Executive summary

The recovery is gathering pace

The pandemic interrupted the strong economic growth performance in 2016-19, which entailed large increases in employment and real incomes, and the lowest unemployment rate in thirty years.

Strong growth is returning (Table 1). The government used general containment measures during the first wave and more targeted and sector-specific measures in the second wave, allowing for more economic activity. Together with stronger international demand, this benefited manufacturing and many service sectors, leaving hospitality as the most affected sector. The swift rollout of vaccine programmes allows a faster recovery from mid-2021 onwards, as pent-up demand is released and external demand strengthens. However, the pace and strength of the recovery is uncertain, reflecting the potential scarring of the economy arising from the prolonged crisis. New variants could add pressures on the health sector and potentially lead to new restrictions and lower domestic spending.

Table 1. Macroeconomic outlook

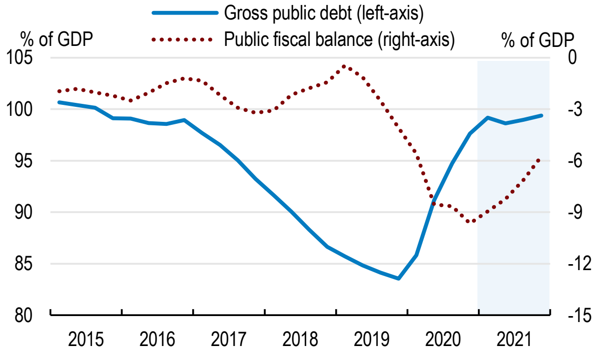
Y-o-y % changes	2020	2021	2022
Gross domestic product	-5.1	4.6	5.0
Final domestic demand	-3.5	2.6	5.0
Net exports (contribution to GDP growth)	-2.1	2.1	0.2
Unemployment rate (% of labour force)	4.2	4.0	3.4
Consumer price index	3.3	3.9	3.9
Current account balance (% of GDP)	0.1	0.8	0.8

Note: Data for 2021 and 2022 refer to projections.
Source: OECD Economic Outlook 109 database (June 2021).

During the pandemic, the government supported jobs and incomes. A new short time working scheme has been the principal measure to contain the rising unemployment rate. Businesses have been supported by a moratorium on loan repayments, reduced interest rates, lower social security contributions and grants, contributing to a historically low number of bankruptcies. Nonetheless, corporate and household loan defaults are likely to increase, requiring the close monitoring of bank vulnerabilities.

Fiscal and monetary policies are supportive. In 2020, discretionary fiscal policy amounted to 5% of GDP, which with the weak economy raised the public deficit (Figure 1). In 2021, the economic recovery and the termination of many support measures should reduce the deficit by ½-percentage point. The release of pent-up demand in the second half of the year should ensure that no new short-term fiscal stimulus is needed. From 2021 onwards, annual inflows of EU funds in the order of 3 ½ % of GDP will support growth. As the recovery becomes self-sustained, the fiscal focus could return to preparing for impending ageing-related spending increases and secure fiscal sustainability. The central bank has appropriately maintained an accommodative monetary policy stance, but inflation pressures remain high.

Figure 1. Fiscal policy has been supportive



Note: National accounts definition of gross public debt. The shaded area denotes projections.
Source: OECD Economic Outlook database.
StatLink https://doi.org/10.1787/888934266590

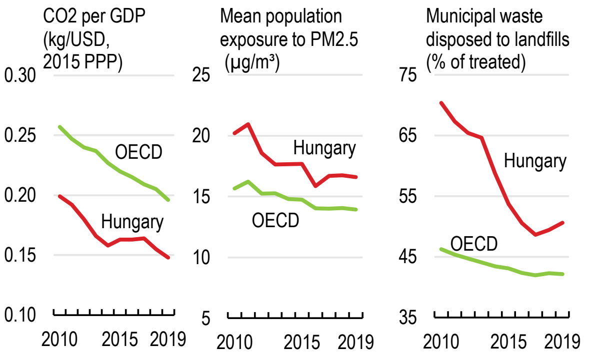
The prolonged pandemic strains people's well-being and threatens social inclusion. Some of the social costs will be temporary. Others will have longer lasting impacts, including the effects of increased domestic violence and the educational damages created by the difficulties of providing all pupils with high-quality distant learning.

