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**Former Prime Minister
of the Republic of
Hungary**

Crisis Management in Central Europe The Hungarian Case

**Korea-FSB Financial Reform Conference: An Emerging Market
Perspective
Seoul, September 3, 2010**

HANDOUT

Challenges of the Global Crisis Facing the Government

Before April 2009

The decline of the Hungarian economy may be higher than expected, mainly due to the performance of the main export markets
→ - 5- 6%

According to market estimations, the impact of the steps announced in 2009 is considerably less than required. A programme of this nature gives the impression that the government falsely assesses the gravity of the problem

The feasibility of the announced measures is doubtful as the confidence of markets is missing

According to the unanimous opinion of analysts, the only way out of the pitfalls of the situation is to stimulate growth

April 2010

The Hungarian economic policy is again credible: the trend is positive, the decline of the Hungarian economy was not too dramatic, the macro-economic data are better than expected

• *Le Monde*: „Hungary has shown the way out of recession.”

• *J.P. Morgan*:

„Hungary can be the first among the aspirant countries of the region to introduce Euro”

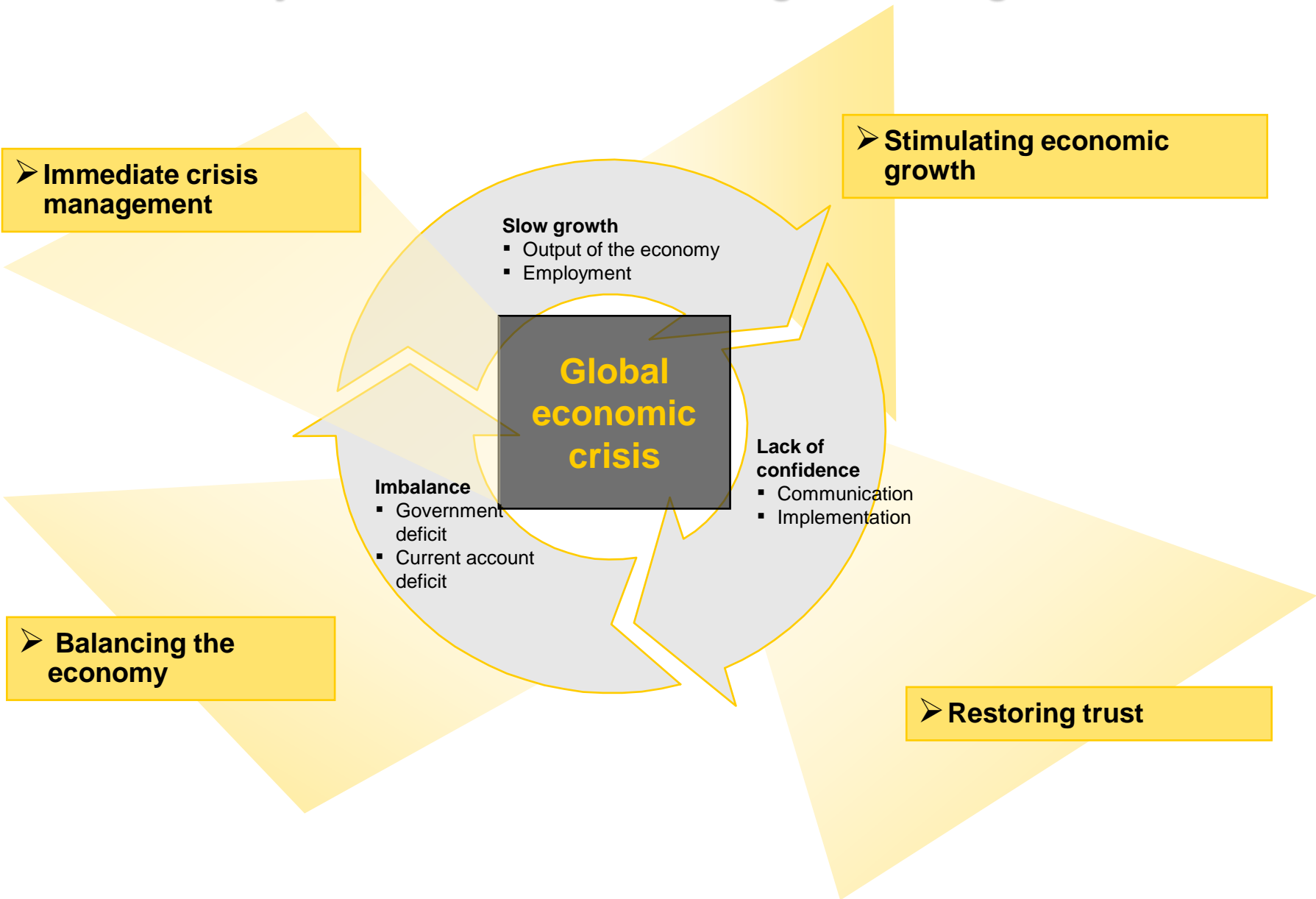
„probably the most ambitious fiscal adjustment in Europe”

