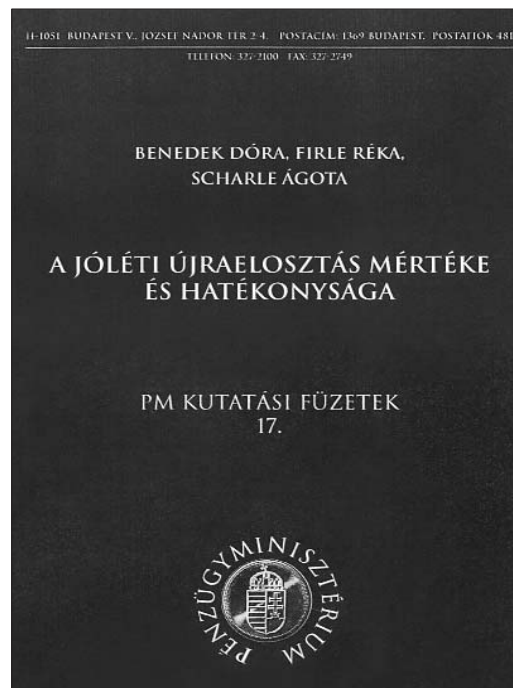


Results of an outstanding workshop

*Ministry of Finance
Research Working Papers*



In this novel introduction to specialised literature, I wish to present a series of studies which constitutes a fundamental part of research conducted in the subject area of finance in Hungary. In reviewing 17 different working papers, the only aim can be awakening interest – which in my view is a very important one.

The editors and, in most cases, the authors of the working papers are researchers of the Ministry of Finance. By operating its Economic Research Division (the former Strategic Analysis Division) and by publishing this series, the Ministry fulfils a significant mission. The task of the Division is defined in the series of studies as follows: “it aims to support evidence-based policy-making in priority areas of financial policy.” It is then added: “The Working Paper series serves to disseminate the results of research carried out or commissioned by the Ministry of Finance.”

By going well beyond its task of promoting

policy-making, the series of studies makes a substantial contribution to the accomplishments of local economic research. Five of the 17 working papers published so far are produced by the small research team operating within the Ministry of Finance. These studies are rated among the best, so we can say that the Ministry staff members play a central role not only in organising the work done in the workshop, but also in contributing to its success. A wide range of external experts is involved with excellent results. However, the most valuable of all is the distinctly outlined concept and the closely interlinked thematic structure of the researches which facilitate diverse approach to and identification of the major problems in the Hungarian economy. There is an apparent aspiration for a uniform internal structure in the researches, i.e. the presentation of the theoretical background, summary of the results of empirical research as well as frequent references

to international comparisons depending on the nature of the subjects under review. Besides providing a successful summary, it also enriches science with several new research results and provides good foundations to economic policy which are useful in many respects.

The subject matters of the research projects tackled by the working papers can be divided into two major groups. The first seven studies in the series clearly elaborate one main subject area – systematically and thoroughly: competitiveness, the foundation stone of every economy's success. The working papers published within this subject area in 2003 and 2004 are products of the research carried out by the Ministry of Finance team with the contribution of external experts. In her introduction, research project leader *Orsolya Lelkes* describes the structure of her study on competitiveness, according to which the analysis of the factors influencing competitiveness is centred around three main themes as listed below (we add in brackets reference to the study issued in the series).

I. Resources

Infrastructure (*Fleischer*, Working Paper No. 2, August 2003)
 Labour market (*Scharle*, Working Paper No. 4, October 2003)
 Direct foreign investment (*Sass*, Working Paper No. 3, September 2003)

II. Operation of the market, regulatory environment

Innovation, research and development (*Borsi*, Working Paper No. 6, February 2004)
 Enterprise environment (*Kállay, Kissné Kovács, Kőhegyi*, Working Paper No. 1, August 2003)

III. External effects

Environment protection (*Pataki, Bela, Kohlheb*, December 2003)
 Social cohesion (*Lelkes*, March 2004)

A lot of papers are published on competitiveness, and because of the varied approaches, it is necessary to give the definition of the concept. This is already briefly and clearly outlined in the introduction to the review of the

research results: competitiveness is interpreted as a growth potential, which – both at the level of national economy and that of a company – depends on the adaptability of the economic unit. An appropriate macro-economic, political, social and legal environment will create the potential for competitiveness, but efficiency depends, ultimately, on the improvement of the micro-economic capabilities of the economy, along with the quality of local competition.

