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Economic policy reflections in view of the 2006 convergence programme

Member states that have not yet adopted the euro submit convergence programmes to the competent organisations of the EU, the Council and the Commission each year. It is common knowledge that the Council requested that the Hungarian programme submitted in 2005 should be revised for the known reasons. This updated programme states already on the first page that "…the new Government, which took office in June 2006, presents in the programme the medium term objectives of its economic policy, in particular the way to consolidate the high deficit." (Convergence Programme of Hungary, 2005–2009)

We find it important to state early on that the title of this article was initiated – among other things – by the aforementioned. It is obvious that the publication of the programme were long awaited not only by the citizens, but also and in particular by the professional circles of the country. From our point of view the most important question was whether the economic policy would finally be properly outlined after so many years. (Veress, 2006) Since in the last years macroeconomic parameters have shown a worrisome downward trend, especially for the lack of a marked economic policy, it was expected that the convergence programme would include crisis management elements, i.e. there would be a pool of assessable economic policy measures even in the absence of a specific philosophy.

According to the programme "…the New Hungary Development Plan (NHDP) and the National Action Programme (NAP) are being prepared simultaneously with the convergence programme. The NHDP outlines the main trends of development policy of the 2007-2013 period." (Convergence Programme of Hungary, 2005–2009) We need to add that the elaboration of the New Hungary Rural Development Strategic Plan (2007–2013) is also under way. We possess the available versions of said materials, however since these documents have not yet been fully elaborated, we will not include them in our analysis. Nonetheless, we draw attention to the fact that the convergence programme, which is explicitly regarded as a collection of economic policy ideas by its authors, does not contain such development policy benchmarks that could set the trend for the New Hungary plans. This is either a mistake, or lack of concept (lack of strategy), or a conscious (economic) policy premise. This can partly be judged by time, and partly by one's own specific economic philosophy.

The convergence programme outlines Hungary's medium term path and naturally, the underlying measures that will lead to the fulfilment of the Maastricht criteria. However, the requirements pertaining to the means used to achieve the objectives are seldom heard of. The convergence programme must fit into the general social and economic development concepts – if such exist at all – to the greatest possible extent.

In this paper our aim is not to examine whether the measures earmarked by the updated convergence programme will lead to the desired quantitative improvement in relation to the public finance deficit. Competent expert opinions are explicitly positive in this field, and it is undoubtedly true that the outlined macroeconomic path *(see Annex)* is (more) realistic this time. However, we find that the evolution of certain indicators in time is not well-founded. (We will discuss such indicators later on.) The main objective is to scrutinise how the tool portfolio of the programme suits the topical problems of the Hungarian society and economy, as well as the development trends that we have all right to expect therefrom. Due to the chronic internal and external imbalance, and the grasp of the international monetary market, the convergence programme necessarily contains emergency restrictive fiscal policy elements, the natural consequence of which is the short-term decline in growth and welfare. However, it does matter a lot how we structure the package of economic policy measures we intend to use. If we significantly deviate from the necessary minimum setback, the short-term negative impacts may sustain in the medium and long run, too.

Yet, the evaluation of the convergence programme from the aspect of the Hungarian economy and society is only one – albeit the most important – aspects. We also examine to what extent the programme fits into the frameworks of neoliberal mainstream economic policy, particularly into the directives formulated in the Washington Consensus.

ECONOMIC AND SOCIAL REVIEW

Internal and external imbalance: facts and background

The GDP proportionate deficit of public finances has been extremely high since 2002. Incessant overspending can also be felt in the growth of state debts, which will reach nearly 70% of the GDP this year according to the forecasts. In addition to the need for evading the debt trap and all the negative economic and social impacts thereof the increasing loss of confidence by the international money markets also call for immediate adjustment.

The chronic external imbalance of the coun-

Table 1

INDICES OF THE INTERNAL IMBALANCE

	2000	2001	2002	2003	2004	2005	2006*
Public finance deficit (GDP %)[1]	3.6	3	9.1	7.3	6.6	7.5	10.1
Gross state debts (GDP %)[2]	54.4	51.5	56.6	58.9	60.2	62.3	68.5

Source: www.p-m.hu

[1] 2000–2001: GFS without revenues from privatisation, 2002-2006: ESA95 figures
[2] 2000–2001: gross debt of the central budget, 2002-2006: consolidated state debt according to ESA95

* forecast

try is also growing at a worrisome pace. The total deficit of the current balance of payments and capital, which determines the country's need for external funding, has been around 6.5 to 9 percent of the GDP in all years but one since 1998. So far the different forms of foreign investments have usually covered the economy's excessive need for resources, but it is evident that this cannot be maintained in the long run. With such external funding the GDP proportionate net external debt[1] of the national economy and the outflowing incomes will continuously rise.

Unfortunately, the structural trends of the current balance of payments convey an unambiguous message: the country is being in an external debt trap. The need for external financing exceeds the growth rate of the GDP, and the problem has been augmented by the outflow of incomes yielded from foreign investments at a rate of 7 to 8% of the GDP since 1996. This means that the restoration of the external balance is very urgent. *(See Tables 1 and 2)*

However, the chronic external imbalance actually stems from the fatal economic policy "blunders", which, together with the export demand related consequences of the dissolution of COMECOM led to the collapse of the Hungarian corporate sector in the years following the political turnaround: the straightforward introduction of the accounting and bankruptcy laws, as well as the drastic liberalisation of imports. The place of companies that went out of business because of chain debts and competitive disadvantage compared to western companies was taken over by imported goods and multinational companies that settled in Hungary to satisfy internal demand. The deterioration of the foreign trade balance caused by increased imports could be alleviated by the exports of multinational companies at a much smaller extent than it could have been done by the exports of domestic companies, since these multinational companies have not yet fully integrated into the Hungarian economy, as a result of which they work with a high import ratio. The income produced by foreign direct investments

Table 2

SIZE OF THE EXTERNAL IMBALANCE AND THE MAJOR FACTORS THEREOF*

(as a percentage of the GDP)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Balance of goods and services	–0.3	0.5	1	–1.5	–2.7	–3.8	–1.4	–2.3	–4.5	–2.9	–1.3
Balance of incomes	–3.8	–4.4	–5.9	–6.3	–6	–5.5	–5.5	–5.5	–5	–6	–6.3
Outflow of income from direct capital portfolio and other investments[1]	5.7	7.1	9.1	8.8	7.7	7.8	7.8	7.3	6.5	7.8	n.a.
Income yielded from foreign direct investments	0.4	2	4.1	4.5	4.5	4.3	4.5	4.8	4.3	5.4	n.a.
Current balance of payments +balance of capital (need for external funding)	–3.5	–3.6	–4.2	–6.8	–7.8	–7.9	–5.5	–6.8	–8.7	–8.3	–6.6
Balance of payments (changes in internal reserves)	10.2	–3.2	–0.3	1.8	0.5	2.3	–0.1	–2.8	0.7	1.9	4.4

Source: National Bank of Hungary. HCSO

* rounded values, relevant items of the balance of payments

[1] outflow of income yielded from (foreign) direct capital, portfolio and other investments

also deteriorates the current balance of payments and increase the need for external funding (by 4 to 5 percentage points in the past ten years)[2]. The domestic corporate sector has not been able to regain sufficient strength to occupy its former position on the domestic markets, or to act as a significant exporter or investor on the external markets. This is also reflected in the inequilibrium of the balance of goods and services and that of incomes. Therefore, the dual real economy still plays a major role in the external imbalance, which is augmented by the traditional twin deficit problem.