• *Bank of America Merrill Lynch*:

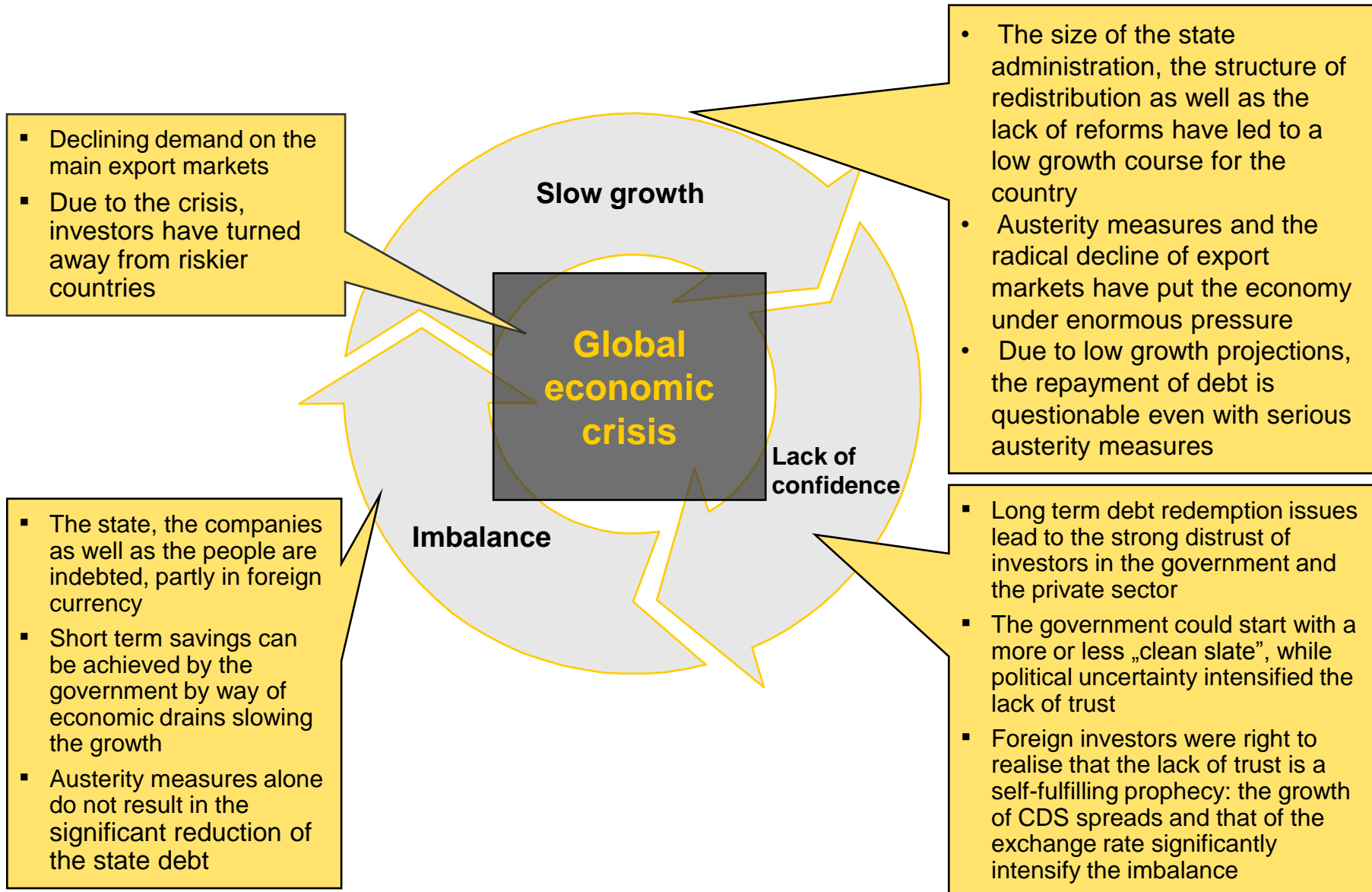
„The growth of the economy in the region will be the fastest in Hungary..”