This interpretation explains the significance of the theme of the study first published (*Kállay, Kissné Kovács, Kőhegyi*, 2003). Market environment, regulation and support for small enterprises – which is the very title of the working paper – are areas where the state exerts its influence. The authors state that (according to a survey carried out in 1997–1999), high public taxation and unpredictable regulations were key obstacles to the growth of small and medium-sized enterprises. They point out that contrary to international practice, where the emphasis has been shifted from subsidized services to legal regulation and to programmes that in the medium term can be operated without support, in Hungary the tools applied were limited to the provision of relatively inexpensive funds to small groups of recipients, and thus they made their impact alongside with the distortion of competition. We should mention that EU accession probably asserted a positive change in this respect.

The study appearing as Working Paper No. 2 deals with the relationship between infrastructure networks and competitiveness. The author, *Tamás Fleischer*, rightly lays special emphasis on the role of info-communication. It is often apparent to the reader that he does not share the great expectations about motorway development, underlining that in order for regions to enjoy the positive impacts of investments they must have other prerequisites which are essential for the absorption capacity, e.g. local network linkage systems.

In Working Paper No. 3, which focuses on the function of direct foreign investment, *Magdolna Sass* highlights that in order to halt the lag of an otherwise smaller extent in the capital inflow Hungary has shown since 1999 compared to its competitors, and to improve the country's capacity to attract capital, it is necessary to eliminate macro-economic imbalances and to develop the infrastructure as well as education and training. She calls our attention to the institutional changes that had to be made to investment promotion in order to meet the requirements of EU-accession, highlighting within this the co-financed forms of assistance and compliance with the aid ceilings.

Working Paper No. 4, the work of *Ágota Scharle*, addresses the relationship between the labour market and competitiveness. The author considers the high inactivity rate as the key impediment to competitiveness, and seeks, first of all, to find an explanation for that in her study backed up by abundant statistics. In the course of systematically reviewing the factors determining the labour market, she examines a number of important and highly current issues. Talking about government transfers, the author refers to the possible effects of increasing the retirement age, and raises the issue of the employment of disability pensioners and disabled persons. In the absence of sufficient empirical analysis, Scharle does not take a view on how the changing of taxes, tax increases or tax cuts would influence labour demand and supply. She dwells upon the effects of the minimum wage rise and the low level of labour mobility. With respect to training, she makes a noteworthy statement: the ratio of enterprises organising professional further training is low in comparison to EU Member States and to other countries of the region.

The study published in Working Paper No. 5 was prepared by *György Pataki*, *Györgyi Bela* and *Norbert Kohlheb*, staff members of Szent István University, Institute of Environmental

Management. In relation to the other studies, this paper elaborates at greater length and details upon theoretical foundation and reviews international practice and empirical evidence. It can be considered fully justified if we think of how unacknowledged environment management aspects are in the country compared to their real and great significance, and how undeservedly they are pushed into the background in society as well as in economic decision-making. It is a pity that in the absence of substantial empirical survey, the presentation of the rather disappointing local circumstances is falling short.

In research paper No. 6 *Balázs Borsi*, member of the Heller Farkas Innovation Research Team of the Budapest University of Technology and Economics deals with the subject area of technological modernisation, innovations, and research and development. After the introductory chapter defining the main terms based on the concept of the National Innovation System (NIS), the specific features of the Hungarian innovation system are outlined. Macro-economic statistics reveals, among other things, that the more developed a country is the higher the proportion of researchers will be who, out of the total number of researchers, are involved in the private sector. In this respect, Hungarian figures are among the worst within the OECD countries. The analysis of the micro-level is based on a business survey which demonstrates, inter alia, that almost two-thirds of the enterprises introduced new technology in the previous years. Chapter III, which is aimed at formulating possible economic policy steps, highlights the significance of a systemised approach.

The problem of social cohesion plays a special part in competitiveness, which is the topic *Orsolya Lelkes* addresses in the last paper (No. 7) within the first large subject area. Improving social cohesion and taking efficient action against social exclusion, unemployment and extreme income differences enhance economic

growth potentials. The author stresses that the real question is how the state finances the welfare systems rather than how much it spends on them. Her statement is very topical, i.e. the relevant issues are the various forms of benefits, their eligibility criteria and the impact of such benefits on business behaviour. The quality of welfare services is measured by the extent they promote social integration, including in particular, participation in the labour market. The low employment rate of the Roma population is linked to social exclusion. The author underlines that it is related to the low education level characterising this social group. With respect to the income position, she establishes that regarding the indicators of relative poverty, Hungary has a relatively favourable position compared with other EU countries.

Orsolya Lelkes's study leads on to the other large group of researches which falls within the subject area of consumer income, social redistribution and welfare systems. The Ministry of Finance research team has carried out the major part of the research, but a few invited external experts have also made some contribution.

