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OECD Economic Surveys: Hungary

Chapter 2

Assessing the government's strategy for fiscal consolidation

This chapter takes an in-depth look at the Hungarian government's consolidation programme. The plan is ambitious, the deficit was over 9% of GDP in 2006 and the aim is for a deficit below 3% in 2010. The various new measures to tighten fiscal discipline in budget processes are examined and suggestions for further changes are made. Revenue-raising measures have been necessary for the initial phase of consolidation but in the longer term there is a need to get back on track with reducing tax burdens on businesses and households. The spending freezes are proving difficult to maintain but reasonable progress is being made on the wide range of structural reforms, though further reforms need to be considered.

The government's consolidation programme involves a series of fiscal measures with immediate impact on the budget deficit (many of them intended to be temporary) and a simultaneous process of widespread structural reform to cut public spending. This chapter assesses the key measures with a view to helping progress towards a full completion of the government's consolidation strategy. The assessment begins with an analysis of immediate spending measures and new initiatives to strengthen budget discipline. This is followed by sections on the key areas of structural reform, namely, public administration, healthcare, education, early retirement and pensions, and finally transport. The policy recommendations are summarised in Box 2.1.

Box 2.1. **Policy recommendations concerning strategy for fiscal consolidation**

The new measures to tighten fiscal discipline

The new rule requiring a primary-balance surplus is useful but should be augmented by safeguards against misuse of revenue and expenditure windfalls. Other mechanisms to strengthen longer-term fiscal commitment should also be considered. As previous *Surveys* have suggested, a system of binding medium-term spending limits may be one way forward.

Immediate spending measures

An agreement to a re-scheduling in the payment of the 13th month salary was concluded in February 2007. Any further pressures to spend anticipated "windfalls" need to be strongly resisted and some form of ring-fencing round unexpected gains should be made. For example, if the deficit is on track to being below target then funds should be used for deficit and debt reduction.

The freeze on public-sector pay is anyway perpetuating a stop-go cycle in public sector pay that has damaged morale and recruitment. In the longer term, the cycle should be stopped, for example through the multi-year agreements.

Public administration reforms

There are plans for a more flexible system of pay for civil servants with a stronger element of performance evaluation. Currently, the basic wage is augmented by various mandatory additional payments – the 13th month salary, payments for language proficiency, a "clothing bonus", and so on. These components should be de-restricted so as to allow managers to reward their employees more freely according to performance.

The further diffusion of e-government is also important for public administration reform. However, the existing regulatory framework needs to be closely monitored if e-government is to be introduced both swiftly and effectively.

Healthcare reforms

The implementation of the new regional hospital network needs to be supported by measures to strengthen the gate-keeping function of general practitioners.

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Box 2.1. **Policy recommendations concerning strategy for fiscal consolidation** *(cont.)*

The financial responsibilities of the National Health Insurance Fund Administration (NHIFA) could be better defined in ensuring good decisions in choices between hospitalisation and outpatient treatment.

Hospital managers should be given greater responsibilities for deficits and debts. Such a move would also help hospitals adjust their workforce to suit requirements.

Education

The connection between fees and examination results should be reduced. The majority of students should pay back a large share of the tuition costs but with safety nets to prevent exclusion. A system where fees are more uniformly applied that builds on the existing system of government loans ought to be considered.

Early retirement and pensions

The scheduled changes to early retirement schemes are welcome. But, as recommended in the previous *Survey*, the "advanced early retirement pension" ought to be eventually removed altogether because there is no reduction in the annual pension payout, while the "reduced advanced early retirement pension" should be checked for actuarial fairness.

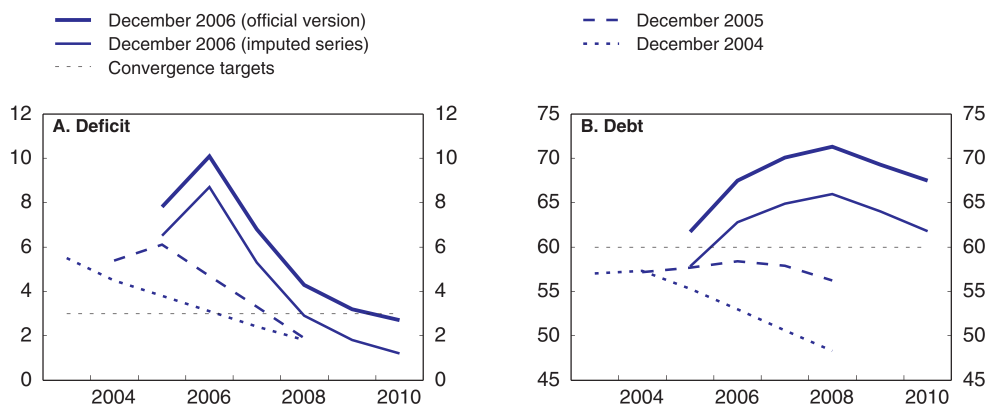
The proposals for reform to the old-age pension system currently being developed should include increases in the statutory retirement age beyond 62 years.

Overview of the government's strategy

The speed of the government's planned fiscal adjustment is impressive, with the plan envisaging to cut the general government deficit by some 5 percentage points of GDP between 2007 and 2008, and another 1½ points over the following two years (Figure 2.1). The projected improvement of the primary balance over the period is of roughly the same magnitude. All in all, this effort is expected to bring the level of the deficit down to 2.7% of

Figure 2.1. **Deficit and debt objectives under successive Convergence Programmes**[1]

% of GDP



1. Figures show the ESA general government deficits and debts outlined in the Convergence Programmes. The official series in the Programmes for 2004 and 2005 included contributions to second-pillar pensions in revenues. This practice was abandoned in 2006; the imputed series enable comparison with the previous series.

Source: Convergence Programme of Hungary (various issues).

GDP by 2010 and to result in a primary balance surplus. The level of the general government debt is set to start falling towards the 60% benchmark used in the EU's convergence assessments in 2009.

With the immediate steps of the programme in place (Table 2.1), the government's priority is now on structural reforms. These are mainly aimed at improving spending efficiency but some also aim to improve the tax base by narrowing the grey economy (see Box 2.2). There are two interrelated challenges:

- *Adequate delivery on structural reform*. Many measures require legislation that has yet to be passed by Parliament and, even when this is successful, structural reform is often inherently slow to implement and the speed with which efficiency gains are realised is uncertain. Furthermore, some areas of reform are likely to meet considerable political opposition.[1]
- *Ensuring temporary measures expire*. Spending freezes account for a large share of the budgetary savings; unless they are backed by structural reform measures, the longer these are sustained, the greater the build up of future spending pressure. Some other measures should also be reconsidered if the competitiveness of Hungary's export sectors is to be sustained, although there are no immediate plans to lower the overall tax burden. Negative surprises in fiscal outcomes and poor progress in structural reform would likely mean such temporary steps end up as permanent.

