effect.
- In addition to the freezing of family subsidies, other social transfers do not increase either.
- Appropriations of budgetary chapters are based on the levels decreased by the 2011 stability reserve, making those measures structural.

The impact of the measures included in the Convergence Programme on the 2012 Budget Bill

	Billion HUF	In per cent of GDP
Freezing wages with the compensation of low income employees for the elimination of tax credit	43	0.54
Freezing social benefits other than family benefits	8	0.03
Freezing chapter reserves of constitutional chapters and reserves of the Media Service and Asset Fund	13	0,04
Elimination of spending included in the "stability reserve"	241	0.83
Total	305	1.05

Significantly stricter spending rules apply at central government level. Thus, in light of the new measures as well, intermediate consumption expenditures will decrease (see below).

SPECIFIC EXPENDITURE AREAS

After reviewing the financing position of the public transport companies, a debt takeover of MÁV and BKV in 2011 might be proposed to the Government, though in a smaller size than suggested earlier. The elaboration of the detailed measures is ongoing.

- Extra expenditure need in previous years from transfers to the railway transport company (MÁV) was typically related to track maintenance that was *not* included in the budget. (Bond issuance of MÁV amounting to HUF 35 billion backed by state guarantee this year is also attributable to this item.) The financing of passenger transportation proved usually to be sufficient. The appropriation for this latter purpose does not change significantly in 2012, while further to the subsidies of around HUF 192 billion (expenditures on interlocal

public transportation services and consumer price subsidies), HUF 47 billion is now appropriated for track maintenance. In addition, a part of the debt of MÁV is expected to be taken over this year, thereby decreasing the debt service expenditure of MÁV in both 2011 and 2012.

- In 2011, the public transport company of Budapest (BKV) received subsidies of HUF 52.2 billion (HUF 32.2 billion normative subsidies and gross HUF 20 billion consumer price subsidies). Additional expenditure need of HUF 24 billion (subsidies of HUF 19 billion already disbursed and government guarantee of HUF 5 billion to be provided) has arisen. The 2012 Budget Bill contains subsidies of again HUF 52.2 billion. No additional subsidy need is expected for 2012 due to the take over of the bulk of BKV's debt in 2011.
- The recapitalisation need of Malév can be tackled within the general reserve appropriations, if necessary. A number of factors indicate that this measure can be avoided. First, even under the present circumstances, there seems to be an interest from private investors to engage – after a possible restructuring – in the company. Second, there is an ongoing review of the possibilities for strategic changes ensuring the viability of the company, if it remains in state ownership. These may include organisational, operational and destination related changes. Altogether, recapitalisation would only be needed if none of the above options is realised. In that case, the reshuffling of appropriations within the budgetary chapter of state-owned assets and/or the partial use of the general reserve could safely ensure the recapitalisation without endangering the attainment of the deficit target.

In view of the increased risks surrounding the macroeconomic projections, the Budget Bill includes substantially **higher reserves** than what was assumed in the Convergence Programme. Apart from the general reserve (HUF 100 billion) to be used for exceptional measures by the government, i.e. to cover unforeseeable expenditures and/or revenue shortfalls, a new, special reserve for interest expenditures (HUF 50 billion) caters for any risks arising from potentially adverse global financial market developments. Furthermore, an additional safety reserve of HUF 150 billion (0.5% of GDP) is set aside to tackle any unexpected revenue shortfalls or expenditure overruns due to possibly worsening macroeconomic conditions. Sensitivity analyses suggest that a 1% slower GDP growth implies a deterioration of only around 0.4 percentage point, even if the deceleration is taking place in the worst structure, i.e. with the most negative effect on the balance (a weaker domestic demand). If a weaker growth path is accompanied by higher inflation, higher VAT revenues would partly offset the deterioration of the budget balance. On top of

the overall HUF 300 billion (1% of GDP) effective reserves, additional earmarked reserves of HUF 154 billion (0.5% of GDP) are also included in the Budget, that cover principally the compensation related to the changes in the tax system.

