

Anna Moździerz

Department of Finance  
Cracow University of Economics

## FISCAL CONSOLIDATION IN HUNGARY IN 2010–13

### Abstract

The purpose of this paper is to identify the fiscal consolidation methods implemented in Hungary in 2010–13 and to gauge whether adjustments on the expenditure side or on the revenue side had the greater influence on improvements in the budget balance and reduction in the public debt. The chief aim of Viktor Orbán's government is to restrict the public debt. The instrument that was to achieve this was the Széll Kálmán plan for structural reform, which at its current stage of implementation has contributed little to improving the state of the public finances. The paper concludes from the presented evidence that the reduction in the budget deficit brought about by the consolidation measures is primarily the result of adjustments on the revenue side (increased rates of taxation, the introduction of new public levies). The paper takes the provisional position that consolidation has not proved an effective means of securing changes in the ratio of public debt to GDP.

**Keywords:** fiscal consolidation, public finance, public debt, tax system, financial crisis, Hungary.

### 1. Introduction

The global financial crisis has altered the fiscal positions of the member states of the European Union, some of which have been so severely struck by worsening budget balances and increasing public that it has threatened them with insolvency. Though Greece has endured the worst, the general turbulence was visited on other countries also. Hungary, where the general government sector debt increased from 67% of GDP in 2008 to 81.8% of GDP in 2010, provides an excellent example. That Viktor Orbán's government went so far as to compare the situation in Hungary to that in Greece, and to suggest the country was threatened by the spectre of

bankruptcy, demonstrates the scale of the problem. While the majority of EU member states saw the crisis as the main reason for the growth in public debt in recent years, in Hungary a specially-appointed parliamentary committee attributed it to the errant economic policy pursued by left-wing governments in 2002–10. The three prime ministers produced by the Hungarian Socialist Party in that period, Péter Medgyessy (2002–04), Ferenc Gyurcsány (2004–09), and Gordon Bajnai (2009–10), under whose governments there was an increase of 29% in the ratio of public debt to GDP, were thus held responsible for the horrendous state of the public finances. The remarkable thing was that Hungarian parliamentarians approved an amendment to the criminal code at the end of 2011 permitting criminal cases to be brought against leading politicians responsible for the country's "unjustified debt" (IAR 2011). The measure was adopted along with a constitutional amendment, which entered into force on 1 January 2012, naming the opposition Hungarian Socialist Party a "criminal organisation" that was to take full responsibility for the "crimes of the communist regime in this country" (Niewiadomski 2011).

The formation of Orbán's second government saw the beginning of a series of structural reforms and public finance recovery programmes designed to reduce the country's debt. The overall policy was so unforeseen that people began to refer to it as the Hungarian experiment or as "Orbanomics".

Fiscal consolidation aims to reduce the budget deficit and public debt by running a discretionary fiscal policy. If this is the case, the policy instruments can be based on adaptation measures involving a) increasing revenue, b) reducing expenditure or c) increasing revenue and reducing expenditure at the same time.

The purpose of this paper is to identify the fiscal consolidation methods implemented in Hungary in recent years and, in particular, to gauge whether adjustments on the expenditure side or on the revenue side had the greater influence on the changes to the budget balance and reduction in the public debt.

By reason of the above sketch of recent political history, the analysis of changes in the size of the public debt runs from 2002, while the assessment of the state of public finances is based on information available at the time of writing, that is, at the end of 2012. The turning point for testing the fiscal consolidation method was 2010, which is when Orbán came to power. The analysis of changes in the tax system runs to 2013.

## 2. The State of Public Finances in Hungary in the Years 2002–12

The Hungarian case has stimulated particular interest because, having recorded permanently high budget deficits (sometimes approaching even 9% of GDP) in the years preceding the global financial crisis, the country has surprised many by improving its fiscal position.

In 2008–12 the deficits lay between  $-4.6\%$  and  $-1.9\%$ . The general government sector result reported in 2011, when the budgetary surplus of  $4.3\%$  of GDP was associated with an increase in government revenue of  $8.4\%$  of GDP, was especially notable. Given that spending decreased by only  $0.2\%$  of GDP, the improved state of the public finances was mainly the result of adjustments on the revenue side.

From 2011 there was an improvement in the ratio of public debt to GDP. However the cost of servicing it placed a burden on successive budgets and influenced the scale of Hungary's debt. The data presented in Fig. 1 show that, had it been possible to exclude the cost of servicing the public debt from the nominal balance in 2008–10 in Hungary, it would have been possible to achieve a relatively balanced budget. The primary surplus in 2011 came to  $8.5\%$  of GDP and, though this fell in 2012 and was the reason for the unfavourable economic conditions, its value in that latter year was still a positive one at  $2.2\%$  of GDP.