„Hungary to Be World’s Fiscal Leader”

Objectives of the Crisis Management Program



The initial situation kept the country's economy in a vicious circle ...



... which we must break out from, otherwise we face a serious social and economic crisis that concerns everyone.

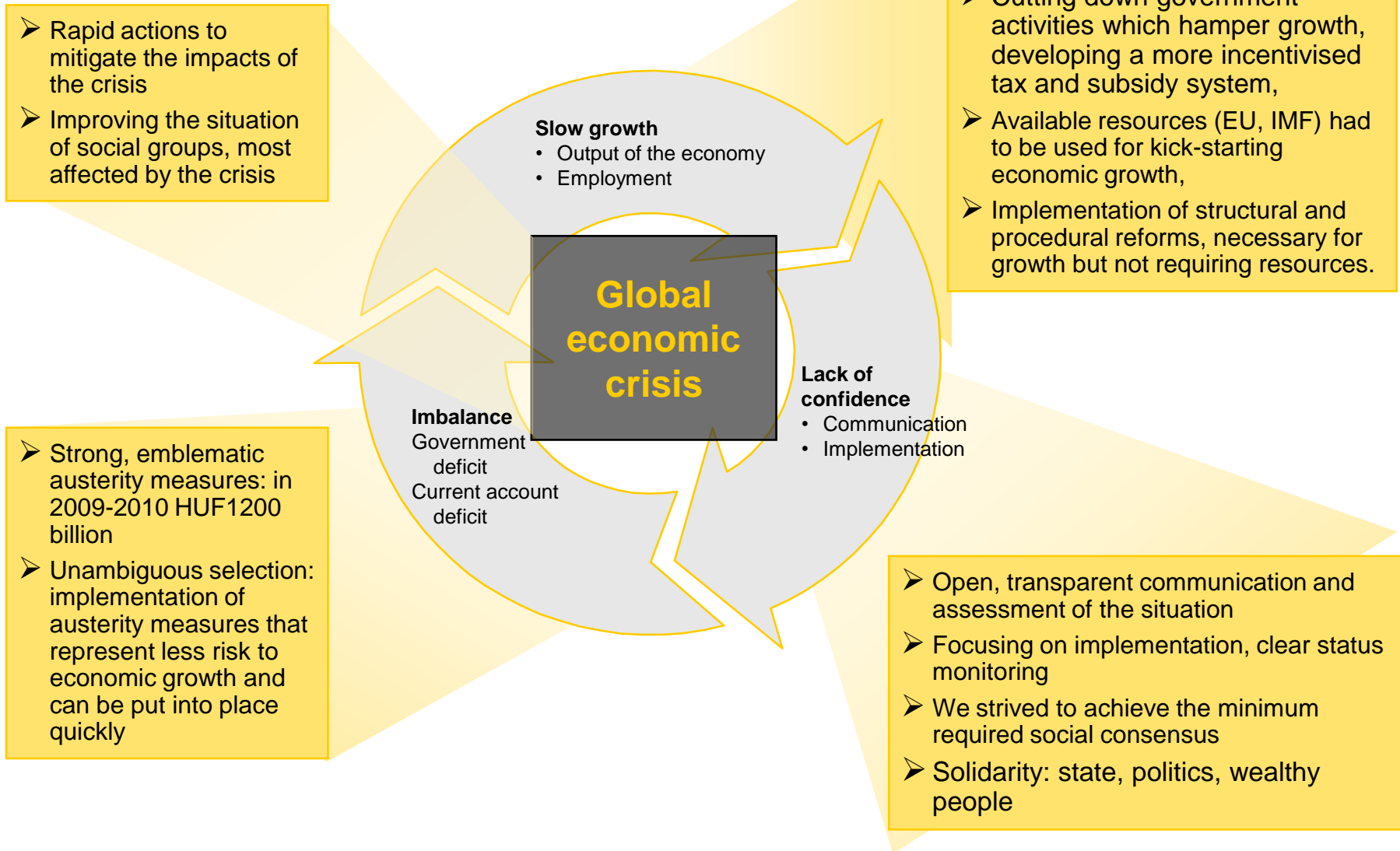
What could have happened without us taking action?