In light of the weaker growth outlook and also due to the decision of the Government to create sizable extraordinary reserves in the budget, the measures included in the Convergence Programme would not have ensured the attainment of the deficit target (net of the reserves). Against this backdrop, the Budget Bill contains further balance improving measures both on the expenditure and revenue side.

- The bulk of the measures on the expenditure side generate further savings at the central budgetary chapters, by the revision or complete elimination of tasks, by limiting the possibilities of assuming liabilities and the restriction of non-indispensable purchases.
- Tasks related to the operation, renovation and development of the national public road network (former Road Fund appropriation) are financed, besides the fees paid by users of highways, from extra revenues stemming from the extension of the road toll (instead of budget transfers). Details of the extended user fee system are elaborated by Ministry for National Development. A proposal with several alternatives is expected to be submitted to the Government in November.
- Concerning social benefits provided by local governments, employment substitute benefit should be brought in line with public employment wage determined as lower than the minimum wage. The Bill T/4656 on the modification of certain acts underlying the Budget amended the Act III of 1993 on social administration and social benefits. In accordance with the amendment, the employment substitute benefit decreases by 20%.
- The Bill T/4656 on the modification of certain acts underlying the Budget amended the Act LXXXIV of 1992 on the financial funds of the social security system. From 2012, pension entitlements will be significantly streamlined at the Pension Insurance Fund: entitlements paid below the mandatory retirement age will be provided partly by the Health Insurance Fund (disability benefits) and partly by the newly established National Social Policy Fund (advanced old age allowance, service dues and early retirement benefits).
- The Government submitted the Bill T/4662 on the modification of certain acts on taxes and other related acts to Parliament. On the revenue side, some tax bases will be broadened and certain tax rates will increase. The macroeconomic risk reserve (National Protection Fund) is practically financed from the revenue from the VAT rate increase.
- Contrary to the plans outlined in the Convergence Programme, tax credits in the personal income tax system and, below an income of HUF 202,000 per month, the so-called super-

grossing will be abolished already as of 2012. These changes are expected to be neutral to the balance, since the generated windfall revenues cater for the compensation of low earners.

Additional balance improving measures in the 2012 Budget Bill

	Billion HUF	In per cent of GDP
Expenditure side		
Narrowing of tasks in chapter managed appropriations and increase of own resources (fee revenues)	35	0.12
Review and more efficient management of public tasks and duties, reduction and abolishment of certain public tasks	110	0.38
Reduction of social subsidies granted at local level (decrease in employment substitute benefit)	18	0.06
Reduction of spending related to public assets	5	0.02
Expenditure reduction	168	0.58
Revenue side		
Increase of the standard VAT rate from 25% to 27%	140	0.48
Increase of excises (tobacco*, alcohol, gasoline)	42	0.14
Increase of gambling tax and taxing of on-line gambling	32	0.11
Increase in employee's contribution by 1 percentage point and broadening of the base of contributions	112	0.38
Broadening of the PIT base	16	0.05
Stricter condition on accounting losses in the CIT and increase of the company car tax	50	0.17
Increase of tax on unhealthy foods and broadening of tax base	10	0.03
Introduction of (insurance) tax on car accidents	27	0.09
Increase of other fees	11	0.04
Increase of product fees	36	0.12
Change of licence plates	12	0.04
Revenue increase	488	1.68
Total <u>additional</u> adjustment	656	2.25

* The impact of the increase of excise duty on tobacco was partly already included in the Convergence Programme projections.

As a result of the structural reform programme and of additional adjustment measures, the structure of public expenditures will change considerably. Social transfers will decrease by one percentage point of GDP and despite the significant extension of public work schemes, GDP-proportionate current operational expenditures (compensation of employees and intermediate consumption) will also decline. At the same time, taking into account the growing EU transfers, government investment will rise.