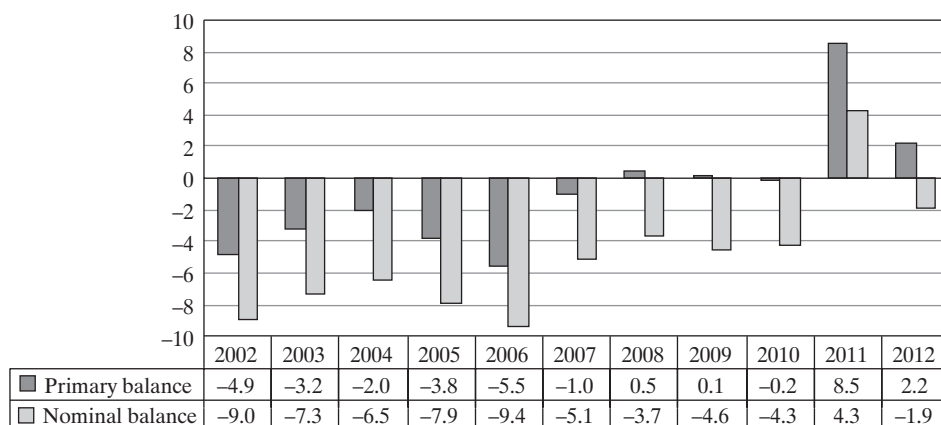


Fig. 1. Nominal and Primary Balance in Hungary, 2002–12 (% of GDP)

Source: Eurostat.

Table 1. Main Parameters of the Assessment of Public Finance in Relation to Changes in GDP

Item	Unit	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Public revenue	% of GDP	42.5	42.4	42.6	42.2	42.7	45.6	45.5	46.9	45.4	53.8	46.6
Public expenditure	% of GDP	51.5	49.7	49.1	50.1	52.2	50.7	49.2	51.4	49.8	49.6	48.6
Nominal balance	% of GDP	-9.0	-7.3	-6.5	-7.9	-9.4	-5.1	-3.7	-4.6	-4.3	4.3	-1.9
Public debt	% of GDP	55.9	58.6	59.5	61.7	65.9	67.0	73.0	79.8	81.8	81.4	79.2
Real GDP growth	%	4.5	3.9	4.8	4.0	3.9	0.1	0.9	-6.8	1.1	1.6	-1.7

Source: Eurostat.

The extent of the primary surplus in 2011–12 was caused by the high degree of fiscal consolidation supported by the use of tax instruments, which will be described later. This observation can be confirmed by analysing the nature of budgetary imbalances in Hungary (Fig. 2). The striking feature of 2002–08 is the considerable influence of structural factors on budgetary imbalances. Measuring the structural imbalances by two methods, one based on the Cobb-Douglas production function and one on the Hodrick-Prescott statistical filter, it was established that the deficits at this time ranged from 12.3% in 2006 to 5.1% in 2008. In 2009–10, meanwhile, the influence of structural factors on the imbalance was noticeably diminished. By 2011, Hungary had been able to record a structural surplus of approximately 5% of GDP, while by 2012 the structural balance was close to equilibrium and the medium-term budgetary objective was set at 1.5% of GDP.

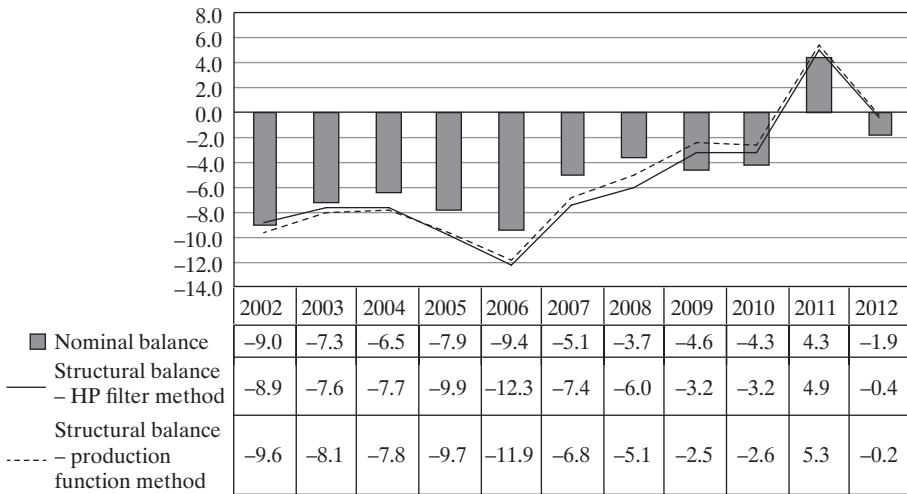


Fig. 2. Nominal Balance and Structural Balance in Hungary, 2002–12 (% of GDP) – Hödrick-Prescott Filter Method, Cobb-Douglas Production Function Method  
 Source: European Commission (2013, p. 38, 84, 86).

The Hungarian Civic Union, which is known colloquially as Fidesz, won an election in April 2010 and proceeded to form a coalition with the Christian Democratic People’s Party (KDNP). This gave it a constitutional majority that would permit rapid and radical changes, such as pension reform, amendments to the constitution and the introduction of new taxes. The most fundamental structural reform was the abolition of the mandatory

private pillar of the pension system in 2011; as in the Polish case, the experiment with open pension funds had failed. In 2008, before the reform, one third of pension funds came from loans, which increased the debt. The share of pension expenditure in GDP increased from 8.5% in 2000 to 10.9% in 2008 (Ministry for National Economy 2011, p. 17).

