

## **Hungary**

1. Since the mid-1990s, the Hungarian economy has grown at an average annual rate of 4%, one of the highest growth rates in the EU. Labour productivity growth is also well above the EU average. However, the budget deficit (5.4% in 2004) will, instead of declining as foreseen, increase above 6% in 2005. GDP per capita is currently at 60% of the EU average. Following a temporary acceleration in 2003, employment growth turned negative in 2004 and the overall employment rate has decreased to 56.8%, far below the Lisbon target, while unemployment has increased (6% in 2004), though remaining below the EU average. Low unemployment is however coupled with a very low rate of activity (60.5% in 2004)

### **PART I: GENERAL ASSESSMENT**

2. The Hungarian National Reform Programme (NRP) identifies nine main challenges: reducing the fiscal deficit; R&D and innovation; business environment; competition; infrastructure; raising the employment and activity rate; improving the labour market situation of the disadvantaged; reducing regional labour market disparities; and enhancing human capital through better education & training. The Commission shares this analysis of the main priorities.
3. The medium-term strategy presented in the NRP aiming at a continuous catching-up with EU average GDP per head through robust economic growth and increasing employment appears realistic, but the level of ambition implied in the programme is difficult to assess, as in places, the presentation of measures is not fully clear or concrete. The programme does not fully explain how the reforms in various areas are integrated and whether there are possible synergies between them. Their overall coherence across policy areas is not always evident, for example when assessing the objectives regarding infrastructure investment against the background of aiming also for fiscal consolidation. The NRP refers to the ambitious employment rate target of 63% by 2010, as set by the Government in 2004. No target for R&D spending by 2010 is specified. For some measures, the NRP highlights support from the Structural Funds. Given the strong emphasis on development needs, the role of cohesion policy in the delivery of the “growth and jobs” agenda could have been more strongly highlighted.
4. Consultation and efforts to develop ownership of the document have been substantial. The programme has been formally endorsed by the Hungarian government. It has been subject to wide consultation with social partners and local authorities. Furthermore, a consultation conference has been organised for a wide range of key partners. In addition, the draft was available on-line for comments. The document was presented to the Employment Committee of the Hungarian parliament.

### **PART II: ASSESSMENT BY POLICY AREA**

#### **Macro-economic policies**

5. The macro-economic key challenge of reducing the fiscal deficit is a central issue for the Hungarian economy. The policies and measures proposed are generally relevant

to respond that challenge but they lack detail and quantified estimates of their impact. A clearer presentation of the integration and the overall coherence of the proposed measures would facilitate their assessment.

6. The strategy of ensuring long-term sustainability by complementing a gradual approach to cutting the fiscal deficit with further progress with healthcare and pension reforms addresses crucial issues for the Hungarian economy. Coupled with a planned reform of the tax regime, including a considerable reduction in the VAT rate, the measures presented seem likely to be effective in contributing to growth and employment and to improving the business climate. However, the information provided in this regard is not sufficient to assess fully the consistency of the proposed measures with the medium-term macroeconomic objectives. The absence of a clear timeline for achieving budgetary balance and the reduction of government debt makes it difficult in general to assess the macro-economic strategy.
7. While the policy objectives, strategies, and measures presented in the programme to tackle the macroeconomic key challenge can be regarded as a suitable response in principle, several questions remain unanswered owing to insufficient detail in the programme. The absence of clear timelines risks undermining the credibility and effectiveness of the strategy, in particular given the importance of careful sequencing of those measures envisaged which will have a fiscal impact.