- **In the macro-economy:**
 - Persistent recession, left behind by the countries of the region
 - Quickly growing level of state debt
 - Radical devaluation of HUF
- **In the entire country:**
 - A wave of company bankruptcies
 - Several hundreds of thousands of jobs at risk
 - Several hundreds of thousands of home and car owners with foreign currency loans can be at risk
 - The value of pensions and family allowances is jeopardized



- This requires the following:
 - Stopping rising indebtedness
 - Improvement of the growth potential of the economy
- Hungary has undertaken contractual commitments with international organizations (IMF,EU) in such a way that
 - Crisis managing measures cannot undermine the balance of the state budget
 - Public debt should start decreasing as soon as possible

The Government's programme had to tackle all the elements of the vicious circle



1. Immediate crisis management measures

Stabilization of the financial system

- With international loan-agreements (IMF and EU) the accessible financing framework is Euro 20 billion
- Reducing the repayment rates for 1 million 700 thousand families with foreign currency based loans
- From January 1st 2010, clients are protected by the Code of Conduct, signed by 260 credit institutions, financial enterprises and cooperatives
- The Hungarian Financial Supervisory Authority also acts as a consumer protection authority, authorised to impose penalties up to HUF 2 bn
- Modernizing and strengthening Bank supervision

Safeguarding jobs, supporting those who lose their jobs

- Maintaining 100 000 jobs with HUF 52 bn grant by the government within the 4+1 Program
- Reallocation of over HUF 20 bn from EU funds in order to help the unemployed find new jobs
- 120 thousand people involved in the extended adult education system (through projects, such as „Step forward” and „Development of Labour Market Competencies”)
- Eventually 20 thousand people can return to the public sector in part-time employment
- State guarantee to provide security for people with risky mortgages