The structural changes to the pension system, which were designed to make pension funding more secure and to reduce public debt, proved successful as they attracted both one-off and fixed revenues thereby improving the general government balance sheet. A sum of HUF 3 billion (EUR 10.7 billion) (Forbes 2010) was collected from the private system. Nevertheless, maintaining low budget deficits and making further reductions in the public debt called for greater fiscal discipline – a point which was frequently raised by the European Commission and the Council of the European Union (Government of Hungary 2012a). Orbán's government responded with the Széll Kálmán structural reform plan announced in March 2011, which set out measures to reduce public debt.

### **3. The Széll Kálmán Plan to Combat the Public Debt**

The name of the plan was a tribute to one of Hungary's best known and most successful politicians, who served as Minister of Finance of the Kingdom of Hungary in 1875–78 and as Prime Minister in 1899–1903<sup>1</sup>. He made his name by achieving a remarkable reduction in the budget deficit, founding the tax office and replacing the Bank of Austria (which covered only the Austrian part of the Austro-Hungarian Empire<sup>2</sup>) with the Austro-Hungarian Bank. He cut the budget largely by increasing the tax burden – especially income tax. Given the moves made by Orbán's government to reduce the budget deficit and limit the public debt have consisted mainly in increasing the rates of operating taxes and introducing numerous new public contributions, the choice of this particular ex-finance minister as a patron is a revealing one.

There were two versions of the structural reform plan: Széll Kálmán (1.0) (Government of Hungary 2011) and Széll Kálmán (2.0) (Government of Hungary 2012b). Version 1.0 was announced in March 2011 and version 2.0, with “the next step” added to its title, was published in April 2012. The main objective of version 1.0 was to reduce the public debt, although the need to reduce company and household debt was also intimated. The plan

<sup>1</sup> <http://wyszehrad.com/wegry>. Accessed: 4 October 2011; <http://budapesttimes.hu>. Accessed: 11 March 2014.

<sup>2</sup> Ibid.

estimated that total public and private debt at the end of 2010 would exceed 130% of GDP (Government of Hungary 2011, p. 10), which was high enough to represent a barrier to economic growth and the prosperity of the Hungarians. Having identified the weak points, the plan proceeded to propose its remedy: structural changes to increase the competitiveness of the Hungarian economy. The main assumptions of the plan, whose completion date was 2014, were:

- 1) increasing the investment rate from 17% to 25%,
- 2) increasing economic growth from 1% to 4–6%,
- 3) creating 300,000 new jobs,
- 4) reducing the budget deficit to below 3%,
- 5) reducing the public debt from 82% to 65–70%.

The following path of budget-deficit reduction, which did not take the additional revenues from pension reform into account, was determined: 2.9% in 2011, 2.5% in 2012, 2.2% in 2013, and 1.9% in 2013 (Government of Hungary 2011, p. 11). Once the additional revenue had been factored in, the budget balance in 2011 and 2012 was even more favourable. A 50% ratio of public debt to GDP was established as a target to be reached by 2018. To ensure that such an ambitious plan could be carried out, a constitutional ban on passing a budget sanctioning public debt in excess of 50% of GDP was imposed. It took effect from 1 January 2012 (Fundamental Law 2011, Article 36.4). Furthermore, for as long as public debt exceeded the accepted limit, parliament would only be permitted to pass bills to limit it (Fundamental Law 2011, Article 365).

A further institutional change significant for debt reduction was carried out in 2011 when the fiscal council, which had been operating in Hungary from 2008, was reorganised. Though its competences were restricted, it was given the power to veto annual budgets that would push debt over the adopted limit. It should be noted that a requirement exists whereby this project must be discussed once again in parliament. The Act on the Economic Stability of Hungary specified that the fiscal council participates in the preparation of the budget and monitors compliance with the rules on public debt (Act CXCV 2012, Part IV, Article 15.1).

The economic and financial objectives set out in the Széll Kálmán Plan were to be accomplished through structural reforms in employment, education, public transport, health care and the pension system.

The employment rate in Hungary in 2010 was 55.4% of the population aged 20–64 years, which was poor compared to the EU 27 average (62.4%), and even worse compared to countries such as Sweden (76.8%),

Finland (72.5%), Denmark (72.2%) or Germany (71.5%). This has harmed the economic situation of the Hungarians and, through loss of tax revenue and the need to spend on social security, also the public finances. The programme of public works begun from 1 January 2012 (Government of Hungary 2011, p. 17), whose purpose was to increase employment, was a qualified success: alongside a year-on-year decrease of 1.7% in real GDP in 2012 the employment rate increased to 56.6%. Yet the job market, whose major flaw the Orbán government identified as a mismatch between what was being taught and what employers required, remained far from fluidity and health. One of the challenges in this regard was to retain educated Hungarians and thereby curb the negative effects of labour migration on public revenues and public debt (Government of Hungary 2011, pp. 12–24). A plan was therefore devised to change the scholarship system so that it favoured science students.

