

# UPDATE

## on

### HUNGARY'S STRUCTURAL REFORM PROGRAMME (HSRP)

#### TIMETABLE

1 April 2011

### Target Deficit 2010

In January the Ministry for National Economy –based on the relatively favourable preliminary data of the central state budget- assumed that the target deficit of 3.8% for the year 2010 would be met. However, the results of the revised reports of the municipalities already forecast an overrun.

The connection between the EDP deficit and the cash-based deficit of the state budget, as the Hungarian budget presentation formulates, the so-called EDP-bridge in the year 2010. The structure of the EDP-based on the prediction of the Ministry for National Economy and the new calculations of the Central Statistical Office- is the following.

Breakdown of the EDP bridge	2010 expected (NGM)		2010 (KSH)		Deviation (Preliminary-expected)	
	HUF bn	GDP %	HUF bn	GDP %	HUF bn	GDP %
<b>Balance of the central budget</b>	-882,3	-3,3%	-869,8	-3,2%	12,5	0,0%
<b>Balance of the self-governments</b>	-190,0	-0,7%	-247,3	-0,9%	-57,3	-0,2%
<b>Balance of the cash-based budget</b>	-1 072,3	-4,0%	-1 117,2	-4,1%	-44,9	-0,2%
<b>Accrual calculation</b>	74,3	0,3%	3,1	0,0%	-71,2	-0,3%
<b>Financial transactions</b>	-10,0	0,0%	24,9	0,1%	34,9	0,1%
<b>Organisations (NIF Zrt., non-profit organisations etc.)</b>	-3,1	0,0%	-9,7	0,0%	-6,6	0,0%
<b>Other corrections</b>	-25,1	-0,1%	-33,2	-0,1%	-8,1	0,0%
<b>Balance as of EDP</b>	-1 036,2	-3,8%	-1 132,0	-4,2%	-95,8	-0,4%
<b>EDP-bridge</b>	36,1	0,1%	-14,8	-0,1%	-50,9	-0,2%
<b>GDP</b>	26 980		27120			

*Differences in the table are due to rounding*

Government steps taken in connection with maintaining the deficit had a significant role in the deficit of 2010: first action plan consisting of 29 points (budgetary savings, introduction of bank tax), the second action plan (introduction of crisis tax, re-direction of the contributions of compulsory private pension funds) furthermore measures stipulated in the Government decisions

of 1132/2010. (VI. 18.) and 1268/2010. (XII. 3.). The actions carried out in the two action plans and in Government decisions -- in order to sustain appropriate budgetary management -- resulted in a 420 billion HUF excess revenues. By the freezing of funds and strict budgetary management 200-250 billion HUF expenditure cuts have been achieved. The majority of organisations obliged to pay extra taxes have properly fulfilled their obligations- contributing the sustainability of the Budget of last year and the development of stable macro-economical environment, however, insignificant leeway of payments stretching to the year 2011 can be observed. The Ministry for National Economy published a detailed report on the 2010 cash-based deficit of the central state Budget.

The majority of the corrections for the EU standard EDP balance are connected to the central subsector statistically. Funds in the Budget, business organisations, non-profit organisations and transactions on behalf of the state without cash-flow or transactions with money circulation out of Budget belong to this area. In the central Government the conversion to the accrual-based accounting causes deviation in relation with the 3.8% target deficit. The major areas of this are the following:

1) The EDP-bridge of the personal income tax of 2010 came in 0.1% below the expectations:

- The traditionally high non-regular payments in December (e.g.: bonuses, dividend etc) lag behind in December 2010 compared to the values of December 2009 as the tax payers postponed their payments in order to take advantage of the more favourable tax regulations of 2011.
- The changes in tax regulation between December 2009 and December 2010 also resulted in paying less tax.

2) In the accrual-based accounting of the value added tax there is a negative deviation of 0.1% of GDP with similar payments in January 2010 and 2011. Intensifying VAT claims for 2010 are shown. The VAT refunds had a significant impact on the net VAT revenues in the first months of 2011.

3) According to the calculations of the Central Statistical Office, the accrual-based interests showed 0.1% loss of the GDP in the balance. However due to the different statistical method in the so called EDP interest the cash-flow of financial derivatives is also present with 20 billion HUF extra in the balance causing a neutral effect.