Programmes to help the financing of SMEs

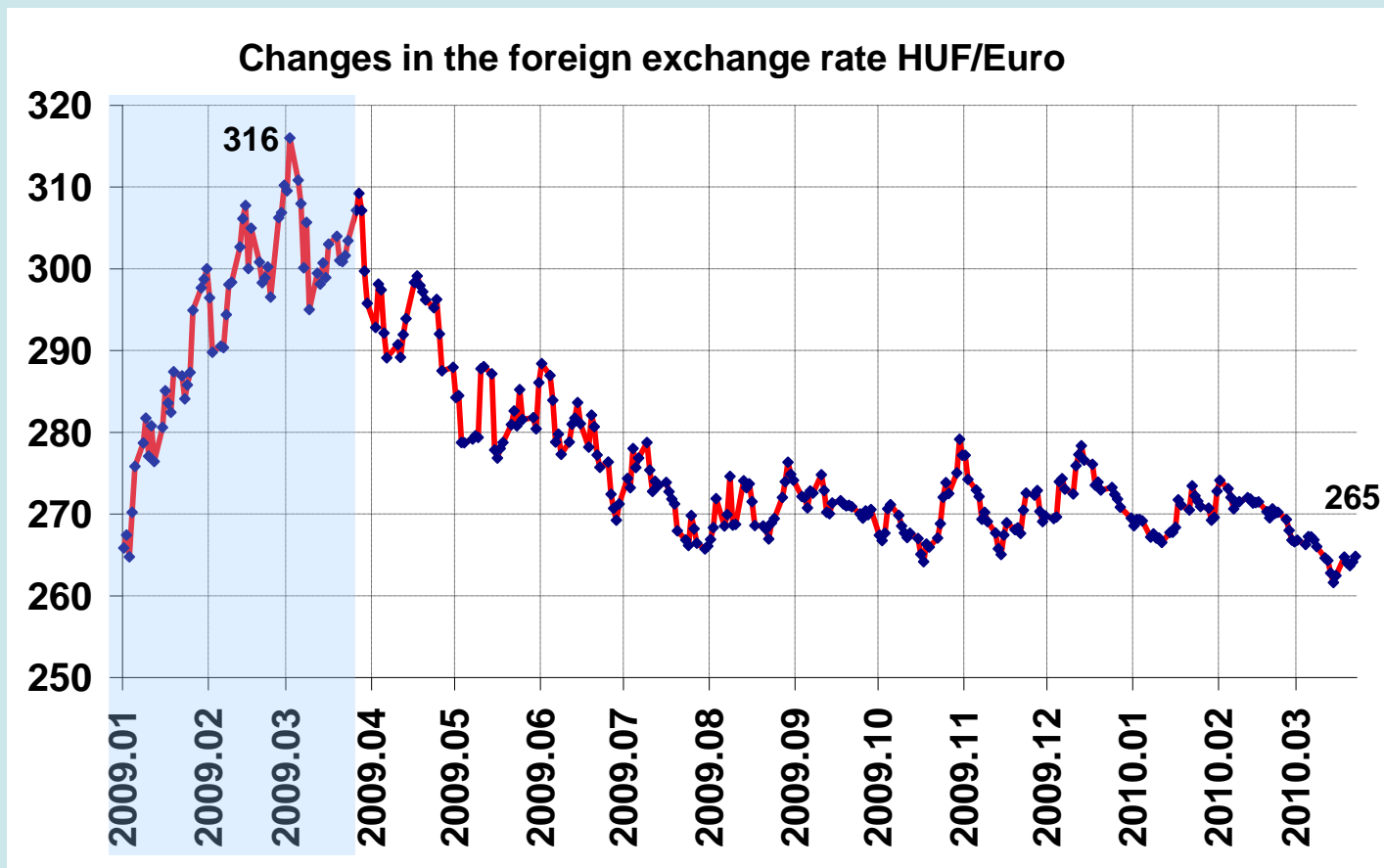
- HUF 1400 bn for loan-, guarantee- and capital- as well as tender programmes, out of which HUF 670 million has already been awarded to 48 thousand enterprises
- HUF 2400 bn for supporting the construction industry, so far 2208 public procurement procedures have been advertised for 915 projects to the value of HUF 1041 bn
- In the enterprise development programme, 1126 enterprises received HUF 82 bn worth of special credit facilities for development and 364 enterprises have drawn HUF 46 bn in working capital loans
- As a result of the measures, introduced to reduce the administrative burden of the entrepreneurs, the expenditure of enterprises will decrease annually by HUF 43 bn from this year on

Accelerating the absorption of EU funds

- NHDP: 44 thousand applications with a total of HUF 3592 bn awarded allocation, out of which HUF 852 bn has been paid
- Accelerated decision making; in case of automatic applications, decisions are made in an average of 37 days
- With the extension of the normative application procedure payment deadlines were reduced significantly
- Acceleration of payments: extended exemption from certified copies of invoices
- Mitigating the guarantee burdens by extending the guarantee-exempt range
- Raising the advance payment maximum to 40%, accelerating the payment of advances
- In most applications, companies are required to pay less as co-financing
- Late payment penalties to be paid by paying agencies, if they miss payment deadlines