Another weak point of the Hungarian economy was public transport, which required subsidies that contributed to the growth of public debt. This unsatisfactory state of affairs was to be rectified from 1 January 2013 through restructuring and the introduction of electronic toll-collection (Government of Hungary 2011, p. 22).

The reform objectives also included removing administrative barriers to enterprise, measures to combat corruption and restrictions on pensions privileges. Savings were also sought by reducing subsidies to pharmaceutical companies, while at the same time prevailing upon them not to increase the prices of medicines and thus to accept reduced profits.

With Széll Kálmán (2.0) ready for introduction, the first phase of structural reforms was declared a success. It had brought savings of HUF 458 billion (approximately EUR 1.5 billion<sup>3</sup>), which amounted to 83.3% of the plan (Government of Hungary 2012b, p. 7). The plan had thus made it possible to reduce public spending by 0.8% of GDP. Data retrieved from Eurostat, which was chosen as a source to ensure probity, revealed that between the end of 2011 and the end of 2012 general government sector expenditure decreased by 1% of GDP from 49.6% of GDP to 48.6% of GDP. An analysis of changes in the structure of public expenditure revealed that the fall in the ratio of total expenditure to GDP was a result of reductions in defence (0.3% of GDP), economic goals (approximately 1% of GDP), education (0.4% of GDP) and social benefits and security (0.6% of GDP). The savings were accompanied by an increase in expenditure of 0.1% of

<sup>3</sup> Exchange rate of the NBP (30 March 2012).



GDP on the maintenance of public order and safety, building and housing management, health care, recreation, culture and religion, and by an increase in expenditure of approximately 0.2% of GDP on general public services<sup>4</sup>. There is no doubt that fiscal consolidation in Hungary was at least in part accomplished by limiting public spending. Nonetheless, improvements in the public finances were primarily achieved through measures taken on the revenue side. That in 2012 there was a year-on-year increase in public revenue alone of 1.8% of GDP, which climbed to 39% of GDP in that year, is very much consistent with this assertion.

#### **4. Fiscal Consolidation through an Increase in the Tax Burden**

The Orbán government, in its changes to the taxation of income, consumption and capital, has overseen continuous reform of the tax system. The taxation of personal income underwent its most significant change in 2011 when a flat-rate tax of 16% replaced the progressive, two-tier rates of 17% and 32%, and 27% of an employee's social security contribution was excluded from the basis of taxation and instead became an employer social security charge. It was not long, however, before this seemingly beneficial change – at least as far as personal tax payers were concerned – was neutralised. This came about when, from 1 January 2012, social security contributions paid by the employer were excluded from the basis of taxation and replaced by a social tax of 27%. What is more, this change raised serious legal and social consequences in that the social security contribution paid by the employer was previously linked by law to the insured person's entitlement to insurance benefits, whereas the social tax did not entitle that person to benefits<sup>5</sup>.

Tax deductions, which had been extended to a considerable degree in 2006–07, were all but eliminated in 2012. Nevertheless, relief for small farmers was retained and the range of child tax allowance extended to families with one child.

Changes were introduced in 2012 to the income tax individuals were obliged to pay on non-cash benefits (cafeteria plans) in Hungary. Under the new arrangements the tax due was determined by increasing their value<sup>6</sup> by 19% and then imposing a tax of 16% and social security contributions

<sup>4</sup> Eurostat Database (15 March 2014).

<sup>5</sup> Material prepared by the Bisztrai law firm at the request of WPHI Budapest. Source: Embassy of the Republic of Poland in Budapest (15 November 2013).

<sup>6</sup> The catalogue of tax-exempt, non-cash benefits was set out by the legislator.

of 10%. The taxation of non-cash benefits has made this form of remuneration unattractive.

Though it may be asserted with some conviction that since 2010, when the basic rate of tax was 19% and the preferential rate 10%, the taxation of legal persons has stabilised, the same may not be said of the response to the financial crisis, in whose wake specific regulation was introduced to tax energy, telecommunications, financial institutions and trading networks.

The banks, who were now liable to pay 0.15% of their total net asset value up to HUF 50 billion and 0.5% thereafter, were the first to be affected by the new arrangements. A rate of 6.2% of the revenues from net insurance amounts was imposed on the insurance companies and of 6.5% of the tax base on other financial institutions. The bank tax, which was set to run until the end of 2013, but which was extended to 2014, raised HUF 187 billion (approximately EUR 600 million). As a result of an agreement between the Hungarian government and the Association of Bankers, which concerned the deduction of a proportion of loans granted after 11 September 2011 from the basis of taxation, the proceeds for 2013 were expected to be much lower at a “mere” HUF 72 billion (approximately EUR 240 million) (Biuletyn 2012). The loans in question were extended to SMEs to cover pre-financing, and financing shortfalls, in EU projects and to individuals with a mortgage security.