General government revenues and expenditures

in per cent of GDP

	2010	2011	2012
Revenues			
Total taxes and social contributions	37.6	35.7	38.6
Of which: taxes on production and imports	16.9	15.8	17.8
current taxes on income and wealth	8.0	6.3	7.1
social contributions	12.1	13.1	13.2
Other	7.6	16.1	7.6
Total revenues	45.2	51.9	46.2
<i>Total taxes and social contributions excluding one-off VAT refunds</i>	37.6	36.6	38.6
Expenditures			
Compensation of employees + intermediate consumption	18.7	17.7	17.4
Social transfers	18.5	18.3	17.3
Gross fixed capital formation	3.3	3.2	4.1
Other	4.8	5.0	5.9*
Primary expenditures	45.3	44.1	44.7
<i>Primary expenditures excluding EU-transfers</i>	43.0	42.1	41.6
Interest expenditures**	4.1	3.9	4.0
Total expenditures	49.4	44.0	48.7
Balance	-4.2	3.9	-2.5
Primary balance	-0.1	7.8	1.4

*: Including general reserve and macro-economic risk reserve

** : According to the EDP-methodology; in 2012 with the interest risk reserve.

REGULATION ENSURING THE SAFE IMPLEMENTATION OF THE BUDGET

Concerning implementation of the budget during the year, the Hungarian fiscal framework has binding breaks, i.e. several safety elements built into the regulation which ensure the achievement of deficit target.

- Budget transfers to any appropriation that would result in an increase of expenditures would need, as the organic law stipulates, the amendment of the budget law, and thus the decision of the Parliament. Neither the Government, nor the line ministries can increase their own budget transfers. (The government itself can only pursue the opposite: it can *decrease* these transfers.)

For any particular appropriation, expenditures can only increase above the budgeted figure for that appropriation, if additional windfall revenue of the line ministries occurs (that is not tax or tax-like revenue). However, such an increase of expenditures is deficit neutral; it does not increase the deficit as it is financed by extra revenue in that particular area.

Furthermore, also necessary *technical* condition would have to be satisfied to allow for overspending, namely that the Treasury would have to open an account on behalf of the beneficiary line ministry with a higher amount than adopted in the budget law. This is in fact not possible by law.

- Regarding additional savings in the appropriations of central budgetary chapters, the Government approved a resolution (Government resolution of 1334/2011. (X. 13.)) in which it calls managing directors of chapters (primarily ministers) upon to prepare an action plan for the implementation of savings incorporated in budget appropriations. The action plans must be approved by the Minister of National Economy, who only approves plans if these ensure the planned savings without any doubts. The action plans have been worked out by the ministers and are under evaluation of the Government, the decision about the further steps needed are expected in early November.
- Finally, the Audit and Budget Committee of Parliament submitted an amendment to the Budget Bill with the aim to introduce a rule-based framework on the use of the interest risk reserve and the macro-economic risk reserve. The amendment stipulates that these reserves can not be used before 30 September 2012 and that the Government may decide on the use, only if in the Autumn 2012 Notification the expected EDP-deficit for 2012 does not exceed 2.5% of GDP. When preparing the decision, the Minister for National Economy has to present a report on the economic and budgetary developments and expected EDP deficit and debt figures for 2012.

REDUCTION OF PUBLIC DEBT

The new Constitution, adopted on 25 April 2011 and entering into force on 1 January 2012, defines a 50% of GDP upper limit for the public debt, and requires the reduction of debt ratio until it reaches the reference level.

According to the new Constitution, another law may require the consent of the Government in case of borrowing or assuming any obligation by a local government exceeding the amount defined by the law.

In order to operationalise the debt rule set out in the new Constitution, a new law replacing the current Law on public finances of 1992 is under preparation. As planned, the Government will discuss the legislative proposal at the beginning of November, following which the proposal will be submitted to Parliament.