4) The profit oriented accounting of the revenues deriving from the European Union budget means that the Union revenues must be accounted at the time when the expenses of the project are paid regardless when, in fact, the EU transfers them to a member country. As it is well-known, developments that were started from national resources can be qualified as a Union project afterwards based on a special permission and in such cases and also in the case of all programmes in their final phase when the member country is obliged to pay the final (5 or 20 percent) instalment in advance the difference in the timing of expenses and the related revenues will appear in the financial budget. On the basis of the information from a relevant authority the difference can be evened out. Based on the negotiations of 2010, accounting was more favourable with the amount comprising 0.1 percent of GDP than forecast in December.

5) The amount of debt of the central budgetary institutions owed to suppliers increased by 27 billion HUF, i.e. 0.1 percent of GDP in comparison with the one at the end of the previous year. This results in a worse balance according to accrual-based accounting. The Hungarian Treasury publishes the changes and composition of its outstanding or rescheduled debt monthly and also operates the system of treasury supervision to control the institutions in a dire financial situation.

As far as the institutions are concerned which are under direct governmental management, the government met the deficit target set before – moreover, the result was better if calculated relative to GDP.

**Social security** is an independent governmental subsector in the Union's statistical accounting. The 2010 EDP balance of social security is influenced by the following correction items:

1) The 2010 EDP bridge of the revenues that derive from social security and healthcare contributions was 0.1 percent less than expected in December as the revenues from the contributions in December 2010 were below the expected level regarding the fact that the non-regular payments at the end of the year were postponed to 2011 when personal income taxes became lower.

2) Statistically, the 27 billion HUF accounted as the utilization of the remnants of 2007 in social security contributions could not be qualified as current revenues of 2010.

3) Debt restructuring or relief is an item that influences EDP balance in the Union's statistical accounting. It does not affect the EDP balance of the governmental sector as a whole but the fact that the Parliament will decide on relieving the liquidity loan of the social security funds at the end of the accounting year, within the framework of the act on accounting, has a substantial impact on the independent EDP balance of the central governmental and social security subsectors. This decision is reflected by the statistical accounting in the year of its making that the amount of debt

relief, which was 156.7 billion HUF in 2010 as defined by the accounting act of 2009, appeared as an expenditure of the central government and the revenue of social security.

According to the budgetary report of **municipalities**, their deficit reached 97 billion HUF in the first three quarters. That is why in December the Ministry for National Economy could not find it justified to change the deficit of the municipality subsystem that was estimated to have reached 190 billion HUF. In the past years deficits usually ran high in the final quarter but such a deficit of 150 billion HUF had not really been expected in the final quarter. The financial accounts statistics of MNB (National Bank of Hungary) based on bank and securities-statistical data and published in February forecast that the accrual-based deficit of municipalities would also be higher than the municipal deficit calculated to the 3.8 percent target deficit.

According to the January report of the local municipalities, the cash-based deficit amounted to 247.7 billion HUF. By learning from the situation, the Ministry for National Economy examines not only the more regulated loan applications of municipalities where licensing is necessary but also the necessary means to monitor the budgetary and financing position of municipalities more frequently.

The abolition of business tax and the realisation of the motor vehicle tax, duties and other revenues in lower amounts were decisive in the creation of the higher payment deficit of municipalities. Simultaneously, the fact that the profit-oriented deficit of municipalities was a bit lower than the payment deficit, the number of unpaid invoices hardly increased and the balance of the January/end of January wages and salaries resulted in some savings can be stated favourable. The business companies and non-profit organisations listed in the municipal subsector by the statistical definitions further increased deficit although to a slight extent.