The reasons behind internal imbalance include the protracted reform of public administration and the large provision systems, but we can state that dual economy may also have a role here (Lóránt, 2006).

Therefore, if we aim at providing a proper remedy rather than merely treating the symptoms of the twin deficit, we must give up the lopsided traditional therapy: by restraining government and private consumption we must focus on the conscious strengthening of the domestic corporate sector, too (Lóránt, 2006). The solidification of the Hungarian companies would increase budgetary revenues, improve the foreign trade balance, and reduce the GDP proportionate outflow of incomes generated by the multinational companies. Thus, the external balance would be achieved by relying on internal resources, which would ensure long-term sustainability and foster the balance of public finances. However, the latter inevitably requires the rationalisation of public administration and the large provision systems.

This means that cure is available, however the patient's condition is already too critical. This is why the current economic policy management is in real trouble. The need for alleviating economic imbalances already in the short run leads to such revenue increasing and expense curbing measures that are necessarily somewhat inconsistent with the creation of sustainable balance (the strengthening of the Hungarian economic sector). Despite this fact the convergence programme cannot go without measures showing towards the latter aim, or at least the concepts for the period following the temporary consolidation of the imbalance.

Labour market

The neuralgic point of the Hungarian labour market is the economic activity and employment rate of the population. The two indicators pertaining to the "economic activity" of the working age population is low even by international standards. Although a slow improvement has started since the mid 1990s, Hungary is very much lagging behind the EU average. *(See Table 3)*

The low employment rate puts excessive burden on those maintaining the society. It is inevitable to increase the economic activity rate of the population if we want to handle more

Table 3

RATE OF ECONOMIC ACTIVITY OF THE POPULATION AGED 15–74

	1998	1999	2000	2001	2002	2003	2004	2005
Activity rate[1]	51.4	52.6	53	52.8	52.9	53.8	53.8	54.5
Employment rate[2]	47.4	48.9	49.6	49.8	49.9	50.6	50.5	50.5

Source: HCSO

[1] (employees + the unemployed)/population in the 15–74 age group

[2] employees/population in the15–74 age group

easily the challenges arising from the demographic processes in the coming 50 years. Therefore, the primary task of the economic policy is not only to create jobs, but also to increase the willingness to be employed.

Income polarisation and poverty in the Hungarian society

According to OECD's poverty and income polarisation statistics for 2000, Hungary is not lagging behind in this respect by international standards. The GINI index more or less corresponds to the OECD average, while the applied relative poverty index[3] shows a below average value. However, poverty cannot be observed in a relative manner, since subsistence is an absolute category.

The income polarisation of the Hungarian society has slightly grown in the past ten years, however, the deterioration is considerable compared to the level immediately preceding the year of the political turnaround. While in 1987 the average income in the upper income percentile was 4.6 times higher than the income in the lowest percentile, the same ratio was 7.6 in 2004 (HCSO, 2006a).

Despite the fact that there exists a multitude of relative poverty indicators, one can obtain an objective picture about poverty only on the basis of subsistence level calculations – provided we accept the relevant methodology developed by the statistical offices. According to the HCSO figures, the subsistence level in Hungary was HUF 56,408 in 2005 per consumption unit[4]. We have no information as per how many households may live below the subsistence level computed based on the composition of the households. At the same time, using the subsistence amounts calculated by HCSO for different family types *(See Table 4)* and the average incomes we can picture the load-bearing capacity of a demographically sound, average Hungarian family. In 2005, the average income of households with one earner was HUF 103,149[5], or twice as much (HUF 206,298) in case of two earners. If we compare these amounts with the subsistence levels calculated for demographically sound Hungarian households (1 or 2 adults with at least two children) we can see that one-earner families cannot bear any additional burden, and two-earner families can only hardly do so.

EVALUATION OF THE TOOL PORTFOLIO

It is required from any economic and social policy programme that its tools should fit as much as possible to the neuralgic points of the economy and the society, and the development trends that can be derived therefrom. In the first part of the study we briefly reviewed some of the issues that are important for Hungary. Here we are trying to find out how the measures – already adopted or planned – laid down in the convergence programme will help

Table 4

SUBSISTENCE LEVEL OF HOUSEHOLDS

(2005)

HUF/month	1 adult	1 adult, 1 child	1 adult, 2 children	2 adults	2 adults, 1 child	2 adults, 2 children	2 adults, 3 children
subsistence level	56.408	93.073	121.277	98.714	135.379	163.583	186.146

Source: HCSO (2006b)

resolve or deepen these problems. We pay special attention to the evaluation of structural reforms – stipulated in the programme – vital for the long-term balance of public finances in the fields of central and regional public administration, healthcare, the pension system, higher education and public education. The tool portfolio of the convergence programme is contained in the Annex broken down according to the subjects of evaluation. Where preliminary calculations were available, we also indicated the amounts of the expected income growth and expense cuts in order to illustrate the relative weight of the individual measures.

Impact on the economic activity of the working age

Apart from making the conditions for unemployment benefits more stringent, the economic policy can increase the willingness of the working age population to be employed by reducing the rate of taxes and contributions payable after employee earned incomes. The measures earmarked by the convergence programme show in the opposite direction. Apart from the extension of the personal income tax brackets, the changes planned to be implemented by the end of 2007 will all decrease net incomes, and thus offset incentives such as the transformation of the unemployment benefit into job seekers' benefit at the end of 2005, or the system of pension premium[6]. It is only the solidarity tax affecting higher income earners that is not expected to significantly affect the willingness to enter into employment.

It is true that the tax and contribution rises affecting employee earnings include measures that are reasonable from the social or economic point of view, such as the rise in the health insurance contribution – in the light of the funding difficulties of the healthcare system – or the introduction of the solidarity tax, or the inclusion of pension in the consolidated tax base. However, this does not change the fact that the measures counteract the aim of increasing the activity rate of the working age population, which should be a top economic policy priority given the expected drastic rise in the rate of dependents/potential supporters (people above the retirement age/working age population)[7] if the current demographic trends continue. Naturally, income centralisation is expected to reduce as the balance of public finances improves, however the programme does not elaborate on which tax and contribution elements will be concretely affected.

Impact on poverty and the polarisation of the living standards

We have already concluded in relation to the complex economic and social review that a demographically sound average Hungarian family (1 or 2 adults with at least 2 children) cannot or can only hardly bear further burdens, since they either live below the subsistence level, or their income is only 10 to 25% higher than that. This also means that these families spend the overwhelming majority of their income on consumption, and their savings are not significant. As a result, taxes on consumption or the rise in public utility and public service fees will immediately affect their living standards, while taxes on savings will affect their ability to accumulate (and thus indirectly they also slightly deteriorate their future living standards). These taxes and prices also increase the subsistence level, and consequently poverty, even if this is not necessarily reflected in income polarisation. Therefore, the immediate effect of the augmentation of public utility and public service fees, as well as that of consumption related taxes will be the polarisation of living standards.

The programme's measures pertaining to the taxes on consumption and savings, as well as to public service and public utility fees temporarily project the increase of poverty and the further polarisation of living standards, the time horizon of which depends on the dynamics of per capita real income. It is uncertain whether households will be able to live through this period without any "permanent scars".

Apart from the immediate need for increasing revenues and decreasing expenditures the only measure that shows the signs of long-term thinking about sustainable public finance balance is the review and reduction of consumer price subsidies.