According to the concept of the new legislation, it will stipulate the implementation rules of the requirements included in the new Constitution with respect to government debt. In this context, the new legislation will include the definition and calculation of government debt,

the corrections to be applied with respect to the deviations within the given year, and the rules constraining the accumulation of debt. Regarding the rules constraining the accumulation of debt, the legislation will include an explicit rule requiring a legislative authorisation of debt creating transaction. This means that, as a rule, budgetary institutions on their own behalf are not allowed to conduct these types of transactions, while local governments and institutions belonging to the government sector according to the ESA95 definition but not counted in the Hungarian definition of general government are allowed to conduct this type of transactions only with approval. This measure will ensure that the transactions conducted by organisations so far outside the scope of the Government and Parliament will be controlled as well.

As to the definition of government debt, the legislation aims at a definition close to, but not entirely identical, with the Maastricht definition. This means that the scope will roughly correspond to the scope of ESA covered institutions (general government and other institutions of the government sector), but regarding specific transactions, the consolidated debt defined according to the Hungarian accounting standards will be taken into account. This indicator, with minor statistical adjustments, will correspond to the general government debt concept of the EU standards.

Structural Reform Programme (Széll Kálmán Plan)		455
		Billion HUF
1. EMPLOYMENT AND LABOUR MARKET		158
		Legal status of decision
Reduction of passive labour market provisions	Termination of job seeking assistance	Act CVI of 2011 on the modification of the Acts on public employment and related to public employment and other Acts
	Overhaul of the wage supplement system	0,0
	Tightening the conditions of job seeking benefits	50,0
Reduction of active labour market and vocational training provisions	Replacement of part of the active labour market and vocational training provisions by EU funds serving the same purpose	Budget bill for 2012
	Review and modification of the conditions of granting sick pay	40,5
Reduction of sick pay expenditures	Review and modification of the conditions of granting sick pay	Amendment of Act LXXXIII of 1997 on the benefits provided by the mandatory health insurance system
Capping social benefits	Capping the total amount of social and family benefits which can be granted on various grounds	Act CVI of 2011 on the amendment of the Acts on public employment and related to public employment and other Acts (social assistance); Budget bill for 2012, annex 3, item 10 (nursing and specific child care subsidies granted by local governments; Amendment of the Act III of 1993 on social management and provisions 69(8) (abandon local home maintenance subsidies)
Family benefits	Nominal freeze of family benefits	11,9
		18,0
		2012 Budget Bill; Bill number T/4365
2. PENSION SYSTEM REFORM		42
	Changing the rules of the pension increase at the beginning of the year, pension increase based on CPI	0,0
Pension system	Review of the schedule of professions eligible for retirement earlier than the statutory retirement age	Bill number T/4656 on the modification of certain acts underlying the Budget
	Termination of special pension rules for members of the armed forces	8,0
		Bill number T/4663 on "Old age pensions under retirement age, provisions for those under retirement age, and professions eligible for retirement earlier than the statutory retirement age"
		8,0
		Bill number T/4663 on "Old age pensions under retirement age, provisions for those under retirement age, and professions eligible for retirement earlier than the statutory retirement age"
Overhaul of the allowances related to disability status and health status	Review of the qualification conditions of granting disability pensions, overhaul of the allowances	25,9
		Government Regulation 387 of 2007 on Social benefits of disabled persons 22(7) entering into force as of 1 January 2012

3. PUBLIC TRANSPORT

Setting-up of the National Transport Holding Company

Integration of MÁV and Volán, setting-up of an integrated management company, more efficient governance structure

0,0

Re-structuring of MÁV and improvement of its cost-efficiency

Improving the operational conditions of MÁV

10,0

Budget bill for 2012, annex 1, chapter XVII, item 21-1-3, Transfer for the costs of interlocal public transportation