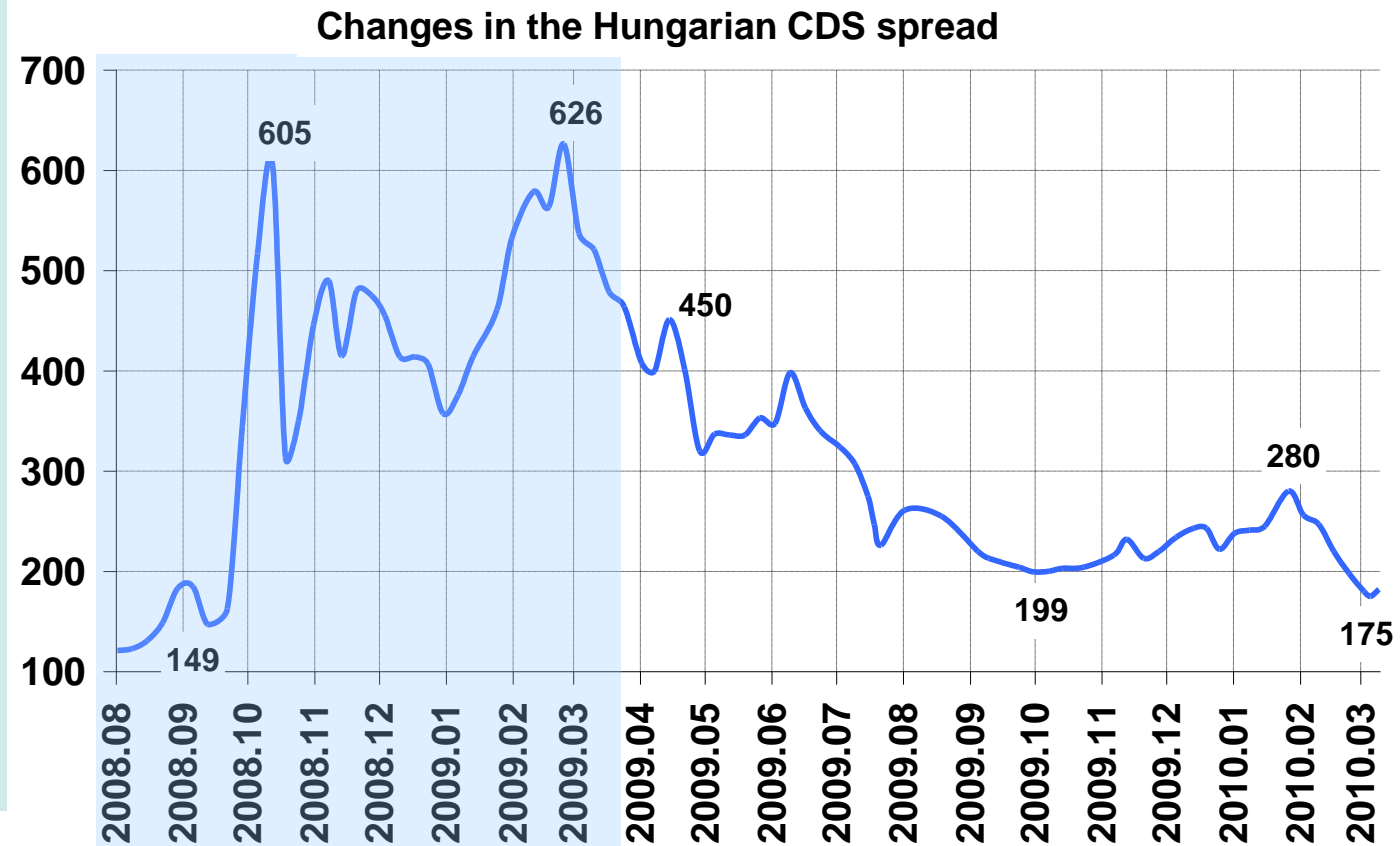
Relaxing foreign currency market: stabilizing HUF exchange rate