A new raft of what were officially described as crisis taxes arrived in October 2010 – three months after the enactment of the bank tax. The new burden imposed on the energy and telecommunications sector, and on retail chains, duly took effect from 20 December 2010. The assessment for the energy sector amounted to 1.05% of the tax base, while thresholds were introduced for the telecommunications sector and retail chains. The rates depended on the applicable tax base, which was set as net sales revenue in 2009 for both telecommunications and retail chains. There were three rates for telecommunications: 2% (tax base ≤ HUF 500 million); 4% (HUF 500 million ≥ HUF 5 billion) and 6.5% (tax base > HUF 5 billion), and four for the retail chains: 0% (<500 HUF); 0.1% (HUF 500 million ≥ HUF 30 billion); 0.4% (HUF 30 billion ≥ HUF 100 billion) and 2.5% (> HUF 100 billion). Given a tax year that runs to 31 December, the crisis taxes were expected to have raised HUF 161 billion (approximately EUR 582 million) already by the end of 2010, while total revenue of HUF 494 billion (approximately EUR 1.7 billion) was expected by the end of 2012.

The Orbán government’s tax policy did not overlook indirect taxation, which was demonstrated by increases in VAT and excise. The standard rate

of VAT was set at 27% from 1 January 2012 and, having been once rebuffed by the European Commission in 2011, Orbán made a fresh attempt to introduce a VAT rate of 35% on luxury goods such as yachts, watches and limousines. In his opinion, this would be, “a small but symbolic element of the tax system that would make the current tax regime more equitable”. (Wprost 2013).

The financial consolidation spurred by the financial crisis in Hungary brought not only numerous changes to existing taxes but also a sort of fiscal expansion in the form of new taxes, which included a financial transactions tax, a public-health product tax, a telecommunications tax, a culture tax, a tax on elements of terrestrial and subterranean networks (pipelines, sewerage, gas networks, electricity networks), a car accident tax and an insurance tax.

The tax, or charge, on financial transactions was established on 1 January 2013 (Act CXVI 2012). It applied to providers of cash-transactions in the form of transfers, cashing checks, postal payments and financial transactions in which a deposit account is held for less than two weeks. The tax did not apply to depositing cash with a bank or to the payment or repayment of loans. The list of transactions was extended from 1 August 2013 so that the tax applied to foreign exchange transactions, servicing debt, cashpoint withdrawals and bank charges. The tax was increased during the fiscal year from 0.2% to 0.3% (to HUF 6,000) for non-cash transactions and from 0.3% to 0.6%<sup>7</sup> for cash transactions. The limit for non-cash transactions, previously set at HUF 6,000, was abolished. Perhaps unsurprisingly, the assumption was already present at the implementation stage that, if revenues were lower than expected, the tax could be raised again during the year. The 2013 act predicted revenues in that year from the financial transactions tax of HUF 283 billion (approximately EUR 908 million) and of HUF 322 billion (more than EUR 1 million) in 2014–16 (Biuletyn 2012). As the proceeds were lower than expected, which threatened the deadline for liquidating the excessive deficit, a decision was taken to increase taxation. Determination to reduce the budget deficit was also the premise for parliament’s decision in 2013 to impose a supplementary charge, which was to amount to HUF 75 billion (approximately EUR 240 million) for the entire sector. Yet in November 2013, mindful of households’ tendency to flee to the cash economy, parliament adopted a new solution that exempted individuals from paying the tax for the first two cashpoint withdrawals in

<sup>7</sup> [http://www.budapest.trade.gov.pl/Jogihirek/article/detail,10706,Wazniejsze\\_zmiany\\_w\\_prawie\\_na\\_Wegrzech.html](http://www.budapest.trade.gov.pl/Jogihirek/article/detail,10706,Wazniejsze_zmiany_w_prawie_na_Wegrzech.html). Accessed: 20 December 2013.

each month up to a total of HUF 150,000 (approximately PLN 2,250). For the exemption to be granted, a special declaration had to be submitted to the bank. From 1 February 2014, the costs of the new arrangements were to be borne entirely by the banks (Biuletyn 2013).

The public-health product tax, which was implemented on 1 September 2011 (Act CIII 2011) and commonly known as the crisps tax or the hamburger tax, is collected at points of sale from consumers who purchase a taxable food product and also from sellers when selling a taxable food product in Hungary for the first time. It applies to products high in sugar, salt, cocoa, methylxanthines, and taurine<sup>8</sup>, juice concentrates, energy drinks containing methylxanthines or taurine, packaged confectionery products, chocolate products, salty snacks produced with the use of grains, potatoes or oilseeds, dry blends of kitchen spices, ready-made sauces or soups, beer flavouring, alcoholic drinks, and other products in which added sugar exceeds 35 g/100 g.

The first year of the tax on telecommunications services, which is calculated and paid by the service provider at a rate of HUF 2.00 on each minute of conversation begun, and on every text message sent, was also 2012. An upper limit was set for the tax in the same year at HUF 400 for individuals and HUF 1,400 for companies. By 2013, however, the maximum monthly tax rate had already increased to HUF 300 for individuals and to HUF 1,100 for companies<sup>9</sup>. A separate increase, which took effect from 1 August 2013, was reserved for legal persons. They were to pay an extra HUF 1.00 per minute and attract a tax limit doubled from HUF 2,500 to HUF 5,000<sup>10</sup>. It was estimated before it took effect on 1 July 2012 that the telecommunications tax would raise HUF 44 billion (approximately EUR 141 million)<sup>11</sup>.