Review of the the preferential tariff system

Reduction of price subsidies

16,0

Budget bill for 2012, annex 1, chapter XLII, item 31. *Consumer price subsidy*

4. HIGHER EDUCATION

Reduction of the number of students

Reducing the enrolment in both state-subsidised and tuition fee based higher education, changing the composition of curricula by giving preference to natural sciences and technology

5,4

Government decisions

Structural measures: reduction of institutional and other organisational capacities and determinations

Elimination of capacities not utilised, termination of statutory financing needs

6,6

	Billion HUF	Legal status of decision
5. HEALTH	83	Government decision 1226/2011. (VI. 30.) contains restructuring of drug subsidies in accordance with SZKT
Revenue increase: raising the payment by pharmaceutical companies	15,5	Amendment of Act XCVIII of 2006 on the general rules of safe and effective supply and distribution of pharmaceuticals
Generic program (system of preferred reference price range, encouraging the use of generic products)	25,0	Amendment of the Decree of the Minister of Health (ESZCSM) 32 of 2004 on rules of social security subsidies to registered drugs and nutrition meeting special dietary needs
a) in case of expired patents - replacement by generic products and b) encouraging the use of first generics	5,0	a) Amendment of Act XCVIII of 2006 on the general rules of safe and effective supply and distribution of pharmaceuticals and amendment of the Decree of the Minister of Health (ESZCSM) 32 of 2004 on rules of social security subsidies to registered drugs and nutrition meeting special dietary needs b) Needs amendment of ESZCSM decree of 32/2004 and EÜM Decree of 41/2007 (in relation to pharmacies operating in health care institutions) with effect from January 1, 2012.
a) subsidy scheme for bio-like drugs and b) subsidies based on therapy results	4,0	
Revision of the therapies	7	Amendment of the Decree of the Minister of Health (ESZCSM) 32 of 2004 on rules of social security subsidies to registered drugs and nutrition meeting special dietary needs
Subsidies conditional on the cooperative behaviour of patients	2,0	Amendment of Act XCVIII of 2006 and ESZCSM decree of 32/2004. to be effective from January 1, 2012. Further, amendment of NEFMI Decree of 11/2011 (III.30.) on the performance review of family doctors; Government decree of 364/2010 (XII.30) on pharmaceutical supply for health care providers, and NEFMI decree of 11/2011 (III.30). Savings show up on the appropriation titled expenditures on pharmaceutical subsidies.
a) international reference pricing and b) review and price fixing of composite drugs	5,0	a) Amendment of Act XCVIII of 2006 implemented in 2009. Needs amendment of ESZCSM decree of 32/2004, to be effective from January 1. b) XXX on the amendment of the Decree of the Minister of Health (ESZCSM) 32 of 2004 on rules of social security subsidies to registered drugs and nutrition meeting special dietary needs
Reduction of subsidies on drugs which decrease the level of cholesterol	9	Amendment of the Decree of the Minister of Health (ESZCSM) 32 of 2004 on rules of social security subsidies to registered drugs and nutrition meeting special dietary needs
Savings through re-shuffling of financing	5,0	The list of newly categorised pharmaceuticals and the professional conditions of their application need to be published in NM decree of 9/1993 (IV. 2) on the financing of health care provision, from January 1, 2012.
Overhaul of the principles applied for equity consideration in individual cases	3	
Overhaul of the special public subsidy system for the poor	2,5	Act LXXXI of 2011 on the amendment of certain acts related to health care and amendment of Act XCVIII of 2006 (transformation of the public curative provision system)
Further long-term measures regarding the enhancement of the effectiveness of the subsidy system	0,0	