Impact from the aspect of the dual real economy

When examining the tool portfolio of the convergence programme in this respect, we intend to learn whether the measures affecting the entrepreneurial/corporate[8] sector differentiate between the domestic and foreign companies in terms of the burden sharing. It is well known that the competition regulation of the European Union prohibits negative discrimination against companies based on the country of origin, however, discrimination is possible in the case of large companies versus SMEs[9] when setting the tax and contribution rates. Due to the duality feature of the Hungarian real economy this would also mean hidden differentiation between the foreign and domestic corporate sectors, since the activity/economic power of foreign companies is much more concentrated in the group of large companies.[10] Furthermore, the structural differences between large companies and SMEs (average turnover, pre-tax profit, import/export ratio, work productivity, etc.) offer various techniques of giving preference to domestic companies on a silver plate.

From among the measures affecting the enterprise sector, the minimum contribution base, the expected tax and the petty cash tax serve the bleaching of the economy. Since the grey economy is mostly typical for the SME sector, (it is easier for the tax authority to control large companies for the quantity of such companies), therefore these measures affect the domestic entrepreneurial/corporate sector to a larger extent. It would be difficult to argue that the declaration of minimum wage for tax or contribution avoidance, or the accounting of revenues as expenditures with bogus invoices, or keeping high amounts of cash in hand in order to escape income tax payments are mostly typical for self-employed people and small enterprises.

Raising the rate of the simplified entrepreneurial tax is also a change that primarily affects Hungarian owned enterprises, since the requirements pertaining to the business form and income ceiling[11] of taxpayers *de facto* narrows the group of eligible entities to the SME sector.

The SME and the large corporate sectors – and therefore foreign and domestic companies alike – are affected to the same extent by the revocation of the plans to reduce employers' contributions, the local business tax and the healthcare contribution, and by the extra tax of 4% payable by corporations/enterprises.

The annuity payable by credit institutions on interest income from loans associated with state subsidies is a reasonable step, and based on the ownership structure of the Hungarian market of financial institutions we can state that in contrast with all the other measures, this measure primarily increases the burden on foreigners[12].

All in all it can be said that all major measures affecting the entrepreneurial sector but one are more detrimental to or equally affect Hungarian and foreign companies. The effort made to bleach the economy is justified and welcome. Furthermore, considering the parameters of the petty cash tax, the minimum contribution base and the expected tax, they will not threaten the functioning of SMEs operating outside the grey economy. Despite this fact, knowing the structural problems of the real economy, it would have been absolutely advisable to increase the tax rate affecting multinational companies instead of raising the rate of the simplified entrepreneurial tax, and to differentiate between measures that now affect the two corporate sectors without differentiation (for example the elimination of the local business tax only for SMEs), especially in the light of the fact that there are huge differences between SMEs and large companies in terms of the average size of tax allowances (payable tax/computed tax), favouring the latter group[13]. Therefore, the relevant measures of the convergence programme do not move in the direction of the liquidation of the dual real economy and unsoundly structured growth. What is more, the wording of the programme suggests that the authors were not aware of one of the most neuralgic points of the Hungarian economy.

Public administration reform

Elements in which the size of savings can be projected relatively well can mostly be found in public sector related measures; expenditures will be cut by 3.2% of the GDP by 2009.

The first step that will have an impact already in the short run is staff reduction in the central public administration. The downsizing of 20% effectuated earlier, and that of 10% to be implemented by the end of the year will save HUF 35 billion in the short run, but its cost reducing effect will linger on for a longer term. At the same time, laid off people will increase social costs (unemployment benefit), and on the other hand – if we would like to redirect them to other segments of the labour market – state support provided for their retraining is also a cost increasing factor. Finally, social security revenues will also decline due to the loss of contributions paid by the redundant employees. These aspects may also emerge as long-term impacts.

The concept of changing the current local governmental system is another important element that is planned to be solved on the funding side. In the past 16 years local governmental resources have continuously dropped, they have been reallocated by each government to their own benefit, just to later be redistributed on the basis of various directives. According to the programme, the operation of the fully fragmented Hungarian local governmental system must be rationalised, regional and small regional associations must be set up to fulfil jointly implementable tasks (for example education). Although the idea seems to be worth supporting, it can cause too many problems that the Government intends to “encourage” the establishment of associations from above, which in reality means the significant curtailment of the number of normative supports, i.e. there is nothing new in this approach. Although it would be more reasonable if forms of cooperation were set up bottom up, using more local resources – based on the local interests and endowments – such cooperation is nothing but utopia under the current conditions. Obviously, the withdrawal of funds can be easily implemented, the Government expects to reduce the costs by over HUF 49 billion, however the impact and implementability of the measures are questionable because of the local resistance.

Performance evaluation and the general use of performance related wages are introduced in the public sector. This idea can be supported at theoretical level, if a definitely exact measurement method is elaborated. However, in most public sector fields but a few it is very much doubtful on the basis of what standards bad or good performance could be identified. On one hand, too many subjective elements in the algorithm may deteriorate workplace morale, while on the other hand wage costs can be occasionally retained, which can be used as a tool to reduce the deficit of organisations working inefficiently due to bad management, and may reduce budgetary expenditures if this becomes a general practice in the entire public sector.

The elimination of parallel functional fields, the winding-up of institutions and the spreading of electronic public administration are elements that would decrease the costs by HUF 22 billion, (real estate related expenditures, drop in material and wage costs), and at the same time they also correspond to the centralisation of institutions and the need for smaller staff. However, the elaboration and development of the new system, and the training of operators[14] temporarily require higher expenditure.

The reform of the pension system

The demographic processes continue to be unfavourable, and increase the deficit of the system despite the envisaged long-term adjustments. Real improvement in the ratio of supporters/dependents would be achieved by making the inactive working age population economically active. However, there is a "simpler solution": changing (raising) the working age category, but basically this is just an emergency measure, the postponement of the problem. Measures that aim to reduce the amount of pension benefits for early retirees and at the same time ban wage-earning activities in such a status, also serve the rapid solution of the problem by making people less interested in leaving the labour market.

The charges payable by employed pensioners will also rise, their income will be untaxed benefits (which will generate revenues of HUF 32 billion in 2007), and employed pensioners will be required to pay a 4% in-kind healthcare contribution (HUF 8 billion in revenues in 2006). The latter raises an interesting question in relation to the planned restrictions of the use of healthcare services: what services will an employed pensioner be eligible for in the doctor's office if he does not pay contribution? Will he be eligible for all services if he "introduces himself" as a pensioner, or only for basic care services if he "introduces himself" as an employee?

The elimination of the anomalies of pension calculation (valorisation), and the 13th month pension also represent long-term expenditure growth. The fact that the 13th month pension has not been abolished, contradicts the principle that says that a shift must be made from the exceptions towards the general rule, and it has not been a good decision for the improvement of the balance either.

Disability pension becomes a separate service branch, with better control to combat abuses and rehabilitation activities. This measure is completely justified since budget expenditures entailed by the enormous number of abuses are huge. Abuses trigger losses not only through the unjustified payment of benefits, but also through those state subsidies that were provided for the employment of people with reduced working abilities, who thus indirectly "reduced" the employment opportunities of "normal" job seekers, since in certain jobs companies preferred the employment of people with reduced working abilities. Therefore, the measure can only be comprehensive if stricter control is extended not only to the new cases, but also to all people on disability pension retroactively. In case an abuse is proven without any doubt, adequate criminal and civil law actions should be initiated.