Repayment of foreign currency loans by seriously indebted enterprises and individuals is eased by several hundreds of billion HUF on a monthly average



The decreased CDS Spread is close to pre-crisis levels

The decreased risk of the state's bankruptcy is recognized clearly and rapidly by investors and the country's external creditors : we are able to finance ourselves again



2. Measures to improve the balance

Measures for the sustainable operation of the public sector

- Fixing the nominal gross payments to relieve the budget in the budgetary institutional sector
- Discontinuing the 13th month's wage results in HUF 180 bn worth of savings for taxpayers
- State subsidies for local governments have been decreased. Simultaneously, their responsibilities have also been reduced, while HUF 1000 bn is paid for community development projects
- The government's institutional expenditure has been cut by HUF 140 bn

Improving the sustainability of the pension system

- Gradual raise of the retirement age to 65 years
- There was a 3.1% rise in pensions in 2009 and the 2010 budget includes a 4.1% pension raise
- Adjusted pensions resulted in higher pension payments for 816 000 elderly people this year
- By eliminating the 13th month pension, funds for the 12th and 11th month pensions can be preserved
- By reforming the pension calculations and introducing the pension premium, the value of old age pensions can be maintained
- Bringing forward the malus system for early retirement

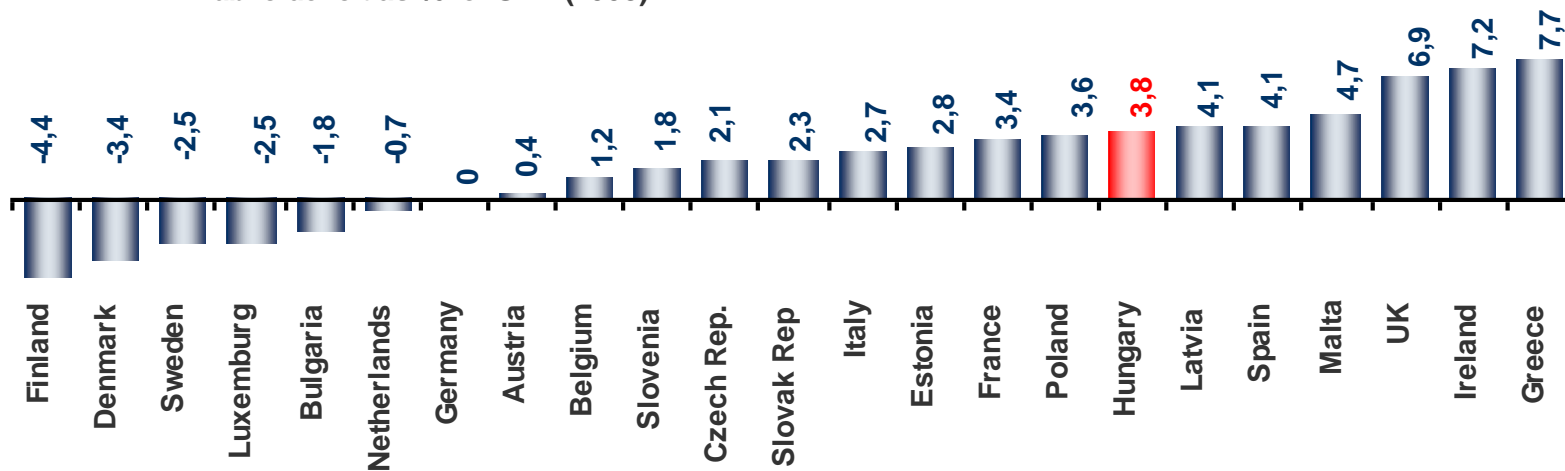
Creating a more targeted social system

- Reducing sick-pay by 10 percentage-points makes other social benefits more secure
- By fixing the family allowance for two years and reducing the eligibility age limit from 23 to 20, we saved HUF 4 bn in 2009 and will save HUF 17 bn in 2010
- By setting the maximum time for childcare allowance and childcare fee payments, introducing the nursery school and kindergarten programme and making childcare regulations more flexible, 70 000 parents can return to work
- New „RÁT” (availability support) rules affect 32 thousand people, resulting in HUF 12 bn in budgetary savings
- The housing grant expenditure was decreased and a smaller, but more targeted system has been introduced, resulting in HUF 50 bn in forecasted savings in 2010
- By reducing and gradually eliminating the compensation for gas and district heating bills, we save HUF 20 bn