#### **Micro-economic policies**

8. The programme identifies R&D and innovation, the business environment, competition, and the development of infrastructure as micro-economic key challenges. The Commission subscribes to these priorities.
9. The NRP recognises the importance of achieving stronger R&D and innovation and analyses many problems that need to be addressed in that regard. First is the small contribution by the private sector to overall R&D spending, which stands at a comparatively low level of 0.95 % of GDP. Regulatory problems, weak links between business and research institutions, surprisingly small spillover effects for innovation from cooperation with foreign companies, as well as the fragmentation of research activities, are all seen as key factors constraining Hungary's innovative capacity. While the R&D and innovation challenge is well presented in its various dimensions, the corresponding policy response is only in some cases clearly laid out. The NRP does not set out a monitoring and evaluation system for the R&D and innovation strategy. To facilitate the move toward a more knowledge-based society, the inefficiencies identified in the Hungarian education system need a more concrete response. The programme fully recognises the importance of spreading the use of ICTs, but says little on how this objective can be achieved in practice.
10. Measures presented to improve the business environment in Hungary comprise the tax reform in 2006, the assessment and reduction of the administrative cost to enterprises and efforts to achieve better regulation through the introduction of impact assessments. The NRP recognises the importance for SMEs of better access to finance, although insufficient detail in the presentation of measures in this area makes assessing them difficult. The relatively low level of attention paid to practical measures to achieve efficient bankruptcy procedures and company restructuring regulations contrasts with the programme's clear recognition of the importance of

these issues. Encouraging and supporting entrepreneurship at all school levels remains an important challenge.

11. The programme proposes to increase competition in the network industries, where incumbents' market shares remain high, and in the case of the gas and electricity sectors, the switching rate is very low. However, apart from stating the general need to continue the process of opening markets and to improve the efficiency and independence of regulatory bodies, policies and implementation measures to achieve more competition are not specified.
12. While the NRP identifies the environmental challenges and corresponding budget allocations, little is said on the steps and timing for putting them in practice. The programme places a strong emphasis on the development of high-quality infrastructure, as regional disparities in this field are increasing, limiting the country's economic potential and regional competitiveness. The important budgetary implications of modernising the infrastructure are not addressed very clearly.
13. The microeconomic key challenges identified are all presented clearly and existing constraints on increasing potential economic growth in Hungary are analysed in considerable detail. The strategies, policy objectives, and measures presented to address these well-understood problems sometimes do not match the analysis in clarity and detail. This raises questions about their level of ambition and likely effectiveness.

#### **Employment policies**

14. Raising the low employment and activity rate, improving the labour market situation of the disadvantaged, reducing regional labour market disparities and enhancing human capital through better education and training are the four key challenges identified for Hungary's employment policies. These priorities reflect well the country's needs in this area.
15. The NRP places strong emphasis on attracting more people to employment and retaining them. Appropriate principles are laid down for a coherent reform of the unemployment and social benefits system, with a view to boosting activity through setting more coherent incentives, for example by making unemployment benefits conditional on an active job search. Without a comprehensive review of the social benefits system, including disability benefits, the effectiveness of the proposed measures remains in doubt. Incentives encouraging active ageing need to be backed by further measures to limit early retirement and by reducing the flow of new recipients of disability pensions. Measures to reach the inactive population through the public employment service by involving municipalities and setting up, with European Social Fund assistance, an integrated employment and social services system promise to deliver results. These measures can build on progress already made with the reduction in employers' social security contributions. Improving the health situation of the population and related health care reforms could also contribute to increasing participation and employment rates. Measures to improve the situation of people with disabilities and of the Roma population and to reduce persistent regional disparities may require stronger coordination and monitoring and closer cooperation with stakeholders.

16. The NRP shows the clear determination of the authorities to transform undeclared work into regular employment through measures instituting strong and coherent incentives and sanctions. In this respect, linking health service entitlements to contribution payments made is an important step forward. The measures proposed to reduce the tax wedge, particularly in the lower income segment, can contribute to more employment and help combat undeclared work. The impact of recent minimum wage increases on the levels of low-skill and low-wage employment needs to be closely monitored.
17. On enhancing human capital, the lifelong learning strategy adopted by the government is not described in the programme in enough detail to permit a full assessment. The measures to reduce the number of drop-outs from school, to ensure equal access to education, and to adjust education and training systems better to labour market needs, do not seem to reflect a clear strategic policy approach. The emphasis placed on upgrading skill levels may fall short with regard to the particularly disadvantageous labour market situation of low-skilled persons.
18. Building on the existing national employment strategy, the programme presents a number of important forward-looking measures aimed at increasing activity. While the clear focus on this area enhances the likelihood of the measures being effective, the policy response to the challenges in the area of education and lifelong learning deserves a similar level of attention.