Better policy coherence would favour more sustainable growth. The environmental performance has been broadly satisfactorily in meeting 2020 emissions objectives. However, insufficient progress has been made in reducing small particles emissions and the extensive use of landfills (Figure 2). Meeting more ambitious 2030 emissions objectives and an expected increase in road transport add to environmental policy challenges. Environmental policy is based on a combination of regulation, subsidies, and tax rates that vary across sectors and activities. Some energy prices are regulated for affordability reasons, often to below-cost levels, leading to an uneven burden sharing and more costly emission reductions.

Despite reform, taxation of labour income remains high, which is not conducive to

growth. The still high taxation reduces incentives to enter employment or move to jobs with higher incomes. In contrast, environmental and property tax rates are relatively low and their tax bases reduced by numerous exemptions. Likewise, the VAT system is characterised by a high standard rate and multiple reduced rates. Rebalancing the tax system through lower and more unified rates and base broadening, while reducing the reliance on labour taxation would improve incentives and increase efficiency.

Figure 2. Environmental concerns remain



Source: OECD Environment database; and OECD Green Growth database.

StatLink https://doi.org/10.1787/888934266609

Strengthen skills and mobility for a more inclusive labour market

Fostering labour reallocation would strengthen the recovery. The pandemic's impact on the labour market was contained by government intervention. Employment is rising again and unemployment is falling, while wage inflation remains relatively high. When business support is withdrawn, job separations will increase, leaving new job seekers with only 3 months of unemployment benefits and limited support from public employment services to connect with new job openings that match their skills. Geographical mobility is hindered by public work schemes that keep low-skilled long-term unemployed in poorer regions. In addition, population ageing leads to a smaller and older workforce, reinforcing the need for improving allocation of available labour resources to sustain growth.

Skills are poorly matched to labour market needs. Vocational training delivers predominantly traditional crafts and trades skills, whereas labour demand is shifting towards higher skill jobs. Occupational mobility is further hampered by many occupations being subject to licensing and certification requirements. Despite progress, few vocational education students have apprenticeship positions, and access to high-quality work-based learning is a concern. At the same time, many university graduates in humanities and social sciences have difficulties in finding employment in their field, while engineering and ICT graduates are in short supply. This reflects that educational output is not adjusting to labour shortages in expanding sectors and oversupply in shrinking sectors.

Job prospects of graduates are reduced by weak educational outcomes. Half of vocational education and training graduates hold unskilled jobs outside their chosen occupation. This reflects that basic and generic skills of vocational education and training are in many respects weak, including gaps in literacy, numeracy and ICT, hindering students' ability to adapt to changing labour market needs. The higher education system pays little attention to generic skills, such as problem solving, that are key for new graduates' labour market success. Stronger basic and generic skills are key to secure graduates' capacity to be more adaptable and thus their long-term labour market success.

Job mobility is also hampered by rigid housing markets. Hungarians live overwhelmingly in owner-occupied housing and most housing support measures aim at home ownership. Meanwhile, housing supply does not respond to increasing demand because of regulatory issues. The private rental market is dominated by short-term rental contracts, absent balanced regulations that take into account the interests of landlords and tenants.

Geographical mobility is also held back by underdeveloped local transport infrastructures. Funding for maintenance of secondary and tertiary roads is low, as reflected in the poor quality of local roads. Similarly, local train and bus connections are underdeveloped, increasing the costs for people wishing to commute from rural areas to nearby cities with better employment prospects.

Minimum wages have increased fast. Minimum wage growth is important for improving incomes of the poorest. However, fast increases relative to other wages reduce job prospects for the low-skilled and long-term unemployed, while lowering the incentives for low-skilled workers in poorer regions to search for better-paid jobs elsewhere.