Table 2.1. **The initial measures of the government's consolidation programme**[1]

% of GDP

	2006	2007	2008
A. Increase in revenues			
Value added tax	0.2	0.6	0.6
Personal income tax (including special solidarity tax)	0.1	0.4	0.4
Taxes on business	0.3	1.1	2.7
Social security contributions	0.3	2.3	2.0
Other taxes	0.3	0.2	0.1
Total revenue gains	1.2	4.5	5.8
Of which:			
Withdrawal of planned tax cuts	0.1	1.2	2.7
Active revenue gains	1.2	3.3	3.1
B. Reduction in expenditure			
Permanent measures			
Employment cuts	0.0	0.2	0.4
Severance payments	0.0	–0.2	–0.1
Health care reform and cuts in drug subsidies	0.3	0.7	0.8
Cuts in energy and transport subsidies	0.1	0.5	0.6
Other permanent spending cuts	0.0	0.1	0.2
Temporary measures			
Public sector wage freezes	0.0	0.2	0.4
Temporary cuts in operational expenditures	0.2	0.2	0.1
Nominal freezes of specific non-wage items	0.0	0.5	0.4
Other temporary measures	0.3	0.0	0.0
Total spending cuts	0.8	2.1	2.8
Total fiscal adjustment	2.0	6.6	8.6

1. Fiscal adjustment measures relative to a path assuming no policy change.
Source: OECD calculations based on figures provided by the Ministry of Finance.

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Box 2.2. **Estimates of the grey economy and recent measures to combat it**

Recent Hungarian research estimates that the hidden (or "grey") economy currently accounts for close to 20% of GDP but is probably trending downwards (in 1993 the hidden economy was perhaps one third of GDP).* Hidden activities are thought to most commonly take the form of unregistered employment, un-invoiced services and underreporting of wages.

The government is intensifying its campaign against these types of activities. The measures focus on reducing the underreporting of wages which typically takes the form of declared wages being topped up by cash payments and in-kind benefits. Some of the measures planned are straightforward, in particular:

- More checks on individuals whose wealth or lifestyle appears inconsistent with their personal income tax declarations.
- Introduction of a "double minimum wage rule" whereby by default the employer is required to pay contributions on the double minimum wage, unless it is proved that the employee actually gets less than the amount of the minimum wage.
- Increase in the number of labour inspectors allocated to checking salary arrangements.

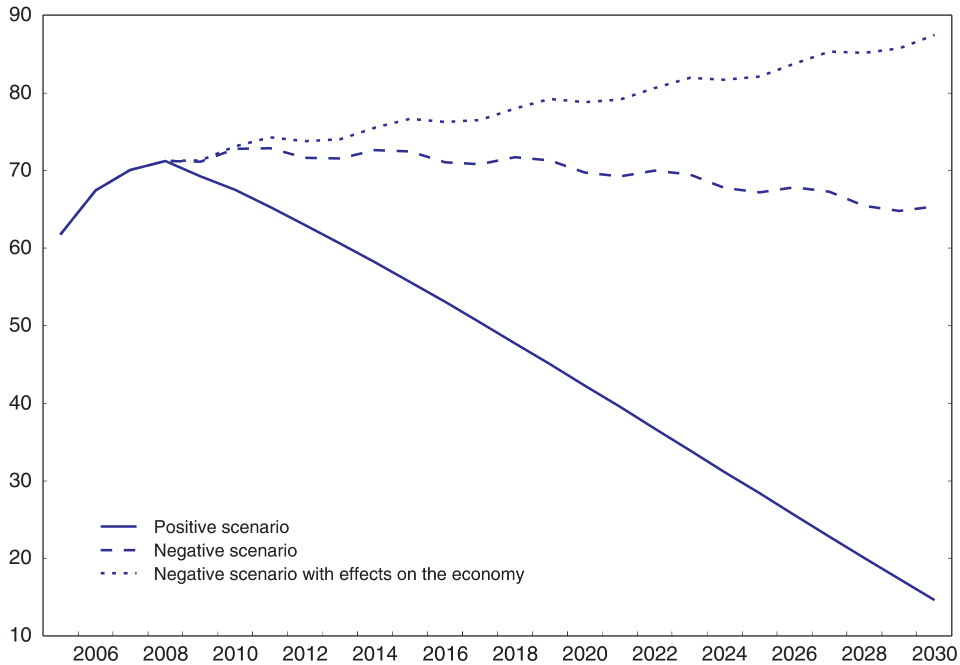
Other measures are more indirect. A system of "guaranteed wage minima" based on educational and vocational qualification for the job has been introduced that is to some extent forcing a "whitening" of employment (see Chapter 1). Also, in healthcare reform, it is hoped the proposed tiered coverage based on social-security contributions will have a similar effect.

* Lackó (2000) and Tóth (2006).

The long-run gains of reaching the goals of the consolidation programme and the consequences of alternative scenarios involving continued strong electoral cycles in deficits can be seen in simulations of public sector debt developments. Figure 2.2 shows simulations up to 2030 for the following scenarios (see Annex 2.A1):

- *Positive scenario*. This assumes that the objectives of the consolidation programme for the period 2007-10 are fully met. Thereafter, stable public sector revenue and spending levels (as a percentage of GDP) are assumed, as well as a stable annual rate of real GDP growth (4.3%, *i.e.* somewhat above recent trend growth). The results show that, after peaking at 71% of GDP in 2008, public debt would decline rapidly and be below the Maastricht debt qualifying criterion as early as 2014. It would then decline further, reaching 15% by 2030.
- *Negative scenario*. This assumes objectives of the consolidation programme are met for 2007 and 2008. However, in the following two years (up to the 2010 election), total public revenues as a percentage of GDP are assumed to decline, while primary spending (*i.e.* total spending once having deducted interest payments) increases. This fiscal expansion is followed by another temporary episode of budgetary consolidation and a new electoral boost, with the same stop-go policies continuing over the remainder of the scenario. In the process public debt declines only gradually so that it would still approximate 70% of GDP by the early 2020s, coming in at around 65% by 2030.
- *Negative scenario with adverse effects to the economy*. The "negative scenario" does not factor in possible adverse effects of government deficit and debt developments on the rest of the economy. These are potentially important since a stop-go fiscal policy would likely lower growth potential and increase the interest-rate risk premium. Factoring in

Figure 2.2. **Debt dynamics under different policy assumptions**
General government debt as % of GDP



Source: OECD calculations based on *Convergence Programme of Hungary*, December 2006.

plausible values for these effects implies debt would be on a permanently upward trend, reaching nearly 90% of GDP by 2030.

These are mechanical scenarios. Importantly, they omit to take into account the fiscal effects of ageing related developments. If these were included, additional impacts would materialise around 2015 (Chapter 1). This underscores the importance of staying within the positive scenario if the benefits of fiscal consolidation are to be fully achieved.

The new measures to tighten fiscal discipline

The most important immediate initiative has been strengthening the system of reserve funds for 2007. The budget for this year is backed up by a system of reserves worth nearly 1% of GDP. Roughly half of these reserves are set aside to meet unforeseen expenditures and to fund the costs of staff layoffs, while the other half is envisaged as a contingency reserve to assure compliance with the deficit target. Under the budget, line ministries are authorised to use 60% of the latter contingency reserves only if spending and revenues develop according to initial objectives. To help monitoring, ministries have to submit quarterly reports of spending and revenue developments.

Most of the mechanisms brought in to help budget discipline in previous years have been maintained and many have been tightened:

- Rules restricting line ministries from running down stocks of unspent appropriations remain in place for 2007. Unspent appropriations may only be used with the authorisation of the government.

- The Ministry of Finance has successfully pressured line ministries to provide more details in the medium-term spending plans (three years beyond the budget year) that must be contained in annual budget submissions. But, as before, there is no formal commitment to stick to these plans.
- Rules on state guarantees have been tightened. Expenditures that qualify for a guarantee have been more precisely defined and a ceiling has been imposed on the total value of guarantees (HUF 150 billion for 2007, equal to 0.7% of GDP). Moreover, any new state guarantee has become conditional upon Parliamentary approval. The central government can only take over debt-creating transactions that have been explicitly authorised in the annual budget.
- Budgeting rules for infrastructure spending (notably public-private partnership projects) have also been tightened. The budgetary cost of these commitments cannot exceed 3% of total central budgetary revenues in a given year. Also, requirements for formal government approval of projects have been increased. A central inventory system managed by the Treasury has been created to keep track of spending in this area.