The introduction of a car accident tax paid by insurers at a rate of 30% of the value of the motor vehicle liability insurance, but not exceeding HUF 83.00 per day, was a further fund-raising measure. An additional tax on

<sup>8</sup> The rates of tax, and list of products to be taxed, were set out in Act CIII (2011). [http://jogszabalykereso.mhk.hu/cgi\\_bin/njt\\_doc.cgi?docid=139113.592852](http://jogszabalykereso.mhk.hu/cgi_bin/njt_doc.cgi?docid=139113.592852); Népegészségügyi termékadó (2013), [http://www.nav.gov.hu/data/cms281407/53\\_fuzet\\_\\_\\_Nepegeszsegugyi\\_termekado\\_\\_\\_Neta\\_\\_\\_2013.pdf](http://www.nav.gov.hu/data/cms281407/53_fuzet___Nepegeszsegugyi_termekado___Neta___2013.pdf). Accessed: 20 March 2014.

<sup>9</sup> <http://www.nav.gov.hu>. Accessed: 10 December 2013.

<sup>10</sup> [http://www.budapest.trade.gov.pl/pl/Jogihirek/article/detail,10706,Wazniejsze\\_zmiany\\_w\\_prawie\\_na\\_Wegrzech.html](http://www.budapest.trade.gov.pl/pl/Jogihirek/article/detail,10706,Wazniejsze_zmiany_w_prawie_na_Wegrzech.html). Accessed: 10 December 2013.

<sup>11</sup> Information from the guide to the market produced by the Department for the Promotion of Trade and Investment at the Embassy of the Republic of Poland in Budapest: <http://www.budapest.trade.gov.pl/pl/przewodnik>. Accessed: 20 October 2013.

insurance, at a rate of 15% for collision damage waiver and 10% for theft or emergency insurance, was introduced after January 2013 (Jankiewicz 2013).

The search for new sources of state revenue resulted in ever more original solutions, including a cultural tax<sup>12</sup> operated from 2012 on manufacturers, importers, and distributors of pornographic products and a tax introduced in 2013 on elements of terrestrial and subterranean networks (pipelines, sewerage, gas networks, electricity networks), which is levied at HUF 125 (approximately PLN 1.4) on every metre of the network<sup>13</sup>.

In 2010–13, the “special” taxes we have been considering made it possible to raise additional revenues of 1% to 1.8% of GDP annually. Detailed data on the size and structure of these “special” tax revenues are presented in Table 2, in which the “Finance” column includes the tax on financial institutions, the additional tax on selected financial institutions, the financial transaction tax, the insurance tax, the income tax on providers of energy services, surtaxes payable by certain economic sectors, the tax on cables and pipelines, and the telecommunications tax.

Table 2. “Special” Tax Revenues, 2010–13 (billion HUF)

Subject of taxation	2010	2011	2012	2013*
Finance	192.3	195.9	94.6	373.9
including: tax on financial institutions	182.3	186.5	84.9	139.1
Energy	81.2	115.9	87.2	98.9
Telecommunications	58.6	51.3	62.9	61.7
Retail	28.9	21.6	33.3	2.2
Total	361.0	384.7	278.0	536.7
as a percentage of GDP	1.4	1.4	1.0	1.8

Notes: \* – forecast.

Source: OECD (2014, p. 25).

In 2012, this group of taxes accounted for 34% of all revenue from “special” taxes, which was forecast to grow in 2013 to nearly 70%, of which 26% would be raised from financial institutions. Another important source

<sup>12</sup> 2013 – A Megújuló Magyarország Adórendszere, Adóváltozások összefoglaló, 27 November 2012, <http://www.kormany.hu>, p. 24. Accessed: 20 March 2014.

<sup>13</sup> [http://www.budapest.trade.gov.pl/pl/Jogihirek/article/detail,10706,Wazniejsze\\_zmiany\\_w\\_prawie\\_na\\_Wegrzech.html](http://www.budapest.trade.gov.pl/pl/Jogihirek/article/detail,10706,Wazniejsze_zmiany_w_prawie_na_Wegrzech.html) (10 December 2013) and 2013 – A Megújuló Magyarország Adórendszere, Adóváltozások összefoglaló, 27 November 2012, pp. 20–21, <http://www.kormany.hu>. Accessed: 20 March 2014.

of additional state revenue in 2012 was the income tax imposed on providers of energy services.

The OECD report (OECD 2014, p. 10) published in January 2014 showed that, though the special taxes introduced in Hungary had helped to reduce the budget deficit, they had also made the tax system more complicated and less predictable. The position of the taxpayer in relation to the state was further weakened by the politicised judicial system: the way changes are introduced to the legal system, including to taxation, do not follow the practices of other EU countries. Spain's Code of Good Tax Practices, which was adopted in 2010, was, for example, the result of cooperation between the National Tax Agency and a forum of the country's 27 largest companies<sup>14</sup>. Returning to the Hungarian case, the International Monetary Fund assessed the country's fiscal transparency practices in relation to the requirements of the Code of Good Practices on Fiscal Transparency (IMF 2007). In this context, it should be noted that the norm whereby sufficient time is allocated for consultation on draft legislation and regulatory changes is not observed in Hungary.