### **PART III: CONCLUSIONS**

19. In line with the Integrated Guidelines, the Hungarian National Reform Programme identifies and responds to the main challenges facing Hungary, namely reducing the fiscal deficit; R&D and innovation; business environment; competition; infrastructure; raising the employment and activity rate; improving the labour market situation of the disadvantaged; reducing regional labour market disparities; and enhancing human capital through better education & training. Overall, the medium-term strategy presented in the NRP appears appropriate given the Hungarian context of aiming to push GDP rapidly towards the EU average. Nevertheless, the programme is not fully integrated, in particular with the fiscal stability strategy, and measures across the different policy areas do not always appear coherent.
20. The NRP contains a clear presentation of challenges and a frank and thorough analysis of existing problems and constraints. The wide and transparent consultation process bodes well for the implementation of the outlined policies. However, in places, the presentation of measures and particularly their medium-term budgetary impact could be clearer and more concrete.
21. The programme's strengths include:
  - measures to improve the effectiveness of the public employment service and the intention to set up an integrated system of employment and social services;
  - measures to transform undeclared work into regular employment.
22. Among the points requiring further attention are:

- strategies to ensure sustainable public finances;
  - clearer and more robust measures to enhance competition in network industries;
  - improving the business environment including SMEs' access to finance;
  - increasing the responsiveness of education and training systems to labour market needs and upgrading skill levels, particularly for low-skilled persons.
23. Taking due account of the above, Hungary is invited to implement its NRP with vigour. The 2006 progress report on the implementation of the NRP should cover in particular the way Hungary has dealt with the issues mentioned in paragraph 22. In this context, the Commission looks forward to discussions with the Hungarian authorities as part of the new partnership for growth and jobs.

#### **PART IV : STATISTICAL GRAPHS AND DATA**

# HUNGARY

	HU							EU-25						
	1999	2000	2001	2002	2003	2004	2010 National target	1999	2000	2001	2002	2003	2004	2010 EU target
GDP per capita in PPS	52.0	53.2	56.1	58.4b	59.6	60.4	63.0	100.0	100.0	100.0	100.0	100.0	100.0	70.0
Labour productivity per person employed	59.6	60.9	64.6	67.1b	67.2	68.6		100.0	100.0	100.0	100.0	100.0	100.0	
Employment rate	55.6	56.3	56.2	56.2	57.0	56.8		61.9	62.4	62.8	62.8	62.9	63.3	
Employment rate of older workers	19.4	22.2	23.5	25.6	28.9	31.1		36.2	36.6	37.5	38.7	40.2	41.0	
Gross domestic expenditure on R&D	0.69	0.80	0.95	1.02	0.95	0.89		1.87e	1.89e	1.93e	1.93e	1.92e	1.90pe	
Youth education attainment level	85.2	83.6	84.4	85.8	85.0b	83.4		74.8	76.3	76.1	76.5	76.5	76.6	
Comparative price levels	46.8	48.4	52.0	56.9	59.0	61.9p		100.0	100.0	100.0	100.0	100.0	100.0p	
Business investment	21.0	20.2	19.5	18.3	18.8	19.3		17.9	18.3	17.7	17.1	16.7	16.9	
At-risk-of-poverty rate after social transfers	:	11.0	11.0	10.0	12.0	:		:	16.0	15.0	15.0	15.0	16.0	
Dispersion of regional employment rates	9.1	9.0	8.8	9.4	8.5	9.4		13.3	13.4	13.5	13.3	12.9	12.2	
Long-term unemployment rate	3.3	3.0	2.5	2.4	2.4	2.6		4.1	3.9	3.8	3.9	4.0	4.1	
Total greenhouse gas emissions	68.5	66.3	68.5	66.1	68.1	:		90.6	90.5	91.4	90.7	92.0	:	
Energy intensity of the economy	642.0	600.5	588.6	579.6	582.0	:		214.9	208.8	209.7	206.5	209.5	:	
Volume of freight transport relative to GDP	99.6	97.5b	91.8	86.9	85.4	91.9		100.7e	100.4e	99.4e	100.3e	99.7e	104.7e	