	Billion HUF	Legal status of decision
6. STATE AND MUNICIPAL FINANCING		
	44	
Organisational development of local governments	15,0	Budget bill for 2012
Re-shuffling compulsory tasks performed by local government based on economies of scale		
Prohibition of taking loans for current operations, introducing Government control on taking loans for investments		
Strengthening the tax authority	0,0	
Strengthening the tax authority, simplification of taxation procedures		
Rationalisation in central public administration	28,9	Decision on the elimination of 7043 positions (HUF 28.9 billion)
Rationalisation of the functioning of central and background institutions, prohibition of outsourcing		
7. CONTRIBUCTIONS TO THE FUND ESTABLISHED TO REDUCE PUBLIC DEBT		
	90	
Electronic toll system	0,0	
Immediate launch of the establishment of a usage-based electronic toll system, use of system from 2012 2nd half year		
Bank tax	90,0	
Compared to the base line (that from 2012 contain 50%) all the tax income appear in 2012 (the difference is the 50% of the current amount), however from 2013 the tax is laid on only for banks.		
Corporate income tax	0,0	
The standard corporate income tax rate will not be reduced to 10% from 2013.		

MEASURES OF CONVERGENCE PROGRAMME

305

	Billion HUF	Legal status of decision
Freezing wages with the compensation of low income employees for the elimination of tax credit	42,8	Budget bill for 2012 57-59
Freezing social benefits other than family benefits	8,3	no legal obligation to increase
Elimination of spending included in the "stability reserve"	241,2	
X. Ministry of Public Administration and Justice	15,8	
X. Government Control Office	0,1	
XI. Prime Minister's Office	0,4	
XII. Ministry of Rural Development	18,7	
XIII. Ministry of Defence	26,3	
XIV. Ministry of Interior	35,0	
XV. Ministry for National Economy	5,9	
XVI. National Tax and Custom Administration (NAV)	13,3	
XVII. Ministry of National Development	20,6	
XVII. Ministry of National Development - with subsidy of KTI/A	9,0	Act CXIV of 2011 on modification of the Act CLXIX of 2010 on the budget of Hungary
XVIII. Ministry of Foreign Affairs	7,6	for 2011
XIX. European Union Developments	0,6	
XX. Ministry of National Resources	38,0	
XXXI. Hungarian Central Statistical Office	1,0	
XLII. Direct income and expenditure of the budget	0,5	
XLIII. Income and expenditure with the state asset	10,0	
XLIV. Income and expenditure with the Found of National Land (NFA)	0,5	
LXIII. Fund of labor market	25,3	
LXVII. National Cultural Fund	1,6	
LXIX. National Innovation Fund	9,0	
LXXI. Pension Insurance Fund	1,1	
LXXII. Health Insurance Fund	1,1	
Freezing of chapter reserves of Constitutional Chapters	7,7	
Freezing of reserves of MTVA (Media Service and Asset Fund)	5,0	

MEASURES UNDERLYING 2012 BUDGET

656

Legal status of decision

Billion HUF

EXPENDITURES

168

Cut in chapter administered appropriations	4.4	Budget bill for 2012, annex 1
Abandon budget transfers to Road Fund (replacement by fees)	30.8	Budget bill for 2012, annex 1, (termination of state transfers to the Road Fund); 2012 Budget Bill chapter XVII, item 8 (introduction of a new fee)
Reduction and abolishment of state tasks	109.6	Budget bill for 2012, annex 1
Reduction of expenditures related to state assets	5.0	Budget bill for 2012, annex 1
Restructuring social assistance provided by local governments	18.4	Bill on the amendment of the Act III of 1993 on social management and provisions (decrease in the level of employment substitute benefit)