## 5. Conclusion

We are justified in referring to a Hungarian experiment when we consider the range of structural reforms introduced to shape short- and long-term public expenditure and the sheer number of often radical, original, and controversial changes made to the tax system. The experiment resulted in increased fiscal discipline and hence in the abrogation by the Council of the European Union of Hungary's excessive deficit procedure, which took place in 2013. The research set out in this paper leads us to the conclusion that this was made possible mostly as a result of fiscal measures in the form of increases in taxation. While Széll Kálmán (1.0) secured a temporary improvement in public finances, its true influence on the latter will only be understood over the long term and, in particular, on completion of the second phase of the Hungarian economy's reconstruction. This will largely rest on the outcome of Széll Kálmán (2.0), which will see reform in higher education, reform of the privileges enjoyed by the police and armed forces, measures to reduce unemployment, and modernisation of the public administration. In view of mass, anti-government protests, however, it is not clear whether it will ever be fully implemented.

<sup>14</sup> <http://www.taxand.com/taxands-take/news/publication-code-good-tax-practices>. Accessed: 27 March 2014.

The positive results of the consolidation measures were due in the main to adjustments on the revenue side, which involved introducing several new taxes and extensively remodelling those already in place. The rapid implementation of successive new taxes, and their introduction even while the tax year is in progress, has become the norm for the Hungarian tax system, which can only be described as unpredictable.

During the four years of research that included the writing of this paper, five amendments to the constitution and eight-hundred new regulations were introduced (Financial Times 2014). The changes, and especially those to the constitution, triggered a wave of criticism from the EU, the US, and international organisations such as the OECD and the IMF. The critical response drawn from the European Parliament was set out in a resolution of 3 July 2013 (European Parliament 2013). It stated that the Fundamental Law of Hungary, which was passed on 18 April 2011, exclusively with the votes of the members of the governing coalition and based on a draft text prepared by the representatives of the governing coalition, had been adopted in a mere 35 days, which was insufficient for a thorough and substantial debate with the opposition parties and civil society on the draft text (European Parliament 2013, point AB). The whole matter had been handled without respect for the norms and values of the EU. The resolution also criticised the limitations imposed on the powers of the Constitutional Court, “(...) under the Fundamental Law the Constitutional Court’s powers of ex post review of the constitutionality of budget-related laws from a substantive point of view have been substantially limited to violations of an exhaustive list of rights, thus obstructing the review of constitutionality in cases of breaches of other fundamental rights such as the right to property, the right to a fair trial, and the right not to be discriminated against” (European Parliament 2013, point AO).

Composing an assessment of fiscal consolidation in Hungary at this stage is not a straightforward matter. There are at least two reasons for this. First of all, consolidation remains incomplete and only its current effects can be evaluated. Second, there are disparate methods by which its success could be determined. The European Commission’s view is that consolidation is a success where, compared to the output year, the cumulative cyclically adjusted primary deficit (CAPB) does not deteriorate in the given country by more than 0.75% of GDP within three years of its completion (European Commission 2007, p. 202). Too short a period of time has elapsed since the implementation of the consolidation measures for a credible assessment to be made. Given that Hungary’s attempts to improve the public finances

are aimed at reducing the public debt, the criterion proposed for judging the effectiveness of consolidation by Alesina and Ardagna (2009, pp. 9–10) may be of use. In their account, consolidation is effective where there is an improvement of at least 4.5 percentage points in the ratio of accumulated public debt to GDP three-years after fiscal adjustments have ended. Taking the year 2010 as the output, and relying on the public debt for 2013 forecast by the Central Bank of Hungary (79% of GDP)<sup>15</sup>, it was established that the current consolidation has not been successful: public debt declined in relation to GDP by 2.8%.

Former Prime Minister Gordon Bajnai said in an interview with the *Financial Times* (Financial Times 2013) that after Orbán's government took power in 2010 it had been involved in a number of struggles, including with public debt, unemployment, the European Union, the International Monetary Fund, the banks and supranational companies, but had failed in the fundamental struggle with the public debt to GDP ratio, which was at almost the same level as it had been before launching the consolidation measures.

It is neither justified nor reasonable to attempt an assessment of fiscal consolidation in Hungary until the structural reforms of the Széll Kálmán plan have been implemented. It is quite possible that they will succeed and come to be regarded as an essential factor in the stability of fiscal consolidation. What may be said at this juncture, however, is that any detailed and definitive evaluation of fiscal consolidation *per se* that comes to be written in a few years' time will be incomplete without an account of the socio-economic reforms implemented within the Hungarian experiment.

## Bibliography

- Act CIII (2011) "Törvény a népegészségügyi termékadóról" [Act on the product tax related to public health].
- Act CXVI (2012) "Act CXVI of 2012 on the Financial Transaction Duty". *Hungarian Official Gazette*, No. 98/2012, 23 July.
- Act CXCIV (2012) "Act CXCIV of 2011 on the Economic Stability of Hungary". Operative Regulations on the Fiscal Council, 25 April.
- Alesina, A. F. and Ardagna, S. (2009) "Large Changes in Fiscal Policy: Taxes Versus Spending". NBER Working Paper Series No. 15438.
- Biuletyn (2012) "Biuletyn Ekonomiczny" [Economic Bulletin]. Department for the Promotion of Trade and Investment, Embassy of the Republic of Poland in Budapest, No. 7/2012.