In addition, a requirement that the annual budget bill shows a primary surplus for the forthcoming budget year has been introduced via legislation passed at the end of 2006. In the 2007 budget submission the government has reported targets for the primary balance for 2008-2010. This rule is aimed at increasing discipline in reaching deficit goals but will also help towards debt reduction.

These recent efforts to tighten budget discipline are welcome but whether they will make a real difference to fiscal discipline remains to be seen (previous measures have led to no obvious improvement). *Ex ante*, there appear to be some potential difficulties that ought to be addressed in further development of budgetary mechanisms:

- The effectiveness of the reserve system is somewhat undermined by the fact that the government can allocate the reserves available even in cases in which budgetary outcomes are better than expected.
- It is reasonable for the rules on carryover spending to be renewed each year, but they should be adjusted as needed to prevent excessive build-up of unspent appropriations.
- The commitment to a primary surplus is useful. However, the primary surplus rule should be augmented by conditions to safeguard against misuse of revenue and expenditure windfalls. Other mechanisms to strengthen longer-term fiscal commitment should be considered as well. As previous *Surveys* have suggested, a system of binding medium-term spending limits may be one way forward.

Revenue measures: many should eventually be reversed

Key elements in the expected revenue gains are changes in healthcare contributions for employees, increased income taxes for both households and business and the rise in the middle value added tax rate (Table 2.1).[2] Further to these active tax measures, revenue "gains" are being made by the suspension of a five-year strategy to cut taxes that was originally approved by the parliament at the end of 2005. The most notable example is the suspension of the decision to abolish the local business tax, a step initially scheduled to take effect in 2008.[3] All in all, revenue-raising measures make for a considerable proportion of fiscal improvement in 2007 and 2008. Indeed, these account for about 70% of the overall fiscal consolidation package in both years. Excluding the impact of the withdrawal of previously announced tax measures, the split between revenue-raising measures and spending cuts is more even for 2007, while for 2008 spending cuts play a dominant role.

Reducing the tax burden, particularly the tax wedge on labour, needs to be an important part of the long-term fiscal strategy, so as to improve growth prospects. Progress on this front has clearly been reversed by the revenue-raising measures and ought to be resumed as soon as fiscal room is available. Much of this depends of course on progress in generating savings from structural reforms to public spending. The risk is that even those measures that are labelled as temporary might become permanent features of the tax system.

Immediate spending measures: wage freezes are difficult to maintain

Expenditure cuts for 2007 and 2008 reflect a mix of temporary and permanent measures. The largest temporary measure in terms of fiscal savings is a two-year freeze on pay increases for all public sector employees and various cuts in operating costs. The largest immediate spending cuts from permanent measures are coming from reduced pharmaceutical subsidies, cut-backs in hospital beds, both of which are part of wider structural reforms to the healthcare system (see below), and a large reduction in spending on household gas-price subsidies. Other spending measures include reduced transport subsidies and cuts in government employment.

The reduction in gas-price subsidies is particularly welcome. As of January 2007, the system of subsidies based purely on consumption was replaced by a scheme that takes into account household income. Only households with a per capita income below a certain threshold are allowed to apply for the subsidy.[4] For those that are eligible, the subsidy then varies according to per capita income. There are also ceilings to the amount of gas consumption receiving a subsidy. The new system is a positive step; it is less costly for the budget and better targets the subsidies to low income families. Subsidy reduction is also underway in public transport with a revision of the target groups eligible for discounted fares.

Cracks in the wage freeze have already emerged. The government has been aiming for a two-year unchanged level in public-sector pay. The core of this policy remains intact in the form of a freeze on the gross basic wage (on which all pay scales are based). However, in February 2007 the government agreed with the public sector trade unions to a complicated re-scheduling in the payment of 13th month salaries that brings spending forward. The 2007 payment was initially intended to be paid in one instalment in January 2008, whereas now half of it will be paid in monthly instalments during the second half of 2007. The new agreement also requires that the payment for 2008 is paid in monthly instalments during the course of the year (rather than in a single payment in January 2009). In addition, if budgetary developments evolve better than expected and contingent upon remaining within the target of the *Convergence Programme*, public-sector workers will receive an extra-half month salary during the first half of 2008. For 2009 and onwards the payment will be made in a single instalment in December of each year.

For 2007, the new agreement is estimated to increase the average gross earnings of public-sector employees by 3.5-4.0% in nominal terms.[5] While this will not alter the ESA budget deficit – in ESA95 accounting terms the 13th month salary payments due in January have to be accounted for in the preceding years – it will widen the gap between cash and accrual accounts.[6] In 2008, there is a chance of further increase, depending on fiscal outcomes. Furthermore, the agreement has arguably increased the risk of strong wage demands for 2009 because the reversion to a single instalment in 2009 will mean monthly pay checks below those of 2008 until December.

Any further pressures to spend anticipated "windfalls" need to be strongly resisted and some form of ring-fencing round unexpected gains ought to be made. For instance, if the deficit is on track to being below target then funds should be used to pay off debt. The freeze on public-sector pay is anyway perpetuating a stop-go cycle in public sector pay that has damaged morale and recruitment. In the longer term, the cycle should be stopped, for example through the multi-year agreements.

Assessment of the main structural reforms

Ambitious public administration reforms

Administrative reform began soon after the election with changes to legislation on pay and conditions for parliamentary members and local government representatives. These changes included stricter reimbursement and immunity rules. The same bill also altered regulations on the duties of senior public officials, specifically *via* new rules limiting the accumulation of responsibilities with a view to reducing conflicts of interest. But plans to cut the number of parliamentary members and local representatives did not go ahead (these changes would require a two-thirds parliamentary majority).

The government also began streamlining ministries shortly after the election. The number of ministries was reduced from 15 to 12 and the two ministerial posts without portfolio were axed. This rationalisation is expected to help towards reductions in ministerial staff. By the end of 2007, nearly 2000 posts are expected to be cut, with the largest downsizing in Economy and Transport (303 staff), Education (241 staff) and Agriculture and Rural Development (227 staff). There is plan to build a new government headquarters, which will reduce operational costs and open the possibility for the sale of the government's many city-centre properties.

There are plans for the centralisation of services in several areas. Operation and procurement tasks, including the purchase and maintenance of IT equipment, will be run by a newly created umbrella institution (the Central Service Directorate), rather than by each ministry independently. Similarly, the co-ordination of e-government services will be centralised. There will also be a single human resource office responsible for assisting ministries in staff policy. Furthermore, the State Treasury of the Ministry of Finance will take responsibility for the administration of all public employees' wages.

Networks of offices for various aspects of state administration are to be rationalised.[7] At present, there are over 800 offices in these networks and there are plans to re-organise them on a regional basis and reduce the number by about one third. It is also planned to reduce the number of state-owned non-budgetary organs (*e.g.* public foundations and service companies). Achieving these objectives will be assisted by the *New Hungary Development Plan* for the 2007-13 period, which includes funding the training of public employees, the renewal of recruitment procedures and improving work organisation methods.