REVENUES

488

Increase of standard VAT rate from 25% to 27% (not calculating with expenditure side compensation)	150.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 104§ (1)
End of prohibition of the deduction of lease of passenger cars	-10.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 117§
Increase of alcohol excise duty by 5% (in certain cases with 50%)	3.0	CXXV law 2011 on amendment of some taxes of law for stabilizing government, 3§, 5-8§§§
Increase of tobacco tax amounts (2011nov-2012may-2012nov): cigarette: 8%-7%-4%, other smoking tobacco: 11,8%-10,6%-7,4%	23.5	CXXV law 2011 on amendment of some taxes of law for stabilizing government, 1 9-11 §
Increase of excise duty of diesel oil with 13F/I/ with the increase of amount claimed by transporters and the increase of refund ratio for agricultural use	16.0	CXXV law 2011 on amendment of some taxes of law for stabilizing government, 1-2§, 17§
Representation and business gift from corporate tax to personal income tax, effect on PIT	6.6	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 19§, 20§
Stricter carry-forward rules of losses in CIT	31.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 36§
Representation and business gift from corporate tax to personal income tax, effect on CIT	-1.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 351 §
Representation and business gift from corporate tax to personal income tax, effect on Health Insurance Contribution	9.4	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 20§
Taxation of online gambling and increase of tax of money gainer machines	32.0	CXXV law 2011 on amendment of some taxes of law for stabilizing government, 18-31§
Widening the base of health SSC (full time individual and associations)	29.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 184 §, (modification of law on social securities contributions 19 § (3))
Increase in employee's health contribution by 1 percentage point	83.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 187-189 § (modification of law on social securities contributions 27, 29 and 29/A §)
New tax (linking with the compulsory insurance of vehicles)	27.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 177 §
Widening the base and increasing the degree of Tax on Unhealthy Food	10.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 174-175§
Increase the corporate car tax level by 40%, based on kW, considering the environmental classes (at the moment the tax based in cm3)	20.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 167 §
Alteration of the base of fee of motor-vehicle asset (in place of the engine of vehicle the fee depend on the age of vehicle and the power)	6.5	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 133 §
Increase of fee of general item	1.0	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 135 §
Increase of certain judicial process fees	3.2	Bill number T/4662 on amendment of respective laws on taxes and on connected laws 138 §
Increase of product fees	36.0	
Change of licence plate	12.0	

Total adjustment measures

1416

Annex 2 The macroeconomic outlook

Renewed risks from the debt crisis in developed countries evoked financial uncertainties that resulted in worsening business and household confidence among Hungary's major foreign trading partners.

The renewed crisis situation affects the Hungarian economy through both external and internal channels. Reduced prospects of external demand for the remaining part of 2011 and for 2012 moderates the growth of exports, which is the main driver of Hungarian GDP growth. The slowdown in export growth has unfavourable effects on manufacturing activity and hence on labour demand, thus decreasing both households' income and corporate profits.

Increasing risk premia bring about tighter credit conditions that constrain investment and household consumption. Even though previously announced major manufacturing investments are carried out as planned, household investments do not grow as expected earlier. The appreciation of the Swiss Franc increased the debt service of households and the resulting lower disposable income moderates private consumption. Moreover, the increased uncertainty is a further incentive for households to build up additional precautionary savings.

The additional adjustment measures underpinning the 2012 budget proposal include a number of expenditure and revenue side elements. The reduction of government expenditures has a direct effect on government consumption and therefore moderates GDP in 2012. On the revenue side, the increase of the VAT rate to 27% has both a one-off inflationary effect in 2012, as well as it reduces real disposable income and thus household consumption. The increase of excise taxes has an impact through the same channels, i.e. it contributes to higher inflation and lowers consumption. The widening of the base of social contributions and the increase of health care contributions by 1 percentage point have also some negative impact on households' balance sheets and slightly on employment.

Mainly as a result of weaker economic conditions and, to a lesser extent, due to the indirect effects of the announced measures, GDP growth is expected to be significantly slower than projected in the 2011 Convergence Programme. Lower growth rates are expected both for household consumption and for gross fixed capital formation. In the public work scheme, the number of full-employed is expected to increase in 2012, whereas the reduction of government expenditure by recent measures offsets this effect on government consumption. Therefore, domestic demand contributes less to GDP growth, while net exports remain the key driver of growth. In 2011, inflation is expected to moderate to 3.8%. In 2012, it is expected to rise to 4.2% due to the above mentioned one-off effects, then to

gradually decline to the central bank's inflation target. The risks around the current forecast are balanced, and mainly stemming from the uncertainties related to external developments.