## **The expected extent of 2011 deficit**

**The Government is still committed to maintain the deficit targeted in this year's budgetary act.** To obey the regulations laid down there it wishes to meet the 2.94 percent deficit fixed by the terminology that has been applied so far. However, 2011 will be an extraordinary year regarding the budget. Due to the changes in the private pension fund system the follow-up of the processes **will require greater attention than before.**

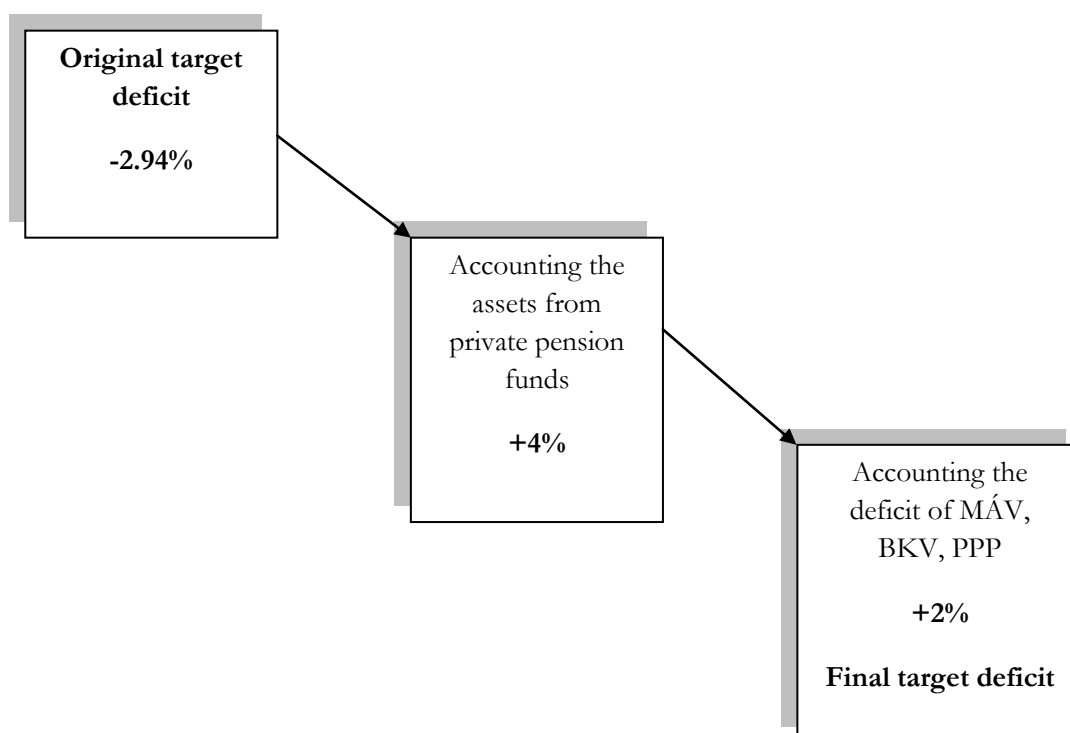
In the process of planning the budget the Government **counted with the fact that 529 billion HUF deriving from the assets of those returning to the state pension system from the private pension funds would be channelled back to the state pension fund**, which is

necessary to meet the deficit target. However, the assets of those returning to the social security system can **improve our Maastricht balance**. Taking the fact above into consideration this year's deficit will become surplus amounting to 4 percent of GDP instead of the targeted 2.94 percent deficit due to statistical accounting. Therefore, the assets of the private pension funds will be channelled back to the state as previously projected. The above-mentioned 529 billion HUF will improve the balance of the pension fund while **the entire remaining part will be spent on decreasing public debt**.

Taking the above-mentioned things into consideration due to the one-off assets consequence our budget would uniquely **show 4 percent surplus which, in fact, has not occurred since the regime change**. However, the Government decided on taking over part of the debt burden of MÁV and BKV. This step will decrease surplus by 1.3 percent as of GDP. Furthermore, another decision was made on **PPP projects**, which means a shift of 0.7 percent as of GDP.

The two great factors of correction detailed above (accounting of pension funds, taking over debt burden) that appear as one-off items **will modify the original deficit figure to 2 percent surplus as of GDP**. However, it is important to note that statistical changes **will not modify the original figures accepted in the budget**. The Government wishes to maintain the target deficit exempt from one-off impacts and this dedication is also reflected in the already accepted blocking of 250 billion HUF.

### Changes in the deficit



## Convergence programme

Cutting public debt is the number one priority of the Hungarian government. The measures implemented in 2010 contributed to the consolidation of the Hungarian budget but the economic and fiscal objectives cannot be met in the medium and long term unless structural reforms are introduced. Budget stabilization, a balanced budget and a medium-term fiscal equilibrium demand additional structural measures. In order to reach ambitious objectives, such as reducing the public debt-to-GDP ratio to below 50%, achieving a growth rate of 4-6% as well as creating one million new jobs by the end of 2020, the Hungarian government must carry out further comprehensive and productive measures.