The cut of some 15 000 staff in central budgetary institutions, corresponds to roughly 6% of total employment in this sector. Central-government is clearly attempting large cut-backs in areas where it has direct control over staffing and it is likely that there is similar room for economies among civil servants in local government and in administrative overheads in the public-sector services run by local government. This underscores the importance of widening the scope of public administration reforms to county and municipal governments (see Chapter 3).[8]

Parallel to staff reductions, there are plans for a more flexible system of pay for civil servants with a stronger element of performance evaluation. The system started this year and is being used for about 1000 managerial staff with plans for extending it throughout the civil service. This programme would be helped if the existing additional payments were more strongly linked to performance. Currently, the basic wage is augmented by various mandatory additional payments – the 13th month salary, payments for language proficiency, a "clothing bonus", and so on. These components should be de-restricted to allow managers to reward their employees more freely according to performance.

The further diffusion of e-government is also important for public administration reform. Indeed, recent OECD work suggests that Hungary has some way to go before catching up with the levels of e-government seen in leading OECD countries (OECD, 2006b). More resources are to go into the development of e-government under the *New Hungary Development Plan* (2007-2013) (Government of Hungary, 2006a).[9] However, as the OECD study points out, the existing regulatory framework needs to be closely monitored if e-government is to be introduced both swiftly and effectively. E-government diffusion has been hampered at least in the past by complex and overly burdensome regulations which have reduced the capacity for benchmarking and the identification of good practices across sectors and levels of government.

Major reforms of healthcare

Detailed assessment in previous *Surveys* has underscored that Hungary's healthcare system suffers from serious structural problems and inefficiencies, in particular the following (OECD, 2005):

- Hospital care is overly dominant in the system. In particular, there has been little progress in preventing uneconomic access to hospital services and the exploitation of cheaper outpatient alternatives to hospital care has been limited so far. As a result, long patient stays in hospital are common.
- Moreover, there are problems within the hospital sector because of limited scope and incentives for making efficiency improvements. Incentives to stimulate competition between suppliers are low.
- Problems of resource misallocation, with key indicators of service levels showing that there are wide disparities across regions in the quality of treatments.
- Overspending of the pharmaceutical budget, linked to a lack of cost effective prescription by both general practitioners and specialists and low cost-awareness of patients. Hungary spends roughly one third of total medical expenditure on medical goods and ranks second in the OECD in terms of consumption of these products as a share of total health spending.[10]

Healthcare reform occupies a large part of the government's programme and progress has been rapid, so far. A blueprint of specific measures was finalised by the Ministry of Healthcare shortly after the appointment of the new government in June 2006 and five Healthcare Acts were passed in the autumn. The Acts' aims are twofold, namely to make permanent savings in government spending and to improve the efficiency of healthcare services. The remainder of this section concentrates on these issues.

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Cutting back on drug expenditure

The new bill on pharmaceuticals intends to contain the growing financial burden of drugs on the public sector, as well as to achieve more responsible uses of drugs. The 2007 pharmaceutical budget was set at HUF 287 billion, which is significantly below the actual pharmaceutical spending for 2006 (HUF 389 billion).[11] From 2007, pharmaceutical producers have been encouraged to strike three-year purchasing price deals with the National Health Insurance Fund Administration (NHIFA). For those producers wishing to remain within the current annual purchase system, purchasing contracts will be contingent upon offering a substantial price reduction or accepting the payment of a 12% compulsory rebate on the selling price. Any medicine expense above specified limits will be paid jointly by the state and the producers according to a risk sharing scheme involving a regressive government contribution. This will apply for the first 9% of spending in excess of budgeted levels while above this any government contribution will be discontinued.

Other measures have been adopted to contain pharmaceutical spending:

- As a measure to raise patients' awareness on pharmaceutical costs, a small co-payment fee of HUF 300 per prescription has been introduced (applicable to drugs fully reimbursed, so far, by the NHIFA).[12]
- The reimbursement system has been changed. The previous system, which used a uniform 90% reimbursement rate, has been replaced by a system involving three rates (90%, 70% and 50%, respectively).
- Inclusion procedures of pharmaceuticals in the reimbursement list have been made more transparent, with price negotiations being conducted via the internet. Also, general practitioners will have access to online data comparing pharmaceutical prices and therapeutic benefits, which can be expected to help competition among generics.
- Concerning drugs promotion and advertising, producers will pay a registration fee of HUF 5 million and a regular annual fee of HUF 1 million per medical representative. Also, rules on the level and types of allowances and benefits physicians can accept from the pharmaceutical companies have been tightened.
- Regulations on pharmacies are being lightened in an effort to improve access and stronger retail competition. Population and proximity based restrictions have been lifted for any new pharmacy willing to provide extra-services, such as extended opening hours. Also, non-prescription drugs (pain killers, for example) can now be sold outside pharmacies, though this is to some extent controlled by a certification system.

Increasing the efficiency of hospital care

Reforming the network of almost 200 hospitals is a difficult challenge. Hungary's hospitals are excessively focussed on acute care (*e.g.* injuries and care during the recovery from a surgery) and smaller hospitals often suffer shortages in specialised and experienced personnel. A recent Act on the efficiency of hospital care aims to close 10% of beds in 2007 as part of a shift away from acute care to chronic inpatient care (*i.e.*, more rehabilitation and long-term care).[13] A mixture of direct financial incentives and structural reform is being used to encourage the conversions and cuts in hospital beds. For a limited period, a one-off cash payment to operators for each acute care bed that is cut or converted into chronic or outpatient care was offered. This scheme is estimated to have prompted 4 000 acute bed cuts, but few conversions.[14]

Legislation aimed at re-organising hospital services is promoting greater specialisation within regions with the aim of achieving scale economies. The new structure will be organised around three levels: "high priority" specialist hospitals, "territorial hospitals" that provide more general services *(e.g.,* maternity services) and outpatient healthcare centres offering, diagnostic tests and one day-surgery, for instance.[15]

The Ministry of Health prepared specific proposals for changing the hospital network, including details about the distribution between acute and chronic beds in each hospital. The Regional Health Council in each of the seven NUTS II regions was asked to agree or propose modifications within a tight deadline of 30 days. The time frame was kept tight on purpose: the sooner operators are informed about closures and the new structure of assigned functions, the quicker they can prepare to re-direct patients and to transfer professional teams. A rapid adjustment will be needed to ensure that the delivery of care services continues without interruptions.

The new hospital structure will be used as the basis for funding hospital services and all new contracts for services between the operators and the NHIFA. Indeed, it has already been announced that from April 2007 five hospitals in Budapest will no longer have a contract, while one hospital will be converted to only chronic care and all acute services will be suspended.[16] Yet, all the regions have not only publicly refused the proposals but also to submit any alternative plan. As a result, the final decision with regard to re-structuring was with the Ministry of Health. Even so, reform may get stalled. In March 2007, many hospitals submitted a request to the Ministry of Health for alteration of the ministerial decrees concerning referral areas for hospitals and the number of beds.