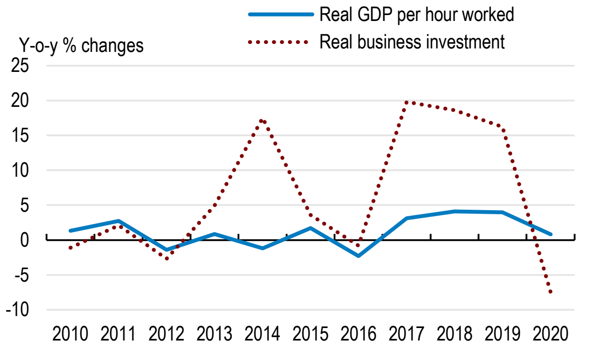
Women's career prospects could be furthered by more childcare services. Female labour participation is close to that of men but gender wage gaps increase with age. This reflects long maternity leaves, which many mothers use in full.

Also, women provide many more hours of unpaid work for domestic and child rearing than men.

Stronger business dynamics and more competitive markets are crucial for higher productivity growth

Long-term productivity growth has been weak. Dynamic business investment has led to a cyclical upswing in productivity growth. Nonetheless, average productivity growth has been weak over the past decade (Figure 3). Despite a recent decrease in the productivity gap, there are still large underlying differences between capital-rich foreign owned investment intensive companies that compete on world markets and domestic capital-poor and low-productivity firms with low investments that are focussed on home markets with few connections to international supply chains.

Figure 3. Productivity growth has been low



Source: OECD Productivity database; and Hungarian Central Statistical Office.

StatLink https://doi.org/10.1787/888934266628

Firm entries and exits have been relatively low, pointing to weak competition. This has allowed low-productivity firms to maintain disproportionally large market shares and has slowed the reallocation of resources to high-growth firms, holding back economy-wide productivity growth and faster income convergence.

The pro-competitive regulatory framework is little used. The competition authority is not sufficiently active in sectors with high risk of collusion, with few market studies and decisions. For example, few decisions have been made in the area of public procurement, despite the high number irregularities reported by the European Commission. This reflects insufficient funding for adequate enforcement and for retaining highly specialised experts. Also, important areas are exempt from competition scrutiny on grounds of national strategic interest.

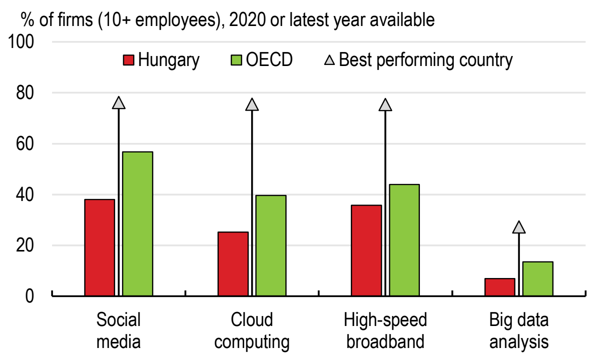
Sectoral taxes on turnover are used in several sectors, including energy, finance and retail. Such taxes hinder new entry and investment, while exits are slowed by lengthy and costly insolvency procedures.

State-intervention in network sectors is extensive. The energy sector is dominated by state-owned quasi monopolies. In the telecom sector, the recent rewarding of new 5G spectrum to incumbents has reinforced market concentration and further reduced competitive pressures.

The formal anti-corruption framework has been enhanced in recent years. However, perceived corruption remains a multidimensional concern and several issues remain to be tackled, including improving trust in institutions and public procurement. Effective anti-corruption oversight is needed to ensure better use of public resources, including the efficient use of procurement in the roll-out of public investments, and fostering stronger business dynamics.

Digitalisation is low. Adaptation of digital technologies in smaller firms and the public sector lags behind other countries (Figure 4). A concern is high mobile internet prices, which reduce mobile broadband usage. In addition, businesses use high-speed broadband less than elsewhere. Low digital preparedness hinders the implementation of new technologies and the integration into national and international supply chains. The public sector can play an important role model by leading the adaptation of digital technologies.