Macro-economic projections*

	2009	2010	2011		2012	
	Fact	Fact	CP	2012 Budget Bill	CP	2012 Budget Bill
GDP growth, %	-6.7	1.2	3.1	1.9	3.0	1.5
Household consumption expenditure	-8.1	-2.1	3.1	0.7	2.2	0.2
Gross fixed capital formation	-8.0	-5.6	5.7	-2.0	5.3	3.2
Exports	-9.6	14.1	9.7	8.8	10.5	8.4
Imports	-14.6	12.0	9.7	7.7	10.4	8.1
Employment growth, %	-2.5	0.0	0.7	0.7	2.0	1.5
Unemployment rate (15-74), %	10.0	11.2	10.9	10.9	10.5	10.7
CPI, %	4.2	4.9	4.0	3.8	3.4	4.2

* The cut-off date of the macro-economic projection for the budget bill was 28 September 2011.

Annex 3 HUNGARY IN THE LIGHT OF THE NEW EU SURVEILLANCE MECHANISM OF MACRO-ECONOMIC IMBALANCES

The Excessive Imbalance Procedure (EIP) is a new element of the EU's economic surveillance framework. Its aim is to identify and repair macroeconomic imbalances and complements the fiscal surveillance mechanism already in place. The first exercise will start at the beginning of 2012. In the first phase the European Commission will prepare a report containing a qualitative economic and financial assessment based on a scoreboard which contains a number of key macroeconomic and macro-prudential indicators, and measures performance of Member States against pre-defined indicative thresholds.

The threshold values would serve as a reference point only, thus exceeding them would not necessarily mean the existence of an imbalance. However, should the forecasting system and the Commission's qualitative analysis indicate the risk of imbalance, following thorough examination, the respective Member State may be declared to be in an "excessive imbalance position".

The finalisation of the precise set of indicators and their indicative thresholds is ongoing. However, the legislation already gives a list on the main areas of the assessment, which allows a preliminary evaluation of the Hungarian position related to the scoreboard. The legislation ("Regulation of the European Parliament and of the Council on the prevention and correction of macroeconomic imbalances") provides separate sets of indicators, measuring internal and external imbalances.

'The scoreboard shall, inter alia, encompass indicators which are useful in the early identification of:

- (a) internal imbalances, including those that can arise from public and private indebtedness; financial and asset market developments, including housing; the evolution of private sector credit flow; and the evolution of unemployment;
- (b) external imbalances, including those that can arise from the evolution of current account and net investment positions of Member States; real effective exchange rates; export market shares; changes in price and cost developments; and non-price competitiveness, taking into account the different components of productivity.'

Conclusions shall not be drawn from a mechanical reading of the scoreboard indicators. The assessment shall take into account many other relevant indicators and factors, which are necessary in order to have an overview of the Member State's position.

Internal imbalances can be assessed by the evolution of public and private debt, by indicators showing the development of asset prices, (for example the evolution of prices in the housing market), private sector credit growth and rate of unemployment. In the case of Hungary, public debt and private sector indebtedness can be considered higher than desirable. The level of the other indicators does not point to the existence of an imbalance.

External imbalances can be assessed by analysing the evolution of the current account balance, net international investment position, real effective exchange rate, export market shares and the ULC. In the case of Hungary most of these indicators do not show extreme levels, with the possible exception of the net international investment position. Nevertheless this indicator should be assessed together with net FDI flows, which gives a more realistic picture.

All in all, the indicators as of now seem to support the view that Hungary's key vulnerabilities are high public and external debt (an issue explicitly addressed in the Structural Reform Programme), while the indicators related to the real economy (like competitiveness) draw a more favourable picture.