Sustainability is designed to be temporarily improved by shifting the proportions within the 29% social security contribution payable by employers, i.e. reducing the healthcare contribution from 11 to 8% and raising the pension contribution from 18 to 21%.

Despite the measures already in place the pension system will require growing budgetary support in the future. The payments to be gradually made by private pension funds will not keep pace with the increment in the total pension spending in relation to the GDP, which will trigger an increase in the expenditures of the first pillar[15]. Knowing the demographic processes, the revenues of the Pension Insurance Fund will not be sufficient to fill that void. The question is raised: if anything else is ignored, how can we meet the Maastricht requirement pertaining to the public finance balance, if the deficit of the Pension Insurance Fund calculated with net pension expenditures will reach 3.9% of the GDP in 2050 according to the projection of the convergence programme? Of course, by then this requirement will probably be a thing of the past.

Healthcare reform

The deficit of the Health Insurance Fund totalled around 1.6 to 1.8% of the GDP in the past years. The deficit is considerable and well exceeds the level witnessed in the second half of the 1990s. Expenditures have also increased in terms of real value.

The "distortions" influencing the Health Insurance Fund can be summarized as follows:

Revenue side

- Unrealized contributions:
  - "social security cheaters": people who would not be eligible for healthcare services other than basic services (accident, emergency treatment, etc.) available on the basis of citizenship. The number of such people is estimated to be 500,000;
  - a group of persons that pay contribution on the basis of the minimum wage presumably earn more than the minimum wage.

Expenditure side:

- Increasing and high pharmaceutical subsidies: between 1998 and 2005, the turnover of subsidised drugs nearly tripled, while we now spend nearly 20% more on inpatient care than on pharmaceutical subsidies. The reason behind this is the small share of lower-cost generic products from the turnover (around 25%), and partly the excessive use of drugs.
- The number of direct "physician-patient contacts" is outstandingly high even by European standards.
- There are under-utilised hospital beds, disproportionate distribution of capacity, fragmented hospital departments.
- Hospital-oriented care as opposed to outpatient-oriented care: some patients treated in active hospital care could be efficiently treated in the less expensive outpatient care. (Active inpatient treatment is the most expensive form of treatment: the maintenance of a single hospital bed costs about HUF 5.5 million a year.) It reveals a lot that in the Netherlands and Great Britain seven and 17 times more one-day surgeries are performed, respectively, than in Hungary (Green Paper on Healthcare). The streamlining of unjustified inpatient care would yield a significant drop in expenditure, since this item accounts for more than 25% of the Health Insurance Fund.
- The "blurring" of curative and nursing services: part of the care provided on active hospital beds is of a social (nursing) character rather than curative after which the health insurance fund pays a normative support available to the considerably more expensive curative activities. Nursing is becoming a more and more serious problem in our aging society. However, for the lack of adequate infrastructure, nursing is mostly an unsolved problem – except for in the fee-paying private institutions – wherefore, in the absence of other alternatives, people in need often end up on hospital beds.

The measures that were mostly just outlined in the convergence programme, but have more or less been finalized since then, affect the distortions of both the revenue and expenditure sides. During the discussion of such measures, we will evaluate the operative decisions if such already exist.

In order to screen "social security cheaters", the control of the payment of social security contributions is planned to be made more stringent, and the introduction of the minimum contribution wage is designed to combat the evasion of contribution payment. Eligibility packages based on non-insurance, insurance and supplementary insurance have started to be worked out. In the light of the equitable and just distribution of public charges and dues these measures seem to be justified. (It is too early to jump to conclusions, however, if only a few persons undertake to have it proven that they have no other source of income than the minimum wage, we must ask ourselves: who does the minimum wage protect? Does it protect the employee from starving to death, or the employer from contribution payment or the distribution of equitable wages?)

The rise in the price of drugs that were formerly subsidised at 100% to HUF 300 is more of a symbolic and psychological measure than a measure practically contributing to the reduction of the public finance deficit. The same can be said about the co-payment and the daily fee payable for hospital stays, from which the Government expects that the number of direct physician-patient contacts – which is outstandingly high even by European standards, and is also unjustified according to us – will drop and tip money will be eradicated. At the same time, while the Government estimates the amount of tips to be nearly HUF 100 billion, it expects to yield HUF 30 to 35 billion from the co-payments and the daily hospital fees. The psychology behind the introduction of these measures is understandable, however the circumstances of introduction are inequitable from several aspects. On one hand, in order to justify these measures and combat the institution of tips a campaign was launched that undeservingly bemired medical doctors in general. The impact on social and human relationships is inestimable. On the other hand, the social groups enjoying exemptions or allowances are too large (approximately 4 million people). It is only the icing on the cake that the difference is reimbursed by the state after the beneficiaries, not to mention the additional administrative costs.

As far as the expenditure side is concerned, the measures are more diverse. The increasing and high pharmaceutical subsidies are planned to be curbed by the revision of the system of pharmaceutical subsidies, by the increased control of prescription habits and eligibilities, as well as by giving preference to the generic drug programme[16]. The other main pillar of expenditure cuts is the rationalisation of curative and preventive care: the elimination of the unjustified disproportionate capacity distribution, the liquidation of under-utilised capacities, the reduction of the predominance of inpatient care over outpatient care, as well as the establishment of "centralized" regional hospitals in lieu of scattered hospital buildings.

In theory one cannot question the raison d'etrê of the Health Insurance Supervision controlling spending by the National Health Insurance Fund. In practice, there is a risk of aggravating the "too-many-chiefs" syndrome by adding even more chiefs. The convergence programme does not reveal exactly what will ensure the transparent operation of the Health Insurance Supervision.

In connection with the liberalization of the health insurance market we need to wait until the end of the year, however, in relation to the liberalization of pharmacies, it is worth hearing some pharmacists' panting cries for help. It is difficult to explain why a market of three thousand pharmacies, which is otherwise regulated by the authorities in terms of margin, needs further liberalization. It is acceptable that certain products should be sold without assistance, however the price setting habits and the margin related regulations do not justify the liberalization of the rules for the foundation of pharmacies. There is tangible pressure by the global actors. What would notary publics say if any law students were authorized to issue certified copies of documents?

Education[17]

The programme does not go into details about the changes planned to be implemented in higher and public education. It is only in the annex that a few measures are named originating from the amendment of the public education and higher education acts in July 2006.

Let us examine higher education first. We cannot or can only hardly argue with the proper recognition of the symptoms (parallelisms in higher education, student headcount that does not meet the needs of the labour market, reduced student activity). However, the solutions give rise to doubts at a few points. According to the preliminary calculations, the development contribution, i.e. the tuition fee, which will unfold completely by 2011–2012, will yield only HUF 13 billion for the university sector, and maximum half, but at least one third of it must be spent on scholarships. The remaining sum available for development would thus fluctuate in the HUF 6.5 and HUF 9 billion range. Said amount can be regarded significant neither for the public finance deficit, nor for the budget of higher education[18]. In contrast with this, the side-effects, the discounts and scholarships that can be granted on the basis of academic achievement and social standing put significant burdens on higher education administration. We must also mention another proposal, the subsequent training contribution ("subsequent tuition fee"), which would have improved the finances of the universities and colleges to a larger extent, albeit only at a later stage. (According to the preliminary calculations, by HUF 120 billion by 2030.) According to the proposal, degree holders would have been required to pay their training costs subsequently, proportionately to their income.