<sup>15</sup> Magyar Nemzeti Bank, <http://www.mnb.hu>. Accessed: 27 March 2014.



- Biuletyn (2013) “Biuletyn Ekonomiczny” [Economic Bulletin]. Department for the Promotion of Trade and Investment, Embassy of the Republic of Poland in Budapest, No. 12/2013.
- European Commission (2007) “Public Finances in EMU 2007”. *European Economy* 3.
- European Commission (2013) *Cyclical Adjustment of Budget Balances*. European Commission, Directorate General ECFIN Economic and Financial Affairs, Economic Databases and Statistical Coordination, Autumn.
- European Parliament (2013) “European Parliament Resolution of 3 July 2013 on the Situation of Fundamental Rights: Standards and Practices in Hungary, P7\_TA(2013)0315.
- Financial Times (2013) “Hungary and the Price of Orban’s Phoney Wars”. *Financial Times*, 5 November.
- Financial Times (2014) “Hungary’s Attacks on the Rule of Law and Why They Matter for Business”. *Financial Times*, 5 February.
- Forbes (2010) “Zatwierdzono reformę emerytur na Węgrzech” [Pension reform approved in Hungary]. *Forbes*, 14 December, <http://www.forbes.pl>. Accessed: 10 March 2014.
- Fundamental Law (2011) “The Fundamental Law of Hungary”, 25 April.
- Government of Hungary (2011) *Szék Kálmán Terv 1.0, Összefogás az Adósság Ellen*, március.
- Government of Hungary (2012a) “Report on Measures Taken in Response to the Council Recommendation of 13 March 2012 under the Excessive Deficit Procedure”. Government of Hungary, October.
- Government of Hungary (2012b) *A Következő Lépés, Szék Kálmán Terv 2.0*, április.
- IMF (2007) “International Monetary Fund Code of Good Practices on Fiscal Transparency”, <http://www.imf.org/external/np/fad/trans/code.htm>. Accessed: 27 March 2014.
- Jankiewicz, G. (2013) *Podatek od wypadków samochodowych i podatek od ubezpieczeń* [Tax on car accidents and tax on insurance]. A Guide to the Market. Department for the Promotion of Trade and Investment, Embassy of the Republic of Poland in Budapest, <http://www.budapest.trade.gov.pl>. Accessed: 11 February 2014.
- Ministry for National Economy (2011) “Hungary’s Structural Reform Programme 2011–2014 Based on the Political Thesis of the Szék Kálmán Plan”. Budapest: Ministry for National Economy, March.
- Népegészségügyi termékadó (2013), <http://www.nav.gov.hu/>. Accessed: 10 December 2013.
- Niewiadomski, A. (2011) “Partia Orbana doprowadziła do uznania partii opozycyjnej za «organizację przestępczą»” [Orban’s party ensures recognition of the opposition party as a “criminal organisation”], <http://fakty.interia.pl/swiat>, 30 December 2011. Accessed: 15 March 2014.
- OECD (2014) *OECD Economic Surveys: Hungary 2014*. OECD Publishing, January.
- Wprost (2013) “Orban obłoży jachty i zegarki 35-procentowym podatkiem?” [Will Orban impose a 35% tax on yachts and watches?] *Wprost*, 29 July.
- “2013 – A Megújuló Magyarország Adórendszere, Adóváltozások összefoglaló”, <http://www.kormany.hu>, 27 November 2012. Accessed: 20 March 2014.

**Abstract****Konsolidacja fiskalna na Węgrzech w latach 2010–2013**

Celem artykułu jest rozpoznanie metody konsolidacji fiskalnej realizowanej na Węgrzech w latach 2010–2013. Chodzi o ustalenie, czy obserwowana poprawa salda budżetowego i zmniejszenie długu odbyły się poprzez dostosowania po stronie wydatkowej, dochodowej, czy też po obu stronach.

Głównym celem rządu Viktora Orbána jest ograniczenie długu publicznego. Miał temu służyć plan reform strukturalnych Szélla Kálmána, który na obecnym etapie wdrożenia w niewielkim stopniu przyczynił się do poprawy stanu finansów publicznych. Badania przedstawione w niniejszym artykule prowadzą do wniosku, że dotychczasowe pozytywne efekty działań konsolidacyjnych skutkujące zmniejszeniem deficytu budżetowego są wynikiem przede wszystkim dostosowań po stronie dochodowej (podwyżek stawek podatków i wprowadzenia nowych danin publicznych). Wstępna ocena skuteczności konsolidacji na podstawie kryterium zmiany relacji długu publicznego do PKB jest negatywna.

**Słowa kluczowe:** konsolidacja fiskalna, finanse publiczne, dług publiczny, system podatkowy, kryzys finansowy, Węgry.