Working Paper No. 12, prepared by researchers of the Ministry of Finance, deals with the analysis of the minimum wage increases between 2001 and 2006, a subject related to the analysis of primary incomes. The study, which also reviews theoretical results and foreign empirical researches, focuses on the effect of minimum wage rises on two areas: income disparities and, in particular, employment. The researchers make a detailed study of the real and expected impact of minimum wage rises in 2001–2002, and in 2006 respectively. In the first case, they conclude that there was no substantial decline in employment in the national economy as a whole, but employment dropped in certain sectors and other economic spheres, which affected smaller enterprises, unskilled and old employees and regions with high unemployment rate. The same effects are fore-

seen in respect of the latest minimum wage increase.

The issue of social redistribution is the central theme of the series. Working Paper No. 9 serves as a starting point with its analysis of empirical evidence. It provides a broad overview of the structure of general government expenditures and revenues in the period between 1991 and 2002 in Hungary. The authors make a consistent use of international comparison.

I presume we can all agree that in the present times when reforms are unavoidable, one of the most important issues to be addressed in Hungary is the extent and manner of the state's role in the welfare systems. The author of Working Paper No. 8 on this subject is a foreign professor, *John Hills*, from the London School of Economics, who held a lecture in Budapest at the invitation of the research team. I recommend this study to all readers, especially because it illustrates the British experience. We should bear in mind the distinction Professor Hills makes and uses as the framework of his lecture: in connection with the role of the state and the private sector he differentiates the following categories: provision (i.e. whether the service provider is a public or a private institution); financing (who pays for the service); and the decision (whether the private individual can select the service provider and the price payable). It is noteworthy that the 18-year privatisation process during the Thatcher and Major governments had hardly any effect on the composition of services in the welfare sector: the share of the public sector remained almost unchanged (dropping from 52 per cent to 49 per cent).

Also comprehensive in its theme, Working Paper No. 17, which addresses the degree and efficiency of welfare redistribution and is focused on the selection of redistribution models and the means of redistribution. The authors – researchers of the Ministry of Finance – give an overview of the system of

Hungarian redistribution supported with ample factual data, and arrive at the conclusion that the domestic welfare system is equitable, but operates with low efficiency, consequently, in its present form it is unsustainable in the long run. They consider the targeting of benefits as acceptable, while that of the price subsidies as poor. The authors take a clear stand in favour of abolishing tax allowances which offer advantages to the well-to-do groups.

Study No. 10 in the series assesses income redistribution in Hungary using a micro-simulation model. Within this framework, the authors show the effect of tax and subsidy systems applied in the period between 2002–2004 on society as a whole and on different groups of society formed according to various considerations. Based on their examination conducted from the perspective of households and individuals, the authors draw the same conclusion that tax allowances tend to benefit medium-income groups, while their abolishment and the increased role of central support are favourable for the most needy, including in particular, families with children.

The high number of inactive people represents an acute problem in the Hungarian economy. We are not only talking about aging and a longer period of life spent in education, nor is it related to unemployment which would affect a large percentage of job seekers. It is instrumental in inactivity that compared to other countries, a large proportion of the working-age population is absent from the labour market, for not at all unequivocal reasons. *Zsombor Cseres-Gergely's* study addresses this vital question (Working Paper No. 13), placing special emphasis on the group of inactive middle-aged people and households. In his study, which is based on analysing a survey of the Central Statistical Office published in the Annex, the author tries to explore the reasons for early retirement and analyses its conditions and impact. Working Paper No. 14 is also connected to the pension scheme. It provides a

long-term overview of the changes in generational accounts, covering the period between 1992–2001, in the study produced by *Róbert Iván Gál, Árpád Törzsök, Márton Medgyesi and Tamás Révész*.

The analysis of the savings incentive scheme, more precisely the incentives built into the taxation system, is linked with the review of consumer incomes, which is the subject matter of Working Paper No. 15 prepared by Anna Vidor. The author starts from the fact that such incentives can only be effective if they, at least partly, encourage new savings rather than resulting in shifting savings from other type of assets. She establishes that in Hungary pension fund savings coupled with tax allowances produce the above described effect.

As we have seen, it is apparent from this series that the key theme of the researches has been the analysis of the financial implications of competitiveness as well as consumer incomes and social redistribution from different angles.

There are two exceptions: Working Papers No. 11 and 12 which address a particular subject. *Mária Lesi* and *Gabriella Pál* introduce to the readers the theoretical foundations and EU regulation of carbon-dioxide emission trading, and discuss in detail its expected impact on the Hungarian electricity market.

In summary, we may conclude that this significant series has become an indispensable part of financial research in view of the importance of the issues raised by it and the success of the research work. Thus, it is an essential resource for economic decision-making as well as for further research and education, and it also provides a useful source for promoting general knowledge and informing the press on these often discussed issues. We hope and expect that the research workshop of the Ministry of Finance will continue its efforts and this invaluable series to the benefit of us all.

Iván Schweitzer

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- 5 György Pataki, Györgyi Bela, Norbert Kohlleb: Competitiveness and Environment Protection, December 2003
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