Government measures of 17 October

Government continues prudent fiscal policy

The Hungarian Government continues to be committed to its policy aimed at getting the excessive deficit procedure against Hungary lifted and pursuing prudent economic management. The measures announced on 5 October the Government had considered sufficient, but acknowledging that the European Union adopted a different standpoint, new string of measures had been decided.

Since 2004 Hungary has been under an excessive deficit procedure (EDP) and since the Government took to office it has declared the abrogation of the procedure as a key priority. The same procedure has been ongoing against 21 countries out of the EU 27. On 7 November the European Commission will publish its Autumn Forecast (covering each countries data) which will provide estimates, among others, of fiscal deficits. With regard to individual countries under EDP, the Ecofin will deliver its verdict only sometime later.

On 5 October 2012 the Government published its Progress Report about the draft measures adopted in order to fulfill the recommendations of the Economic and Financial Affairs Council of the European Union. In line with its commitment for bringing the excessive deficit procedure to an end, the Government has decided to introduce a string of measures totaling adjustments of 133bn HUF for 2012 and 397bn HUF for 2013. The Government is of the opinion that the recently announced new measures ensure that Hungary can keep the deficit well below 3 percent – at 2.7 percent. Markets have welcomed the package which was reflected in prompt forint appreciation and a lower Hungarian CDS spread.

On the other hand, the European Commission has signaled that among the adjustments totaling 397bn HUF, they could not accept the planned balance-improving impacts associated with a potential IMF-EU agreement, therefore without taking further steps the budget deficit-to-GDP ratio would be well above 3 percent in 2013.

The Government of Hungary has been prepared to utilize any instrument at its disposal to bring the budget deficit of Hungary to 2.7 percent for the year of 2013, and make the relevant EU body acknowledge this achievement. Consequently, in order to secure the permanently below 3 percent deficit path required for the abrogation of the excessive deficit procedure even according to the European Commission forecast, the Government decided on an additional package of measures at its session of 17 October 2012 which as a whole amount of 367bn HUF in next year' budget. These will render it possible that even if macro-economic and fiscal risks turn out to be greater than considered realistic by the Government deficit targets would be achieved.

New measures totaling 367bn HUF

Measure	**Effect (billion HUF)**
1. Delaying the halving of bank tax beyond 2013	72
2. Raising financial transaction tax to 0.2 percent	90
3. Raising financial transaction tax to 0.2 percent for Hungarian State Treasury transactions	40
4. Introducing a minimum tax base for local business tax	35
5. Extension of building tax on wires and pipelines	30
6. Raising healthcare contribution tax for fringe benefits to 27 percent	40
7. Further measures aimed at greater economic transparency	60
Total	**367**

The measures in detail:

1. In order to maintain a balanced budget the Government delays the halving of the special tax on financial institutions beyond the formerly planned date of 2013 which step is expected to bring in extra revenues of 72bn HUF.
2. As a measure aimed at increasing the weight of taxes on consumption and turnover the Government will raise the rate of financial transaction tax from 0.1 percent to 0.2

percentand maintain the upper limit of 6000HUF for each transaction. The effect of this measure on the budget is 90bn HUF.

3. The financial transaction tax will also be raised for the Hungarian State Treasury resulting in projected extra revenues of 40bn HUF. The transaction tax will not be applicable to wages, pension benefits, welfare benefits and EU funds.

   Consequently, according to the latest calculations of the Government, incomes from transaction tax are expected to total 260+80bn HUF (retail banks, postal services providers and the Hungarian State Treasury). The Government, however, in accordance with the request of the Commission, no longer reckons with financial transaction tax payments from the National Bank of Hungary.

4. Calculation of local business tax will be modified and thus 35bn HUF of extra revenues are anticipated. With the aim of broadening the base of local business tax, the deductibility of certain expenses from the tax base will be limited from 2013. In line with the planned regulation, the deduction on the acquisition costs of goods sold and services mediated may not exceed 80 percent of the total sales revenues of an enterprise. This will increase tax burden primarily on retailers, but will also impact the energy sector.

5. As an extension of the local buildings tax, the Government plans levies on wires (electricity, phone, television, internet) and pipelines (gas, water, conduit). This measure will result in additional revenues of 30bn HUF at local governments.

6. With the aim of broadening tax bases and simplifying the tax system, the levies of preferentially taxed fringe benefits will be unified with the levies on other fringe benefits. As a result of the measure, with regard to fringe benefits the rate of healthcare contribution tax will increase from 10 percent to 27 percent. This will add 40bn HUF to the budget. As a consequence, the advantage of paying such benefits versus paying wages will not be abolished only reduced (the total tax wedge on wages and fringe benefits will be 49 percent and 34 percent, respectively, as of total employment costs).

7. Further measures aimed at increasing economic transparency which the Government expects to bring in extra revenues of 60bn HUF are as follows:

- In order to reduce VAT fraud the VAT return detailed at invoice level will be introduced from 2013. In the year of introduction in case of invoice value above 2 million HUF (app. 7 100 EUR) both the issuer of the invoice and the taxpayer exercising the right of deduction based on that invoice shall make a detailed report in his/her VAT return on the data contained in the invoice.
- Several other measures have been introduced in order to strengthen the legal means of National Tax and Customs Administration (strong filtering, control of genuineness of single economic events).
- Rules related to sanctions on tax avoidance have become significantly more severe.
- The introduction of the new tax types with simpler administration and lower tax burden in relation to the SME sector as of 2013 – besides the significantly increased risk related to tax avoidance – contribute considerably to the fight against black economy.

The Government has revised its macro-economic projections after having considered the impact of new measures. Growth forecast is to be 0.9 percent in 2013 and 2 percent in 2014, which is in line with market expectations and international estimates. The less favourable growth prospects in 2014 are attributable to the slower trade dynamics of Hungary's main export partners.

Via the former and current measures the Government will keep the deficit well below 3 percent, parallel to reducing general government debt. There are only a couple of countries in the EU capable of this achievement. This latest step of the Government was aimed at getting the EDP against Hungary abrogated, avoiding the freezing of cohesion funds and signaling its commitment to prudent fiscal policy. Most analysts also agree that the Government will meet the below 3 percent of GDP budget deficit criterion. In addition, the budget deficit is estimated to be below 3 percent of GDP according to calculations of the National Bank of Hungary as well.

The Prime Minister has called on the EU to define further requirements more precisely and expressed his readiness to introduce further balance-improving measures regarding four fields.

Budapest, 25/10/2012 Ministry for National Economy