Enforcing the insurance principle of healthcare services

Formally, Hungary's healthcare system is insurance-based with access to services contingent on contributions. But in practice, the link between service entitlements and contribution obligations is extremely weak. Coverage is close to universal (implying roughly 10 million beneficiaries) but only about 3.5 million people contribute to the system (Government of Hungary, 2006). Several of the steps adopted or announced for 2007 intend to re-affirm the insurance character of the system:

- Health services have been re-organised according to a tiered structure. One tier covers basic services (*e.g.* emergency care) and continues to be universally available, no matter whether the individual is insured or not. Another tier of services is contingent on insurance coverage and the payment of small user charges.[17] This tier will mainly cover preventive care and most hospital treatment. In addition, services not directly related to health and recovery, such as extra comfort services (*e.g.* separate hospital rooms), will require full fee payments, or will have to be covered by a supplementary insurance scheme. It is hoped that this new differentiated system will not only generate economies but also help discourage grey-sector employment by adding a "cost" to avoiding taxes and social contributions.
- The contribution base has been extended. The default minimum contribution base has been increased to double the level of the minimum wage (HUF 131 000, at present).[18] It is thought this will in fact bring payments more in line with actual incomes because of widespread use of cash top-ups to reported earnings. However, individuals can apply for a reduction in the contribution subject to proof of earnings. Employees with dependent

relatives who are of working age but not entitled to any insurance coverage must now pay an extra healthcare contribution equal to 9% of the minimum wage.

The new law requires hospitals to introduce a waiting list with a view to increasing transparency and fairness in access to services. These will reduce the use of personal connections and loopholes in the system and may also reduce the widespread practice of under-the-table "gratitude money" to doctors.

Oversight of the system has been strengthened. A new body, the Health Insurance Supervisory Authority, was created in 2007. The Authority's main duties are inspecting contribution payments, supervising quality, ensuring the protection of clients and providing information about healthcare services. These responsibilities were previously under the NHIFA, whose activities are now more strongly focussed on funding issues.

Funding issues

One problem with the current purchaser-provider system is that it leaves limited scope for the efficient allocation of resources across providers. A review of the protocols governing healthcare processes and treatments is underway, with the aim of improving efficiency. Once new protocols are defined, the plan is to use these as the basis for adjusting funding parameters. For instance, this process has already been completed for oncology.

Assessment

The new measures to put downward pressures on public spending for drugs are welcome. However, it is important that government action is also focused on creating an environment that encourages innovation for which competition in the marketplace is needed. The proposed tiered approach to reinforce the insurance character of the healthcare system is also a positive step as it is the expansion of user fees. Current steps to reduce the heavy dependence on hospitalisation are also necessary. Yet, the implementation of the new regional hospital network needs to be supported by measures to strengthen the gate-keeping function of general practitioners. Without stricter prior-to-visit referral requirements, patients would directly visit the specialists of the "high priority" hospitals, when in many cases cheaper and more effective care treatments would be available at the level of the new local healthcare centres. This underscores that strengthening the "dispatching role" role of general practitioners is a key to the success of the current hospital care reforms.

The review of the protocols is important for establishing clear conditions for the minimum provision of treatments, based on the application of economically viable medical parameters. Using the protocols as benchmarks, hospitals should feel that they can organise their treatments more freely, aware that by exceeding the minimum standards they will qualify for more reimbursements. The government has plans to make hospitals' funding become more selective but details concerning this move are still unknown. In this regard, the financial responsibilities of the NHIFA could be better defined in ensuring good decisions in choices between hospitalisation and outpatient treatment.

One complementary step to raise the credibility of the reform of the hospital network would be to expand the scope for managing resources. In particular, managers should be given greater responsibilities for deficits and debts. Such a move would also help hospitals adjust their workforce to suit requirements.

A strategy of moving to a system of multiple insurance providers is under consideration, with the government being expected to take a decision on this issue in 2007. But international experience suggests that in countries such as Hungary, where the institutional structure is centralised, more effort could rather be put on trying to reinforce the effectiveness of the single purchaser. Based on this, the 2005 *Survey* noted that the single purchaser could use its monopsonistic power to pressure caregivers into following best practices. There is *a priori* no reason to expect that in the future the NHIFA will not perform this function efficiently, provided that the division of responsibilities between the NHIFA and the newly created Health Insurance Authority is properly defined.

Welcome reforms in education

A number of regulatory changes have been introduced in primary education that will lead to some budgetary savings and an improvement in the quality of the service.[19] The number of teaching hours per teacher has been increased from 22 to 24 hours per week, though this is still below the OECD average. Central-government grants to municipalities for primary education have been altered in a way that encourages school mergers – primary schools are highly dispersed at present (Chapter 3). Also, village schools with less than eight classes have been given two years to establish co-operation agreements with the bigger schools operating in the same area that cover the full primary education programme.[20] This measure does not aim for school closures but is intended to reduce administrative costs. Also, it will likely result in wider access to education as village schools are often too small to offer a full primary education programme.

Major changes are underway to the way central-government funds for teaching are allocated to higher-education providers, and regulatory changes on student tuition fees will come into force later this year. The measures do not aim to make savings in government spending and focus rather on improving the mix of higher education on offer and widening the share of students who make a contribution to tuition fees. The potential economic returns in this instance therefore come from improvement to human capital, rather than by helping fiscal conditions.

Under the previous system for allocating central-government funds for teaching, the government provided funding to cover around 62 000 free places in public higher education establishments. These places were largely based on precedent. In 2007, a new two-step procedure has been introduced in which the central government first sets the allocation of places by subject areas. Then, within each subject area the data on student applications is used to determine the allocation of funding across providers. Therefore, the new system makes use of demand signals and this will put additional pressure on providers to improve the supply and content of courses.

In addition, from the beginning of the 2007 academic year, more students are going to pay a contribution to tuition costs and it is going to be tougher for students to remain eligible for support during their studies. Under the current system, free places (*i.e.* with no tuition fees) in public universities for undergraduate courses are allocated according to the school grade.[21] In the new system the government will fund fewer places (around 56 000), which is equivalent to about 60% of undergraduate places. In addition, a significant share of these students will have to pay a contribution to tuition costs set by central government. Universities will be allowed to charge between HUF 60 000 and HUF 180 000 per semester for each student. An element of merit-based support is nevertheless maintained because the universities must spend at least one third (but not more than a half) of the amount collected in these fees on scholarships that can partly or fully offset the contribution. The universities have been given discretion in how places for nominal contributions and scholarships are allocated. They can, for example, evaluate students continuously and give out scholarships for welfare reasons as well as for academic performance.

Other aspects of tuition fees will remain broadly the same. The roughly 40% of students who do not make the grade for one of the government funded places will remain partly catered for by unregulated fee-paying places offered by the public universities. These fees are set at the discretion of the universities and typically amount to several hundred thousands forint per year (and higher than the fees that will be charged for the funded places)[22]. Though these fees are essentially market based they probably do not reflect full cost recovery because the fixed costs in teaching are partly covered by the government funded places. The remainder of students are in private higher education establishments where the fees are typically much higher still.

While these are positive developments, further reform is needed to bring the tuition fees more in line with the average cost of provision. The system is still overly focused on providing a majority of students with places that are free or at low-cost on the basis of merit. A preferable system would be one where the connection between fees and examination results is reduced. The majority of students should pay back a large share of the tuition costs but with safety nets to prevent exclusion. A system where fees are more uniformly applied that builds on the existing system of government loans ought to be considered.[23]

Progress in early retirement and pensions

Options and incentives to use early retirement schemes are being reduced. The main thrust of the changes is to raise the effective age of retirement. At present the vast majority of men retire at age 60 or below (the statutory age of retirement is 62) while women effectively retire at age 57 or below (the statutory age of retirement is currently 61 but will increase to 62 years by 2009). The key features of reform are as follows (Annex 2.A2):

- The eligibility conditions for the two universally available schemes (the "advanced early retirement pension" and the "reduced advanced early retirement pension") are scheduled to be tightened in 2009 and 2013 *via* increased contribution-year requirements and reductions in the number of years' early retirement. These are positive changes but, as recommended in the previous *Survey*, the "advanced early retirement pension" should eventually be removed altogether because there is no reduction in the annual pension payout, while the "reduced advanced early retirement pension" should be checked for actuarial fairness.
- Measures are being taken to limit use of special provisions for additional years of early retirement on top of those provided by the two universal schemes for those in "damaging occupations".
- Disincentives to work while receiving an early-retirement pension (notably a cap on earnings) are being introduced. Given that early retirement is already overly attractive, these measures will help somewhat in cutting back take-up. Ideally, reform should work towards actuarial neutrality in early retirement pensions, thus removing the need for such measures.