The outlines of the measures affecting normative funding in a move to transform public education seem to be efficient and reasonable. At the same time we must add that based on the measures outlined in the convergence programme it is not possible to assess their actual impacts. The question is raised about the future of laid-off teachers in areas with an already high unemployment rate. The unemployment benefit and the costs of retraining deteriorate the balance manicured by teachers that have been excluded from normative funding.

ABOUT THE MACROECONOMIC PATH

As we have indicated among the introductory thoughts, according to the competent expert opinions, the macroeconomic path outlined in the programme is much more realistic than the former versions, and on the whole it is accomplishable, however there are significant risk factors. Below we will focus on momentums that we regard most risky and unjustified for the sustainability of the macroeconomic path.

Risks of the GDP growth path

According to the programme, the drop in the dynamics of the internal demand resulting from the restrictive fiscal measures will significantly withhold the GDP growth rate, which will then return to the presumably sustainable rate of 4 to 4.5% from 2009 on. The drop in the growth rate of internal end use affects all three large internal income groups: the real value of household and community consumption will drop in 2007, while the growth of gross fixed assets accumulation will decline by 4.5% partly due to the aforesaid, and partly due to the increasing charges payable by businesses. The measures will not significantly affect external demand, because they do not deteriorate the competitiveness of multinational companies that account for the bulk of exports. The reaction of internal demand to the restrictions outlines a realistic tendency.

Inconsistence in the growth path occurs in relation to the upturn and the background thereof. If we observe the growth components it seems clear that the slow increase in the GDP growth in 2008, and the faster development thereof in 2009 is based on the dynamic growth of investment projects and household consumption expenses. Per capita real income will resume growth in 2009, wherefore the consolidated value of the latter is acceptable. The presumed strong growth of the annual dynamics of investments (5% in two years) is much more problematic, since it is supported neither by the measures outlined in the convergence programme, nor by the other components of demand. On one hand, the restrictive measures against enterprises are not planned to be lifted, and on the other the upturn in household and community expenses is very modest. The investment incentives[19] outlined vaguely and only in general in the programme reflect the characteristic features of supply-side economics and neoliberal economic policy dogmas. Consequently, it is highly doubtful whether they are able to adequately offset the negative demand shock generated by the restrictive measures. Naturally, the positive expectations of businesses can bring about the indicated growth of investments despite the fundamental factors. However, the expectations cannot be predicted in advance, and it would be a mistake to use them as a foundation for the investment path.

Therefore, the actual development of investments is a risk factor in terms of the sustainability of the GDP dynamics and the public finance balance path. *(See Table 5)*

THE INTERNAL RISK OF THE PUBLIC FINANCE BALANCE

The greatest risk in the public finance deficit is caused by the estimated, nearly 6% drop in

Table 5

GDP GROWTH AND ITS COMPONENTS

(change in percentage, at prices valid in 2000)

	2005	2006	2007	2008	2009
GDP	4.1	4.1	2.2	2.6	4.1
Growth components:					
Household consumption expenditures	1.7	3	–0.7	0.6	1.5
Community consumption expenditures	–0.4	1.7	–1.8	–3.8	1.4
Gross fixed-assets accumulation	6.6	6.6	2.1	3.7	7.0
Changes in stock accumulation (as a percentage of the GDP)	–2.3	–3.9	–3.8	–3.8	–3.6
Product and service exports	10.8	12	10.9	9.9	9.4
Product and service imports	6.5	9.5	8.5	8	8.8

Source: Convergence Programme

primary expenditures in the period 2006–2009. The growth in revenues can be calculated based on the measures that have already been introduced, as well as tax and contribution related measures to be introduced during 2007, and therefore serve as a foundation thereof. In contrast with this, structural reforms fostering expenditure cuts in public administration and the public sector, as well as in the pension system, mostly exist as concepts only, wherefore they make the expected savings uncertain. Although the programme outlines the portfolio in which it intends to reach the 5.8% drop in primary expenditures,[20] however, the well-foundedness thereof is as uncertain as the changes in expenditures. *(See Table 6)*

Risks of the external balance path

Naturally, the programme deals with the circumstances of restoration of the external trade balance. It earmarks that exports, which are regarded as a stable growth factor, will grow by around 10% annually, and counts with reduced import dynamics until 2008. According to this forecast, the funding need of the balance of goods and services, which equals 1.2% of the GDP in 2006, will grow to 2.8% by 2009, which would considerably improve Hungary's external positions. In addition, it counts with the inflow of EU funds, which accounted for three quarters of the capital balance in 2005, and will account for 95% in 2009. Therefore, a significant improvement is expected also in terms of capital balance (0.8% in 2005, 2.2% in 2009 compared to the GDP). These two, presumably improving tendencies are put against the constantly negative, over 6%, GDP proportionate deficit of the balance of primary incomes and transfers arising from the dual structure of the economy (dominance of foreign owned companies, increased profit repatriation).

The assumptions can be questioned at several points. The assumption about lower import dynamics is based on the fact that the restrictive measures reduce the disposable income of resident companies, which will also lead to a drop in demand for imports. The introduction of the stabilization package in 1995, the 8% customs surcharge and the one-off 9% devaluation of the Hungarian currency, the sliding devaluation and the 12% drop in real wages were not sufficient to improve the foreign trade balance to the extent which is earmarked by the convergence programme with considerably smaller intervention.

The other realistic threat may be posed by the excessive deficit procedure applied in relation to EU funds. It has been raised in Brussels several times that the excessive public finance deficit of Hungary should be followed by sanctions, which would also mean the withholding of funds from the Cohesion Fund. Since practically the entire capital balance is ensured by the EU transfers, the consequences

Table 6

PUBLIC FINANCES

(as a percentage of the GDP)

	2005	2006	2007	2008	2009
Revenues without EU transfers	42.2	40.9	42.6	42.7	42.2
Primary expenditures without EU transfers	45.6	47.2	45	42.9	41.4

Source: Convergence Programme

of their loss are unpredictable in the current situation. *(See Table 7)*

Should the said external positions develop in a way other than predicted by the programme, a radically different path would emerge, since if the process of indebtedness continues, the planned improvement of the positions of public finances becomes impossible, too. In what correlation can this happen?

If Hungary's external positions do not improve – among other things, due to the aforesaid – a new crisis of confidence may emerge with another deterioration of the country's rating: the expected risk premium of state securities will either stabilize or grow. Since a considerable portion of state securities (28% in the first quarter of 2006) is kept by non-residents, the price of external financing will continue to grow due to the increase in the expected interest rate. This is a factor that directly strengthens external imbalance. At the same time, there is also an indirect impact. A dominant part of state securities is held by financial companies (56% in the first quarter of 2006 without NBH). These companies are almost exclusively owned by foreigners. They realize greater revenues from the increasing interests of state securities, which also means a greater outflow of income if we count with the given rate of profit repatriation, and this also deteriorates the external balance position. The situation is aggravated by the fact that due to the postponement of Hungary's integration into the euro zone, the Forint has become more volatile and its exchange rate has become weaker. This latter largely contributed to the fact that within the gross debt of the central budget, debts denominated in foreign currencies have continued to grow both in absolute and relative terms (25.3% in January 2005, 30.3% in August 2006).