**The convergence programme which will be published on 15 April 2011** will contain the concrete steps essential for increasing employment, boosting economic growth, improving the competitiveness of the country and securing fiscal balance. The convergence programme will provide detailed insight about the measures which the government will implement in 2011 in certain fields of concern (municipality system, pension-type benefits, social system, public finances, public transport) having considered budgetary requirements.

	2011	2012	2013	2014
<b>TOTAL</b>	<b>12</b>	<b>550</b>	<b>902</b>	<b>902</b>
<b>1. EMPLOYMENT and LABOUR MARKET</b>	<b>0</b>	<b>195</b>	<b>213</b>	<b>213</b>
<b>2. PENSION SYSTEM REFORM</b>	<b>12</b>	<b>93</b>	<b>129</b>	<b>129</b>
<b>3. PUBLIC TRANSPORT</b>	<b>0</b>	<b>45</b>	<b>60</b>	<b>60</b>
<b>4. HIGHER EDUCATION</b>	<b>0</b>	<b>12</b>	<b>38</b>	<b>38</b>
<b>5. PRESCRIPTION DRUG SUBSIDY SYSTEM</b>	<b>0</b>	<b>83</b>	<b>120</b>	<b>120</b>
<b>6. STATE and MUNICIPAL FUNDING</b>	<b>0</b>	<b>32</b>	<b>122</b>	<b>122</b>
<b>7. CONTRIBUTIONS TO THE FUND ESTABLISHED TO REDUCE PUBLIC DEBT</b>	<b>0</b>	<b>90</b>	<b>220</b>	<b>220</b>

*Source: Hungary's Structural Reform Program*

## Hungary's Job Creation Plan

The obvious and unequivocal priority of the economic policy of the current Government is the creation of such economic environment where **work stands in the centre of making a living and state support is only provided for those who are really in need**. As a result, the promise of one million jobs in ten years was made, which is one of the few direct undertakings in the Hungarian political life that can be controlled.

The decisions made in the first nine months of the Government have obviously served **balance-centred economic policy as there were no other alternatives to solve the problems inherited from the budget of 2010**. Regarding the measures made during the above-mentioned period that serve budgetary balance **there was not always an opportunity to consider their impacts on employment**. As a consequence, the expected optimal effect on this area was not ensured. However, even at that time such decisions were also made that served to improve the employment situation.

**The decrease of corporate tax, lessening administrative burdens and the introduction of the new personal income tax system** outlined in the action plans belong to the visible and perceptible changes. In addition, an important step was also made **to solve the problems of qualification** by rethinking the system of vocational training and **harmonising it with the entrepreneurs' needs**.

**However, the labour market is a slowly changing system**. Its current problems go back to **the regime change** and moreover, **the situation has been further aggravated in the past eight years**. Everyone knows the important figures that **our activity rate is the lowest in the EU** as approximately there are one million employers less in our country than in the Czech Republic that is of a similar size. Although it is just an indicator but the fact that the trend has been similar for twenty years signals that **our problems also have deep social roots**. A vast number of social layers have been alienated from work and also for a part of the younger generation employment did not represent the example to be followed. Such deeply rooted problems cannot be eradicated within some months' time and **changing them needs more time and a properly formulated strategy**.

That is why the Hungarian Government is committed to **prepare the Hungary's Job Creation Plan by 30 April this year** while **keeping** and supplementing the measures of Széll Kálmán Plan. In it, the nature of the problem will be explored and the factors that generate it will be identified and finally offer a solution to manage the current situation. The objective of the

Job Creation Plan is to show the way and the things to do concerning the one million new jobs to be created by 2020. Within its framework the Government is still **committed to create 300 000 jobs by 2014.**

Within the framework of the Job Creation Plan a suggestion of a **new Labour Code** will be made whose objective is **to create the most flexible labour market of the EU in our country.** Within the framework of the Plan **atypical employment forms** will be analysed together with **the system of communal work** in an international comparison. Further suggestions will be made to lessen administrative burdens concerning employment and **legalise not registered employment.** The **institutional system of employment policy** will also be revised together with **the system of the objectives and instruments of active labour market policies.**

## **Cooperation with the Bank Alliance**

**Several structural transforming measures were made by the Government** to ensure speedy economic recovery and found future growth after the world economic crisis. In addition to the real economic climate **the proper operation of the financial system is also an indispensable criterion to launch constant growth.** When considering the single steps it is essential for the government to count on the expertise of, and cooperation with the banking system.