In addition, the government is currently assessing options for changing the old-age pension system. The plan is to present a detailed proposal by the end of 2007. As stressed in previous OECD assessments, whatever type of reform is chosen ought to include a schedule for further increases in the statutory age of retirement that under current legislation is set to remain at 62 years for men and women from 2009 onwards.

The pace of reform of the system of support for those with disabilities is set to pick up speed from its previously sluggish pace. The government plans for legislation to be passed in the second half of 2007 that will push reform ahead on three fronts:

- Further reform of the medical assessment system towards a focus on remaining work capacity rather than lost work capacity. This process has already begun with transfer of the National Institute for Medical Assessment from under the National Health Insurance Fund to the Ministry of Social Affairs and Labour in January 2007. The aim is that this transfer will allow stronger links between the Institute and employment offices. New guidelines for medical assessment issued in 2004 (and discussed in the 2005 *Survey*) will form the basis of a new assessment procedure.
- Introduction of a "rehabilitation benefit" in parallel to the disability pension. The plan is for existing disability pension recipients, as well as new applicants for disability support, to be considered for this new benefit. The objective is for the benefit to provide support for those with potential to return to the labour market, thus stemming inflows and reducing the stock of those on the disability pension. It is likely that the government will propose introducing this benefit in January 2008.
- Expansion of rehabilitation services and schemes, such as training programmes and wage subsidies for employers taking on workers with reduced work capacities. The main wage subsidy currently comes via the Start Plus programme and gives 50% reductions on social contributions to employers taking on persons with reduced work capacity.

These reforms are a sensible way forward in tackling the disability issue but it will be important to maintain momentum in implementation and monitor the impact of measures. Some aspects of the reform by nature take time to introduce, notably changes to medical assessment systems and the expansion of rehabilitation services. If these reforms are only partial, then there is a risk that the rehabilitation benefit will be ineffective.

In transport, financing has become more transparent

Motorways

Further development of road infrastructure is important for Hungary's growth prospects but requires large investments, particularly in motorways. These have typically been fully government financed; only two motorways have been financed using public-private partnership (PPP) agreements involving four separate arrangements. The recording of government spending on motorways is complex and has sometimes been massaged to help official deficit outcomes. As discussed in Chapter 1, both the 2005 and 2006 budgets, booked large items of spending on motorway construction off-budget on the grounds that they would be funded using PPPs. But the intended arrangements had little chance of passing Eurostat rules, basically because the proposal involved partnership with a state-owned company. In 2005, in compliance with a Eurostat's decision that the sale of already existing motorways should not affect the year's deficit, the revenues generated by this sale were not registered in the budget. For 2006, the spending associated to new motorway constructions was put in budget in the middle of the year.

When the government brought the large item of motorway spending for 2006 in-budget, this involved a fundamental change in the treatment of motorway financing. The financing of motorway construction is made *via* two-state owned companies, National Motorway Co. (NA Zrt.) and the State Motorway Management Co. (ÁAK Zrt.). In mid-2006 the accounts of ÁAK were incorporated in the government accounts (those of NA have been incorporated since 2002). Also, a limit of HUF 5 billion has been imposed on the debt of the two motorway companies, which forces government to fund motorway construction by regular budget appropriations and should help increase transparency. Total motorway construction for 2007 comprises an appropriation of HUF 205 billion for construction and HUF 50.7 billion for service fees paid for the PPP-run motorways (roughly 1% of GDP).

The government has established more formal procedures for selecting PPP projects to ensure that these fulfil Eurostat's risk-sharing criteria and, more generally, are based on sound economic principles. This ought to enable greater success in PPP financing of motorways infrastructure as well as other areas (*e.g.* the railway network).

Rail transport

In rail transport there are efforts to prevent debt accumulation by the state owned railway company (Hungarian State Railways, MÁV). Freight services have already been separated from the incumbent, prompted by EU commitments to liberalisation.[24] MÁV is therefore left with network operation and passenger services, and continues to get substantial transfers from central government. The rail subsidies comprise payments to compensate for discount tickets (*e.g.* for students and pensioners) and a subsidy is made for the overall shortfall between revenues and costs in passenger transport services. A cycle has emerged in which the government has economised on these subsidies to help its fiscal position (MÁV's deficit and debt is off-budget) but has then been periodically obliged to pump extra resources to help MÁV cope with accumulated losses (with the latter resources being recorded in the budget).

In an attempt to break out of this cycle, the government has doubled its subsidy in 2007 (the subsidy is equivalent to 0.4% of GDP) and it is planned to maintain this. In addition one-off capital injections are being made for 2007 and 2008 (equivalent to 0.4 and 0.1% of GDP, respectively) to cover the costs of a rationalisation programme (*e.g.* closure of underutilised branch lines). The government has direct leverage on this rationalisation programme because the Ministry of Economy and Transport has strong rights of managerial control on MÁV. Nevertheless, the "returns" on these injections are uncertain because the rationalisation programme has yet to get fully underway and the long-term savings of some measures are hard to assess. Furthermore, these injections do not address the issue of financing the modernisation of the rail network. Even with the support of EU funds, the level of government support needed for this project is estimated to be large.

Notes

1. An overview of international evidence on the political economy of structural reform can be found in the latest edition of Going for Growth (OECD, 2007, Chapter 7).
2. In October 2005 the VAT rate of 25% was reduced to 20%, effective as of January 2006. Subsequently, the rate of 15% was raised to 20% as of September 2006. Following the above measures, about 86% of consumer goods are taxed with the standard rate of 20%, while 4% fall under a reduced rate of 5% and the remaining goods are tax exempt.
3. Alone, this policy change is estimated to yield some HUF 420 billion more fiscal revenues in 2008, corresponding to 1.6% of GDP.