Meanwhile, the threat of the repeated growth of inflation is realistic, if the imbalance remains for a longer period, but also, paradoxically, if the economic players believe that the immediate restoration of the balance of public finances has been given priority. How can it be? The economic actors are well aware of the fact that the upturn of inflation or the achievement of a certain surprise inflation rise is in the interest of public finances. Therefore, the central bank can offset the integration of any motives to the inflationary expectations only with greater basic rate rises. However, in this case, since the Hungarian state predominantly funds itself from Forint securities with relatively short remaining maturity (approximately 70%; 3.49 years in the first quarter of 2006), the rise in the interest level will increase the interest burden of the budget already in the medium run. Therefore, the restoration of the balance of public finances can be jeopardized by many "quasi-exogenic" factors, too.

Table 7

FUNDING POSITIONS

(as a percentage of the GDP)

	2004	2005	2006	2007	2008	2009
Net external funding ability (+)/demand (–)	–8.3	–6.6	–7.1	–4.2	–2.2	–1.4
including:						
– balance of goods and services	–2.9	–1.3	–1.2	0.6	2.2	2.8
– balance of primary incomes and transfers	–5.7	–6.1	–6.7	–6.5	–6.5	–6.4
– capital balance	0.3	0.8	0.8	1.7	2.2	2.2

Source: Convergence Programme

This means that the correction of the public finance imbalance is neither possible nor independent of the proper development of the external position. And the external position, which becomes less and less sustainable, reveals the fundamental structural problems of the Hungarian economy. External debts, i.e. foreigners' investments, and the country's external debts will remain in place for a long time, since as Hungary catches up (as the profit gap narrows) the volume of new investments will decrease, and profit repatriation (which is currently 50%) will increase.

The Hungarian economy balanced on a knife's edge in the past decade, too, it had no internal mechanism for the automatic elimination of imbalances. If resident companies would contribute with a much greater share to the GDP, the structure of Hungary's real economy would be able to handle damage caused by the too loose budget policy at any time with a smaller shock, since in relation to stabilization – with some exaggeration – the restoration of the internal balance processes would not depend on so many other uncertain factors. An economy that is exclusively based on foreign capital (debt) will regenerate external imbalance again and again, and paradoxically, this problem becomes more and more acute as the catching-up process gains momentum. In this situation budgetary indiscipline generates much graver situations.

MAINSTREAM ECONOMICS AND THE HUNGARIAN CONVERGENCE PROGRAMME (WASHINGTON CONSENSUS)

The Brady Plan[21] (March 1989) which was developed to escape the debt trap was "legitimised" within the framework of a conference series. The term "Washington Consensus" was first used in *Williamson's* (1990) introductory speech at one of these conferences. The word consensus refers to a certain synthesis of views of the World Bank, the Federal Reserve Bank and the Congress of the United States, i.e. of those standing in the centre of these organisations. This also means that 30 to 50% of the members of these organisations do not support the outlined concepts, yet sort of "advanced", ab ovo, the global expansion of these centrist views. Concerns were raised already at the conference, since the proposals were basically made for remedying the problems of one region, i.e. South America, and others feared that the originally novel proposals would turn into dogmas. As it later turned out, these fears were well justified. Later Williamson acknowledged, too, that it would have been more appropriate to use the term "general convergence". These events then developed the "recipe like", universal recommendations, which primarily aimed at the restoration of the balance, the launch and/or acceleration of growth on a new basis. *Kuczynski-Williamson* (2003) emphasise the difference between the original meaning of consensus and the current interpretation thereof, according to which when it was first drafted, the consensus dealt with a much broader spectrum of problems. After being reworded, growth and the question of justice were named as equally important aspects.

The ultimate goals – as Williamson himself put it: growth, low inflation, acceptable balance of payments, equitable income distribution – can really be regarded as centrist views if taken by themselves.

The authenticity of the document is greatly weakened by the fact that the recommendations it contains are often neglected especially in the birthplace of the concept itself. In the United States corruption, the budget policy, the exchange rate policy and the trading policy are often outside the range of vision of the above requirements.

The following 10 points were reworded in 2003
(Williamson, 2003; Szakolczai, 2005)

1. *Budget deficit:* fundability without an inflation tax.
2. *Ranking of public spending:* redirection of resources from unjustified areas toward neglected areas with great yields (which could improve income distribution), such as elementary education, public healthcare, infrastructure.
3. *Tax reform:* increasing the number of taxpayers and lowering the marginal tax rates.
4. *Interest rates:* financial liberalization, where the ultimate goal is an interest rate determined by the market players.
5. Foreign exchange rate: in line with the medium-term macroeconomic objectives (fast growth of exports, fundability of the current balance of payments).
6. Trade policy: replacing quantitative trade restrictions with customs duties, and then gradually decreasing such duties to a flat 10 to 20% rate.
7. Foreign direct investments: removal of obstacles to foreign direct investments.
8. Privatization: privatization of state-owned companies.
9. Deregulation: abolition of regulations that impede market entry or restrict competition.
10. Property rights: providing security for property rights.

Basically, there are two major doubts about the Washington Consensus. The first is empirical in nature, while the other is more of a theoretical dispute of beliefs. Experience showed (e.g. in Mexico) that nothing guarantees that growth would actually set off after adequate stabilization. The Consensus is incomplete at this point and can be criticized with many well-grounded facts, and in fact, this is the most often criticized part of the document. It practically said nothing about the restart of growth; it was considered evident, which was a mistake, as it is shown by practical examples, especially in South America. The other criticism targeted at the theoretical justification (lack of justification?). The measures entirely rest on the views of classical (mainstream) economics, and reject the utilization of the scientific results of growth theory schools.

The latter is the most difficult intellectual challenge in relation to the new stabilization process in Hungary, too. Even if we assume the success of stabilization, it is a question how the Government will create the favourable environment required for the development of the efficient private economy. Investments are indispensable for economic boom, and they are clearly unable to grow in an unstable macroeconomic environment. Therefore, the restoration of the macroeconomic environment is the number one task. Then there are basically two paths to choose from, provided we take into account historical experiences, too.

The first is a neoliberal approach, in which the Government creates the adequate incentives, trends, it acts in a consistent manner, and steps aside after setting the rules of the game hoping that growth will set off. Sometimes this may work and does work in countries with adequate institutional conditions (e.g. Great Britain).

The other path, the approach taken in Eastern Asia assumes a more active and initiative role of the state. Experience shows that a small government apparatus, a consistent economic policy, undervalued currency, conscious export development and the strictly temporary protection against imports, as well as highly qualified and disciplined workforce accompanied by entrepreneurial skills lead to strong growth.

However, a very strong precondition for the success of active industrial policy is that the government should have adequate skills in strategy development. This is not a universal endowment, not even international organizations can give such advice, however, in the absence of such skills it is very difficult to forecast with great certainty, which industries will be long-term winners in the future. Therefore, any inconsistent intervention can do more harm than inaction.

The crises of the past decade all confirmed that universal recommendations to economies of different levels, with different endowments and economic cycles are neither necessarily viable, nor can be forcefully implemented.

Despite the said anomalies, by accepting the Maastrich convergence criteria and the Stability and Growth Pact, the EU practically committed itself to the economic policy trend recommended by the Washington Consensus. In contrast with the rest of the world, the EU is interested in the explicit maintenance of a strong and stable currency, this is what it strives for, since the basic prerequisite for the attraction of direct investments is security and predictability. A stable currency is less vulnerable, however we must pay a price for that. The EU requires a strict budget policy from all member states, consistently with the monetary conditions. This restriction narrows the range of economic incentives (e.g. export incentives), which is detrimental for the EU in international competition.