Based on the facts above, the **Government wishes to make such a contract with the Bank Alliance that has no negative impact on the budget and offers solutions for the following problems:**

### *1. Solving the problem of foreign currency-based debtors*

**The significant depreciation of the Hungarian forint compared to the Swiss franc has swept a lot of debtors to the edge of their solvency.** The temporarily further appreciation of the Swiss currency cannot be excluded due to the debt crisis of the Euro-zone and other global uncertainties, whose impact can significantly raise the proportion of non-payers. To offset this, **the Government wishes to protect the debtors from a possibly unfavourable change in the rate of exchange for a fixed period.**

### *2. The demand of the banks for government securities*

It is essential to count on a demand for more and more stable government securities in the case given even in turbulent periods to ensure the financing of the budget. **A solution can be part of the agreement with the banking sector that helps the stability of state financing and**



considers the prosperity of the financial sector and the launch of crediting that is necessary for economic growth.

### *3. Financing small and medium-sized enterprises*

Regarding the situation of the Hungarian SME sector catching up can be noticed in many important areas although there is still a considerable backlog relative to the developed countries. **SMEs play an extremely important role in the Hungarian economy** and their significance is especially great in employment and also in making the economic prosperity based on increasing domestic consumption constant.

**These enterprises are generally operating undercapitalised at present so they need both capital and loans** to ensure the adequate resources to keep their existing markets and gain foothold in new ones. This can be achieved partly by the involvement of the state and partly by making use of Union funds. However, **the banking sector must also play an important role due to the scarcity of the available financial instruments.**

### *4. Home Projects*

**The prioritised objective of the Government is to assist in acquiring a home** by means of a Home Project. However, **the active participation and support of the banking sector is indispensable** to finance the programme together with forming the common strategy of the state and the banks. **The stability of the banking sector is also an important issue** as only a stable enough financial system can ensure the necessary resources required by the public and the enterprises. In addition to consolidating the credit market **further recommendations aimed at boosting the real estate market must also be incorporated into the Home Project.**

### *5. Restoring the euro-based loans*

**As an aftermath of the global financial and economic crisis of 2008, the withdrawal of foreign exchange –based mortgages started** especially in the case of loans denominated in Swiss francs. Within this framework only 330 billion HUF of housing loans in 2009 and even less, i.e. 230 billion HUF in 2010 were transferred in contrast with 850 billion HUF in 2008. **With the disappearance of Swiss franc constructions the euro-based loans played a decisive role** among the domestic housing loans (half of the housing loans taken on in 2009 were euro-based). However, **this phenomenon was only temporal** that lasted till the regulation that prohibited foreign currency-based mortgages took effect. Therefore, with regards to the current situation, **the re-introduction of the possibility of euro-based loans in addition to the forint must be reconsidered in the case of public mortgages.**

## *6. Career precautionary savings*

**Promoting the long term public savings is an important interest of the national economy** and generally it has a favourable impact on economic growth through the way of life that is in harmony with financial means and the way of life that encourages savings by putting aside. First of all, **a change in attitude and improving as well as developing financial culture would be necessary** to make headway in this respect. The financial culture of the public influences market competition, the efficient allocation of resources and balanced economic growth. Moreover, improving financial culture decreases social expenses and increases social welfare. **Financial consciousness is also important for the banking sector** as the atmosphere of confidence can be created, modern, new financial product can be introduced and the constructions that promote public precautionary savings in the long term can be constructed and diversified only in its presence. Therefore, **supporting such constructions and creating the motivations of the public requires a tight cooperation with the banking sector.**

## **Continuous information flow**

The Ministry for National Economy lays special emphasis on informing the public about its economic policy measures and the details of the Structural Reform Programme. To this end, the ministry will keep supporting the work of analysts and journalists with detailed memorandums in the future.

Budapest, 1 April 2011.

Ministry for National Economy