4. Specifically, in order to qualify for the subsidy the household's *per capita* income cannot exceed 3.5 times the amount of the minimum old age pension and its annual gas consumption cannot exceed 3 000 cubic metres. For larger families the consumption criteria is extended to 5 000 cubic metres per annum. For example, for a couple with two children and one income earner with a net monthly salary of HUF 110 896 (corresponding to the 2006 average monthly salary), the *per capita* family income is HUF 31 685 (this is based on equivalence scale with weights of 1 for the income earner, 0.9 for the other partner and 0.8 for each of the two children). At this level of per capita income the family qualifies for the highest monthly subsidy which equals HUF 6 192.
5. It is important to consider that the official expectation was for an annual increase of about 2.5% in the average gross nominal earnings of public employees for 2007, reflecting the carry-over of wage increases implemented in the course of 2006. Therefore, the new change implies that the overall increase in gross earnings during 2007 will be about 6.0%.
6. This being said, there are indirect effects to consider, as total wage growth for the economy as a whole will accelerate faster than initially expected. With the pension indexation formula assigning a 50% weight to nominal wage growth (the other 50% being accounted for by consumer inflation), the agreement will result in extra pension expenditures. However, the government expects that this additional spending will be relatively limited, in the order of 0.1% of GDP.
7. Such entities include, for example, the network of agricultural administration, as well as the offices of the pension and health insurance and the National Public Health and Medical Officer Service, which is responsible *inter alias* for food safety and epidemiology.
8. Not all areas of the central administration will be negatively affected by the new measures. Specifically, strengthening the revenue raising capacities of the Tax Authority will require 1850 additional employees. Moreover, the planned development of a new healthcare information technology system implies that the National Health Insurance Fund Administration (NHIFA) will be entitled to recruit some 280 more employees.
9. These resources amount to € 375.5 million (at 2004 prices) and will be draw from Structural Funds.
10. Hungary is unique in the European Union context in that of the total amount of public resources spent in healthcare, roughly the same proportions are destined to drug subsidies and hospital care. Elsewhere in the European Union, the proportion spent in hospital care is higher than in Hungary.
11. It should be noted, however, that, unlike in the past, the 2007 budget includes a special reserve fund of HUF 55 billion for drug subsidies.
12. Co-payments now apply to all prescribed drugs, except for individuals "in distress" who are entitled to a special medical cards.
13. The goal is for a cut of about 16 300 acute care beds, with some 7 400 being converted for chronic care. Overall, this implies cut of some 8 900 beds out of the total of 80 200 beds.
14. The scheme offered operators a one-off payment of HUF 2 million for each acute bed cut and smaller amounts for conversions to chronic or outpatient care. Altogether, HUF 6.5 billion was allocated to the scheme, equivalent to about 0.03% of GDP.
15. General rules about catchment areas for each type of hospital are being applied; it is aimed that specialist hospitals will operate within a radius of 55km, the general hospitals 30km and the healthcare centres 20km.
16. It is important to note, in this context, that Budapest hosts fifty hospitals that are heavily specialised on acute care, at present.
17. HUF 300 will be charged per day for primary, paediatric, dental and outpatient specialist care, alongside for hospitalisation. Those who are not up to date with contributions will be charged the full price of the service (except for basic services).
18. By default, the minimum *combined* social contribution from employers and employees has been doubled to that paid on twice the minimum wage with the employer paying the full amount of the increase. Employers can avoid the default level of contributions simply by sending a letter to the tax authority (APEC), which allows them to pay social contributions as before. Indeed, about one million such letters have already been sent, many of which from the self employed. However, sending the letter increases the chance of investigation by APEC.
19. Sutherland *et al.* (2007) discuss public spending efficiency indicators in primary and secondary education in the OECD context.
20. In Hungary, "primary education" usually refers to the first eight years of schooling. This is three years longer than under the international standard classification of primary education. The reason

is that under the Hungarian system primary education also includes secondary lower education which international classification treats separately.

21. During the summer of each year the public universities announce the school-leaving grades that students need for a free place in one of the programmes they have applied for. Students typically register several preferences. The fee for applications is the equivalent to HUF 9 000 for the first 3 preferences together and HUF 2 000 each for additional preference.

22. Universities' fees cannot be lower than 50% of actual teaching cost per student.

23. A student loan mechanism is already in place and could be expanded to cater further widening of tuition fees. In the current loan system a maximum equivalent to around HUF 150 000 or HUF 200 000 for fee-paying students can be taken out each semester (there are two semesters per academic year). All students under the age of 40 are guaranteed access to these loans and the State acts as guarantor. In addition, the payback conditions are favourable. Repayments in the first two years after the graduation are 6% of the minimum wage and after that are set at 6% of wages (or remain at 6% of the minimum wage for those who are not working). Interest is charged but at below the market rate for an equivalent loan.

24. Legal separation of freight services from MÁV was made in 2006 with the creation of *MÁV Cargo Zrt.* and the freight market has been legally open to competition since 2004.

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ANNEX 2.A1

Simulations of debt development

The simple framework used for discussing the long term dynamic implications of Hungary's strong electoral cycles assumes that the evolution of public sector net debt is given by:

$$D_t = D_{t-1} - NLG_t \quad (1)$$

Where, D_t indicates the value of net public sector debt at time t and NLG_t is the net lending of the general government. NLG_t can be rewritten as follows:

$$NLG_t = YRG_t - (YPGX_t + INT_t) \quad (2)$$

In equation (2) INT_t stands for the level of interest payments, YRG_t is the level of total public sector revenues and finally $YPGX_t$ indicates the level of total primary spending, *i.e.* public spending excluding interest payments. Interest payments are driven by the following relation:

$$INT_t = i_t * D_{t-1} \quad (3)$$

Where i_t denotes the apparent interest rate which is given by the sum of three components, the long term interest rate, the short term interest rate (respectively with weights of 0.8 and 0.2) and the risk premium.

Dividing equation (1) by the level of gross domestic product (GDP_t) and assuming that $GDP_t = GDP_{t-1}(1 + g)$, with g denoting the nominal rate of GDP growth, yields:

$$d_t = d_{t-1}\frac{(1+i)}{(1+g)} - yrg_t + ypgx_t \quad (4)$$

Within equation (4), *yrg* and *ypgx* denote the ratios to *GDP* of, respectively, *YRG* and a *YPGX* while *d* is the ratio to *GDP* of *D*.

This debt accounting framework has been used to study the evolution of Hungary's debt to *GDP* ratio based on a set of different assumptions concerning the following variables:

(1) Total public revenues as a percentage of *GDP (yrg)*;

(2) Total primary spending as a percentage of *GDP (ypgx)*;

(3) The level of the apparent interest rate (*i*);

(4) The rate of real *GDP* growth (*G*) (with the nominal rate of *GDP* growth then specified as $g_t = G_t * deflGDP_t$, where *deflGDP* is the *GDP* deflator).

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Three different scenarios have been created, all extending over the period 2011-30. The basis for the construction of the scenarios is the December 2006 *Convergence Programme of Hungary* for the period 2006-10. Table 2.A1.1 details the key features of each scenario.

Table 2.A1.1. **Debt scenario assumptions**[1]

Assumptions \ Scenarios	*G*	*Ypgx*	*yrg*	*i*
1. Positive scenario *Technical characteristics*: The scenario assumes that all fiscal goals for the period 2007-10 are met and maintained over the scenario.	Constant at 2010 level	Constant at 2010 level	Constant at 2010 level	Starting from 2010, the short-term interest rate, the long-term interest rate and the level of the interest rate premium decline by a decimal per year.
2. Negative scenario *Technical characteristics:* The scenario assumes that the goals of the consolidation programme are met only for 2007 and 2008 and the deficit widens in the run up to 2010 election. After 2010 election there is again a temporary (two-year) consolidation period. This "boost and bust" electoral cycle is then replicated until 2030.	As under 1	For 2009 and 2010, spending equals the level a year earlier plus 0.6% of GDP. For 2011 and 2012, spending equals the level a year earlier minus 0.6%. This sequence is replicated until 2030.	For 2009 and 2010, revenues equal the level a year earlier minus 0.6% of GDP. For 2011 and 2012, revenues equal the level a year earlier plus 0.6%. This sequence is replicated until 2030.	As under 1
3. Negative scenario with effects to the economy *Technical characteristics:* The negative scenario does not take into account the effects to the economy of "boost and bust" cycles, notably *via* the impact on real GDP growth and the interest rate premium. The present scenario is a variant of the negative scenario that takes into account the latter two effects.	Real GDP growth accelerates during each two year "boost period" (up to a rate of 4% and 4.5% in the first and second year, respectively).It then decelerates during each two year "bust period" (down to a rate of 2% and 2.5% in the first and second year, respectively).	As under 2	As under 2	The risk premium increases by 0.5% during each two year "boost period". It declines by the same amount during each two year "bust period".