Naturally, the picture is much more varied than that. The European Union is much less strong vis-a-vis the international financial organizations than its economic potential would justify, since there is practically no united action by the member states. The fundamental reason behind this is the political fragmentation, the declared "union"-type structure, which is actually a confederation, and the frequently differing interests of the individual member states. There are countries that could meet the requirements set for the common currency (Denmark, Sweden, Great Britain), but they do not do so because they do not need the common currency. On the other hand, there are several member states that have nominally committed themselves, but in fact do not meet the mandatory requirements (e.g. Germany, Italy), because they can run their social systems – which are completely unsustainable financially in the long run – only with major deficits already today. These countries go upstream against the Washington Consensus, but of course, not explicitly, since no member state of the de facto confederate Europe would undertake this financial policy before the World Bank or the IMF. The new member states, including Hungary, ab ovo fully committed themselves to the achievement of the prescribed parameters, i.e. they have adopted the paradigms of the Washington Consensus.

Since Hungary would also like to become an organic part of the integration, it strives to meet the requirements for the introduction of the common currency. The new convergence plan is in full agreement with the original interpretation of the Washington Consensus, but it also tries to take over a few elements from its reinterpreted version, namely the emphasis on more equitable burden sharing.

In order to examine the concepts behind the plan it is worth dividing it into two parts, which is also justified by the structure of the measures. The first period (2006 to 2009) is the period of stabilization of the macroparameters. The restrictive measures aim to restore the drastically poor fundability of public finances, as well as the external balance (current balance of payments), or as the plan puts it: the structural adjustments create the conditions for sustainable growth. According to the GDP growth related calculations, in this period growth will drop below the potential output, to a mere 2 or 3% (negative output gap), the real income of households will decline, and the trend is expected to change only at the end of the period. According to the Washington Consensus, the growth sacrifice is not necessarily a negative thing, if a new boom may unfold in the wake of successful stabilization. At the same time, however, it is worth remembering the plenty of empirical examples that show that a successful stabilization does not guarantee the take-off of growth. The assumptions behind the long-term projections of the programme contain quite a lot of uncertainties, wherefore it is not impossible, but is greatly uncertain that they will actually come true.

The assumptions of the second stage of 2009–2011 are exactly the weak pillars of the Washington Consensus. As the plan puts it: "Productivity growth is promoted by the increase of the capital stock. Economic policy may affect investment growth primarily indirectly, by enhancing economic stability, adopting a balanced income and fiscal policy, improving the quality of public services, deregulating the administrative burdens of businesses, strengthening the business and innovation environment or improving the physical and human infrastructure, though certain co-financing programmes and tax benefits may also play a role".[22] Observing the experiences of the short history of the Hungarian market economy it can be stated, albeit with strong reservations, that the drastic correction of the macro-parameters may create a certain condition for growth. But what guarantees that the planned structural changes would create a really viable economic environment, and even if rapid growth takes off, "would it not hit against the ceiling again"? The public administration, social security, education and public finance reforms are badly needed, but probably not sufficient conditions for real convergence.

In the first reading the new convergence plan seems to be in conformity with the policy of the Washington Consensus, but more in terms of its intentions than measures. The reason behind this is the trap generated by the unbelievably shaky status of public finances. The programme earmarks measures that contradict the future conditions for growth (e.g. rise of contributions on labour, which will presumably decrease and not increase the rate of economic activity). Despite its declared intentions the programme contains a long list of exceptions and beneficiaries again (e.g. in the case of the co-payment the members of those target group became beneficiaries /pensioners, i.e. the main users of healthcare services, among others/), whose healthcare service using habits the programme intended to change). The state forces itself upon the economy again by increasing tax incidence, by increasing redistribution and dependence, which do not foster the change in attitude demonstrated by the economic players and the population either. It is equally probable that the tax on savings will not increase the internal resource accumulation. However, as the programme says, there is no growth without investment, and as it can be clearly seen already, investments cannot be financed from foreign sources only; the implied risk is a highly vulnerably economy exposed to events in the global economy.

ANNEX

THE PATHS OF MAJOR MACROECONOMIC AND PUBLIC FINANCE FIGURES

	2004	2005	2006	2007	2008	2009
change in GDP (at prices valid in 2000) %	5.2	4.1	4.1	2.2	2.6	4.1
HICP	6.8	3.6	3.5	6.2	3.3	3.0
Unemployment rate %	6.1	7.2	7.3	7.5	7.4	7.3
Net external funding ability (+)/need (-) (as a percentage of the GDP)	–8.3	–6.6	–7.1	–4.2	–2.2	–1.4
Gross state debts (as a percentage of the GDP)	60.2	62.3	68.5	71.3	72.3	70.4
Public finance deficit (as a percentage of the GDP)	6.6	7.5	10.1	6.8	4.3	3.2

Source: Convergence Programme

MAJOR MEASURES DERIVED FROM THE CONVERGENCE PROGRAMME (2006–2009)*

Tax rises that directly affect consumption and saving, changes/introduction of public utility and public service fees (poverty and polarization of the population by living standards)	Employment related taxes and contributions (activity of the working age population)	Measures affecting the corporate sector (dual economy)
Gas price compensation will be replaced by means-tested social subsidies to those in need (2007) Modification of the system of public transport subsidies Changes in the system of pharmaceutical price subsidies ((30) 1st measure: medicaments that were fully subsidized earlier would cost HUF 300) **(30)** HUF 300 co-payment and daily hospital care fee (2007) **(170)** The preferential VAT rate grows from 15% to 20% (2006) **(6)** Excise duties will increase: by 5.7% on cigarette, by 7% on alcohol (2006); further increase of the excise duty on cigarette by 2.7% two times (2007) **(26)** The rate of tax on income from interest and stock exchange deals will grow from 0% to 20% (2006) Abolishment of certain tax allowances, or occasionally the lowering of the income ceiling for eligibility (2007) Changes in vehicle taxation (2007) **(10<)** Introduction of the real property tax (2008) Tuition fee in higher education (2007–2008 academic year)	**(220)** Raising the individual contributions of employees (health insurance contribution in two stages from 4% – to 7%, 2006-2007; employees' contribution will grow from 1% to 1.5%, 2006) **(20)** The tax payable on in-kind benefits will grow from 44% to 54% (2006) The bracket of the two-rate personal income tax will be raised from HUF 1.55 million to 1.7 million (2007) **(8)** Employed pensioners must also pay a 4% in-kind health insurance contribution (2006) **(32)** Pensions will become non-taxed emoluments (2007) **(24)** Private individuals will have to pay a 4% special tax on the portion of their consolidated income above the upper limit of the individual pension contribution (so called solidarity tax, 2007) The health insurance contribution payable by private individuals after certain separately taxed incomes will rise from 4% to 15%. The upper limit of such payments will grow from HUF 400,000 to HUF 450,000 per year.	**(53)** The rate of the simplified enterprise tax is increased from 15% to 20% (2006) **(170)** Corporate businesses must pay a special tax of 4% on their adjusted, pre-tax profits (2006) Introduction of the minimum contribution base (HUF 125,000 per month in 2006; HUF 131,000 per month in 2007). Exemption can be granted upon request and an immediate tax inspection. (Retired) self-employed people and members of corporate businesses who pursue auxiliary activities must pay a 10% healthcare contribution instead of the former 5% accident contribution (2006), the rate will be raised to 16% (2007) **(88)** The healthcare contribution of HUF 1950 per head will not be revoked (2006) **(55)** Minimum tax levied on self-employed people and members of corporate businesses (2% of the total revenues realized in the tax year minus the revenues of foreign sites and the purchasing price of goods sold) (2007) Changes in vehicle taxation (2007) **(50)** Credit institutions must pay a 20% annuity on interest income from loans associated with state subsidies. (2007) **(10)** Introduction of a 20% tax on excessive cash in hand held by corporate businesses (2007) **(210)** The planned reduction of employers' contribution will not be realized (3% in 2007; 2% in 2009) In contrast with the plans, the local business tax will not be abolished (2008)

* In brackets in front of the measures – where such calculations were available – the amount of the revenue growth or expenditure cut expected by the Government due to the measures in HUF billion. Certain items may be shown more than once in the table. The Government expects to yield HUF 9 billion from the changes in vehicle taxation, the distribution of which between companies and private individuals is not yet known. After the measures, either the date of introduction or the date of the relevant bill is indicated.