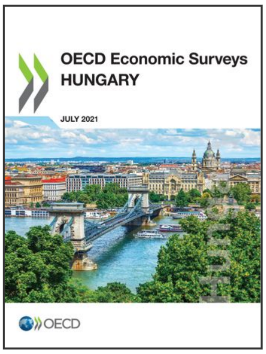
Figure 4. Low adoption of advanced ICT



Note: Firms from the financial sector are excluded. High-speed broadband are subscriptions with 100+ Mbps.
Source: OECD ICT Access and Usage by Businesses database.

StatLink https://doi.org/10.1787/888934266647

Main Findings	Key Recommendations
Macroeconomic and financial policies to support the recovery	
Inflation is above the inflation target of 3% and moved outside the central bank's upper tolerance band of +/- 1% in spring 2021.	Continue to increase policy interest rates if inflation expectations becomes unanchored. Gradually exit from unconventional monetary policy measures.
Fiscal policy is supportive.	Continue to provide targeted fiscal support as needed, while preparing for fiscal consolidation once the recovery has become self-sustained. Adopt a medium-term strategy to reduce debt and prepare for the long-run fiscal challenges of ageing.
Population ageing is accelerating, boosting ageing-related spending pressures.	Complete the ongoing increase of the statutory retirement age to 65 by 2022. Thereafter link it to gains in life expectancy.
Structural reforms for stronger and more sustainable growth	
High labour taxes deter labour market participation and investment in skills. The effective VAT rate is lower than the standard VAT rate.	Make the tax system more growth-friendly by further reducing the reliance on labour taxation, continuing to increase the reliance on consumption taxes and raising immobile property taxes, while addressing adverse distributional impacts. Simplify the VAT system by moving towards a broader-based and lower standard VAT rate.
The tax system imposes heterogeneous abatement costs across sectors and activities.	Gradually unify carbon taxes and set non-carbon environmental taxes and fees according to the polluter pays principle.
Low regulated prices (often below cost) of energy, water, wastewater and waste collection services do not incentivise investments.	Ensure cost recovery in regulated energy and introduce targeted affordability measures to help low-income households. Increase waste collection fees and water and wastewater service tariffs to help finance needed investments.
Support skills development and mobility for a more inclusive labour market	
Skills of vocational graduates do not meet labour market needs. Few vocational students have apprenticeships.	Link funding for vocational schools to the number of students in work placements. Allow apprenticeships to start only once a placement with a company for the work-based part of the programme is secured.
Rental housing is underdeveloped.	Regulate tenancy to better balance the interest of tenants and landlords.
The short (3 months) duration of unemployment benefits discourages geographical mobility.	Consider increasing the duration of unemployment benefits.
Local train networks are underdeveloped and local roads are poorly maintained.	Increase investment in local train networks. Increase funding for maintenance of secondary and tertiary roads. Introduce cost-benefit analysis and co-funding for infrastructure projects.
Employment among young mothers is low.	Expand the availability of affordable, high-quality childcare. Reduce the effective length of parental leave and continue to facilitate more flexible working arrangements.
Ensure dynamic and competitive markets	
Exemptions from competition policy reduce the effectiveness of the competition framework.	Subject all mergers that fulfil the merger threshold to full reviews. Establish limited and explicit public interest grounds for exemptions.
Sectoral taxes discourage expansions and new entry.	Phase out distortionary sector taxes in energy, finance and retail sectors.
Public procurement lacks competition.	Increase the use of e-invoicing through the electronic procurement system. Further enhance transparency and continue to increase the share of public procurement subject to competitive tendering.
Prices for mobile internet are high.	Phase out levies on phone calls and messages. Strengthen network competition through auctioning of additional spectrum to expand the number of mobile network operators.
The anti-corruption framework needs further strengthening to be more effective.	Establish an independent anti-corruption authority or a strong coordination committee.



From:
OECD Economic Surveys: Hungary 2021

Access the complete publication at:
https://doi.org/10.1787/1d39d866-en

Please cite this chapter as:

OECD (2021), “Executive summary”, in *OECD Economic Surveys: Hungary 2021*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/d1580903-en