1. All scenarios assume the same rate of GDP inflation. This is set at 2.9% (corresponding to the level for 2010 presented in the *Convergence Programme of Hungary*) and maintained constant over the scenario period.

Source: OECD.

ANNEX 2.A2

Early retirement pensions

There are two universally available options for early retirement pension:

- The "advanced retirement pension" (ARP) This allows men to retire two years early (*i.e.* age 60) and women five years early (age 57 in 2007) on a full pension as long as they have accumulated at least 38 years pension contributions. In 2005, there were roughly 130 000 beneficiaries.
- The "reduced advanced retirement pension" (RARP) allows the same length of early retirement but with up to five years fewer contributions than required for the ARP. However, the pension payout is permanently reduced (see schedule below). For example, a woman retiring five years early with 33 years contributions will have her pension payout reduced by 30%. In 2005, there were roughly 10 000 beneficiaries.

"Missing" contribution years	1	2	3	4	5
Reduction per year of early retirement	1.2%	2.4%	3.6%	4.8%	6%

Two rounds of changes to the ARP/RARP system are scheduled:

- In 2009 (from legislation passed in the late 1990s) three years early retirement will be possible under ARP/RARP (*i.e.* early retirement will be possible at age 59 for men and women). But, contribution years for eligibility will be increased. For the ARP, 40 years service will be required and for the RARP a minimum 37 service years (*i.e.* a maximum of three "missing" years will be allowed).
- In 2013 (from legislation passed in late 2006), only two years early retirement will be possible (*i.e.* age 60) and 41 service years will be required for ARP while the minimum service-years for RARP will remain the same (therefore, allowing up to four "missing" contribution years).

In addition to the ARP/RARP system there are several occupation-specific provisions:

- Special provisions for "damaging occupations". People can retire one year early for every four years (for women) or five years (for men) spent in certain occupations (with a minimum of 8 and 10 working years, respectively). These provisions can be combined with the ARP/RARP provisions. So, for instance, a man working 20 years in one of the designated occupations could retire at age 55 as long as he has accumulated at least 33 years contributions in total. In December 2006, legislation was passed that will introduce an additional 13% pension contribution in these occupations in 2007. This will initially be paid by central government, but then responsibility for payment will gradually transferred to employers, such that by 2011 they will pay all of the additional contribution. The legislation will allow employers to apply for an opt-out from this system based on proof of certain health and safety standards. As of 2005, there were roughly 50 000 beneficiaries and below the standard age of retirement there were roughly 20 000 beneficiaries.

- In addition to the above schemes there is a special "employer financed" early retirement scheme which allows up to five years early retirement and there are special schemes for certain groups (these are separate from the "damaging occupations" provisions) including the armed forces, miners and artists. At present, there is a focus on reforming the armed-forces pension. Currently, they can retire with 25 years service, only earnings in the final year count and the starting pension is about twice the standard pension payout. The "employer financed" scheme only has about 4 000 beneficiaries and there are several thousands in the other schemes.

Two measures are being introduced that will affect the approximately 15% of early-retirees who continue to work:

- Since April 2007, those working and getting a pension have had to pay the 8.5% pension contribution out of earnings but are compensated by a pension increase equal to 0.4% of the average monthly earnings for each full year of contributions.
- From January 2008, pension payments for those working and receiving an early-retirement pension will be suspended when earnings that have been cumulated in the year reach the annual amount of the national minimum wage. "Suspended" means that no further pension payouts will be made for the rest of the year. Those working beyond the age of retirement will not be subject to such restrictions.

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Glossary

ÁAK	State Motorway Management Company
APW	Average production worker
ARP	Advanced Retirement Pension
CAP	Common Agricultural Policy
CF	Cohesion Fund
CHP	Combined heat and power
EPL	Employment protection legislation
ESA95	European System of Accounts
ERM II	Exchange-rate mechanism II
FIDESZ-MPSZ	Young Democratic Alliance-Hungarian Civic Union
GYED	Childcare benefit
GYES	Childcare allowance
GVH	Hungarian Competition Authority
GYET	Childcare raising support
HUF	Hungarian forint
IEA	International Energy Agency
KDNP	Christian Democratic Peoples' Party
MÁV	Hungarian State Railways
MAVIR	Hungarian Transmission System Operator Company
MDF	Hungarian Democratic Forum
MNB	Magyar Nemzeti Bank (the Central Bank)
MSZP	Hungarian Socialist Party
MVH	Agricultural and Rural Development Office
MVM	Hungarian power companies
NA	National Motorway Company
NAO	National Authorising Office
NFÜ	National Development Agency (successor of the National Development Office, NFH)
NHIFA	National Health Insurance Fund Administration
NUTS	Nomenclature of territorial units for statistics
PAYG	Pay-as-you-go
PIT	Personal income tax
PPP	Public-private partnership
SAO	State Audit Office
SF	Structural Funds
SME	Small and medium-sized enterprise
SZDSZ	Alliance of Free Democrats
TGYAS	Pregnancy and confinement benefit
VAT	Value-added tax

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This Survey is published on the responsibility of the Economic and Development Review Committee (EDRC) of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of Hungary were reviewed by the Committee on 12 April 2007. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 23 April 2007.

The Secretariat's draft report was prepared for the Committee by Philip Hemmings and Alessandro Goglio under the supervision of Andreas Wörgötter. The drafting team was assisted by Roland Natran (on secondment from the Hungarian Ministry of Finance).

The previous Survey of Hungary was issued in July 2005.

BASIC STATISTICS OF HUNGARY, 2006

LAND

Area (1 000 sq. km)	93	Major cities (1 000 inhabitants)	
Agriculture (%)	63	Budapest	1 698
Forest (%)	19	Debrecen	204

PEOPLE

Population (1 000)	10 076	Employment (1 000)	3 887
Inhabitants per sq. km	108	Agriculture (%)	5
Natural increase in population (1 000)	–32	Industry (%)	33
Net immigration (1 000)	15	Services (%)	62

GOVERNMENT

Public consumption (% of GDP)	23	Number of seats in Parliament	386
General government total revenue (% of GDP)	44	Share of seats held by governing coalition (%)	54
General government deficit (% of GDP)	9	Number of political parties	4
Public debt, 2005, Maastricht definition (% of GDP)	58	Last election	2006

PRODUCTION

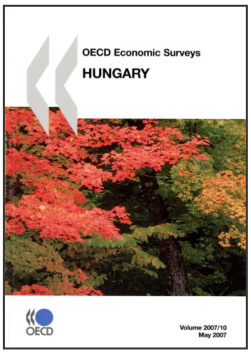
GDP, current prices (billion HUF)	23 562	Agriculture (% of value added)	4
GDP per capita (USD, current prices)	11 121	Industry (% of value added)	30
Gross fixed investment (% of GDP)	22	Services (% of value added)	65

FOREIGN TRADE

Exports of goods and services (% of GDP)	78	Imports of goods and services (% of GDP)	77
Main exports (% of total merchandise)		Main imports (% of total merchandise)	
Machinery and transport equipment	62	Machinery and transport equipment	50
Manufactured goods	28	Manufactured goods	33

CURRENCY

Forints per $	210.40	Forints per €	264.09



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