MAJOR MEASURES DERIVED FROM THE CONVERGENCE PROGRAMME (2006–2009)*

Central and regional public administration (internal balance)	Higher and public education (internal balance)	Pension system (internal balance)	Healthcare** (internal balance)
Central administration: **(20)** A 20% downsizing in the organizations of central administration (implemented) **(15)** A 10% downsizing in the central administration and its regional agencies (by 1 December 2006) **(10)** Centralization of parallel functional areas operating in the same scope (2007) Spreading of electronic public administration (from 2007) **(12)** Liquidation of certain institutions *Local governments:* **(49<)** Task fulfilment within city, small regional or regional associations to eliminate the dominance of county level task performance (public administration, public education, etc.), and the development of the corresponding funding structure (2006 bill) Introduction of performance based wages in public administration (from 2007)	*Public education:* It is optional in 2006, and mandatory in 2007 to increase the number of mandatory classroom hours by two units per week (2006) Transformation of the normative funding of public education: funding on the basis of the number of computed teacher jobs (2006 bill) Task performance in association with other institutions (2006 bill) *Higher education:* Introduction of the tuition fee in the 2007-2008 academic year (approved) Reduction of parallel training courses, and the number of higher education institutions (2007 bill) The structure of state funded education will change and the number of state funded students will drop (Government Decree, 1 October 2006)	Raising the early old-age retirement age by one year Adjustment of the benefit disbursed to early retirees as justified by actuarial calculations (2006 Act No income earning activity can be pursued if pension is disbursed below the retirement age **(8)** Employed pensioners must pay a 4% in-kind health insurance contribution (2006) **(32)** Pension benefits will increase the aggregate tax base (2007) The anomalies of the pension award rules will be eliminated (valorisation, netting).(2006 bill) Disability benefits will become an independent benefit category, and they will be removed both from the healthcare and pension systems (2007 bill) Category III disability pension will be replaced with a temporary benefit and will be supplemented with appropriate rehabilitation required to encourage the return to the labour market. Elimination of abuses when determining the abilities of people with reduced working capacities, review of the eligibility of current disability pensioners (2007 bill)	A decision will be passed about the liberalization of the health insurance market by the end of the year Restructuring of the healthcare system (elimination of regional disparities in capacity distribution, elimination of unused capacities, reduction of the predominance of inpatient care over outpatient care, centralization of active hospital care in "regional central" hospitals) (from October 2006) Drug thrift act for the rationalization of expenses related to pharmaceutical subsidies (Autumn 2006) Pharmacy liberalization **(30)** HUF 300 co-payment and daily hospital fee (2007) The Health Insurance Supervision will be established. Apart from other tasks it will follow spending by the National Health Insurance Fund (OEP) (2007) Medicines that were formerly subsidizes at 100%, will cost HUF 300 (2007) More stringent control of the payment of social security contributions; development of eligibility packages based on non-insurance, insurance and supplementary insurance (from 2007) Primary agricultural producers will also become insured (2007)

* In brackets in front of the measures – where such calculations were available – the amount of the revenue growth or expenditure cut expected by the Government due to the measures in HUF billion. Certain items may be shown more than once in the table. The Government expects to yield HUF 9 billion from the changes in vehicle taxation, the distribution of which between companies and private individuals is not yet known. After the measures, either the date of introduction or the date of the relevant bill is indicated.

** Healthcare measures were formulated with regard to the operative decisions passed at the Government meeting held on 31 August and 1 September 2006

Notes

1 Net external dept = balance of the net external debts of the state, companies and households + direct capital investments

2 This part of the need for external funding generates its own resource proportionately to the rate of reinvestment. However, this alleviates the burdens only temporarily, since reinvested income will sooner or later generate additional outflowing income for the owner.

3 The publication titled Society at a Glance: OECD Social Indicators 2005 used the ratio of the population earning less than 50 of the average wage as a relative poverty index.

4 consumption unit = a single adult

5 The monthly net wage of employees in 2005. Here we do not count with the extra income generated from the social transfers.

6 Since 2004, on each month spent in employment after the retirement age has increased the old age pension by 0.5%.

7 According to the 2005 OECD publication titled Society at a Glance: OECD Social Indicators, the demographic dependency rate (population above 65 years /the 15–64 age group) will grow from 21% in 2000 to 50% by 2050.

8 In this section the words enterprise and company are used as synonyms.

9 SME = small and medium-sized companies

10 In 2003 as much as 61.1% of the registered capital of foreign owned companies concentrated in large companies, while the same ratio was only 36.9% in the case of companies owned by Hungarian companies, and only 3.7% in the case of companies owned by Hungarian private individuals (Kállay – Kőhegyi – Mrs. Kiss Kovács – Maszlag, 2005)

11 Companies limited by shares cannot opt for the simplified enterprise tax, and the revenue ceiling of enterprises and corporations is HUF 25 million.

12 Nonetheless, this has few positive results for the dual economy, since it originates in the production sector instead of the service sector.

13 For instance, in 2003 this indicator (payable tax/computed tax) was 97.2% at SMEs, and only 46.8% at large companies! These ratios were not more favourable in the years before 2003 either. (Kállay – Kőhegyi – Mrs. Kiss Kovács – Maszlag, 2005)

14 Such additional expenses are also taken into account by the Convergence Programme (page 35).

15 Expenditures of the first pillar: 9.3% of the GDP in 2000; 13.5% of the GDP in 2050 according to the forecast of the convergence programme.

16 The share of generic drugs from turnover is low by international standards, too (25%), which can be attributed to the drug prescription and consumption habits.

17 The amounts shown here are the background calculations of the Ministry of Education and Culture.

18 Pursuant to Act CLIII of 2005 on the 2006 budget of the Republic of Hungary, the operational budget of universities and colleges equals HUF 347 billion this year.

19 The following measures are mentioned in the convergence programme as the planned tools to encourage investments: favourable investment environment (expanding physical infrastructure, investment encouraging programmes, simplification of administration, quality state services, vocational training adjusted to the market needs), economic stability, balanced income and budget policy, favourable business and innovation environment, large-scale investments between 2009 and 2011in order to turn Hungary into a logistics centre, as well as in relation to agricultural energy policy and renewable sources of energy.

20 Slightly more than 50% of the 5.8% drop in primary expenditures arises from the reduction of wage and other current costs of the public sector, slightly over 10% is caused by the cuts in in-kind allowances, and slightly over 30% is caused by the curbing of state investments and other government programmes.

21 Debt conversion programme hallmarked by US Secretary of Treasury Nicholas Brady (March 1989).

22 The Convergence Programme of Hungary 2005–2009, page 14

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