Other measures

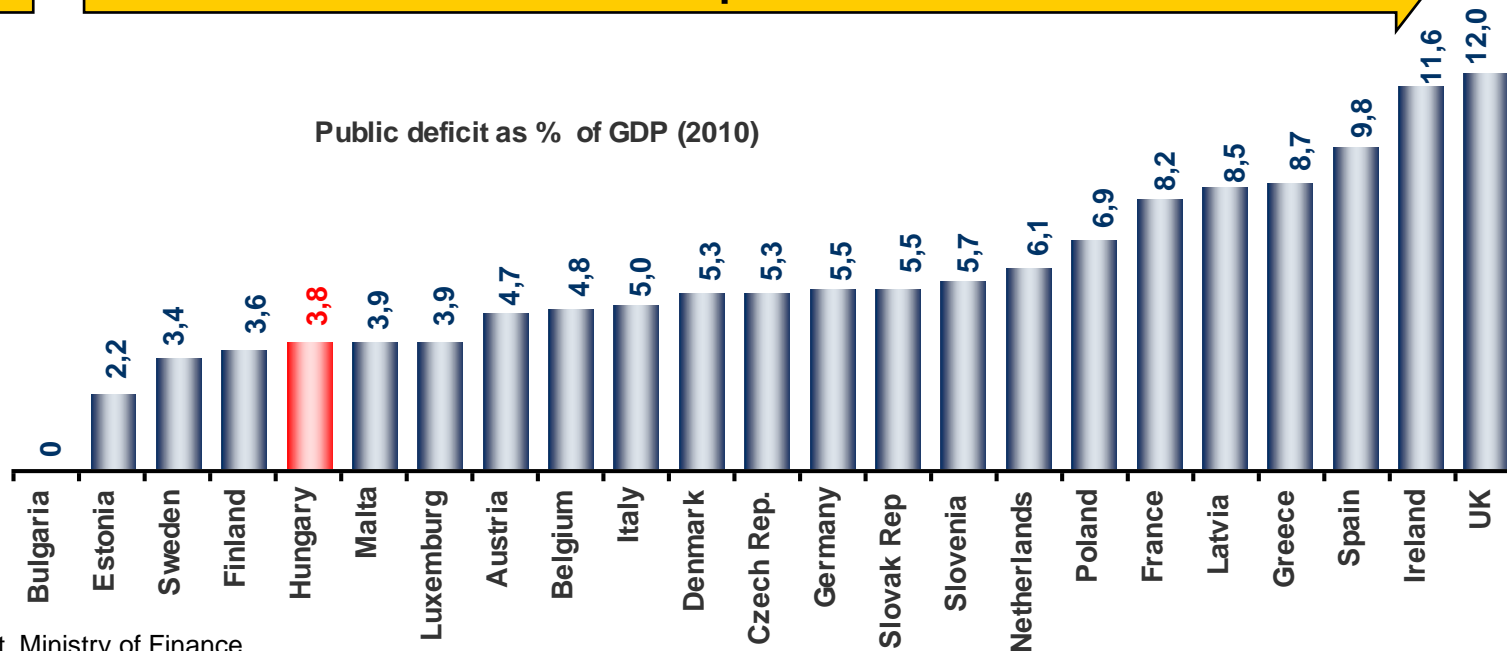
- Creating the financial stability of the MÁV group, introducing organizational consolidation processes
- By reorganising community transportation, reducing its subvention and introducing registration tickets, free use of the transportation system becomes measurable
- The subsidy for public media programmes was reduced by HUF 7,5 bn
- Reducing the national co-financing of community agricultural support by HUF 33 bn

Public deficit as % of GDP (2008)

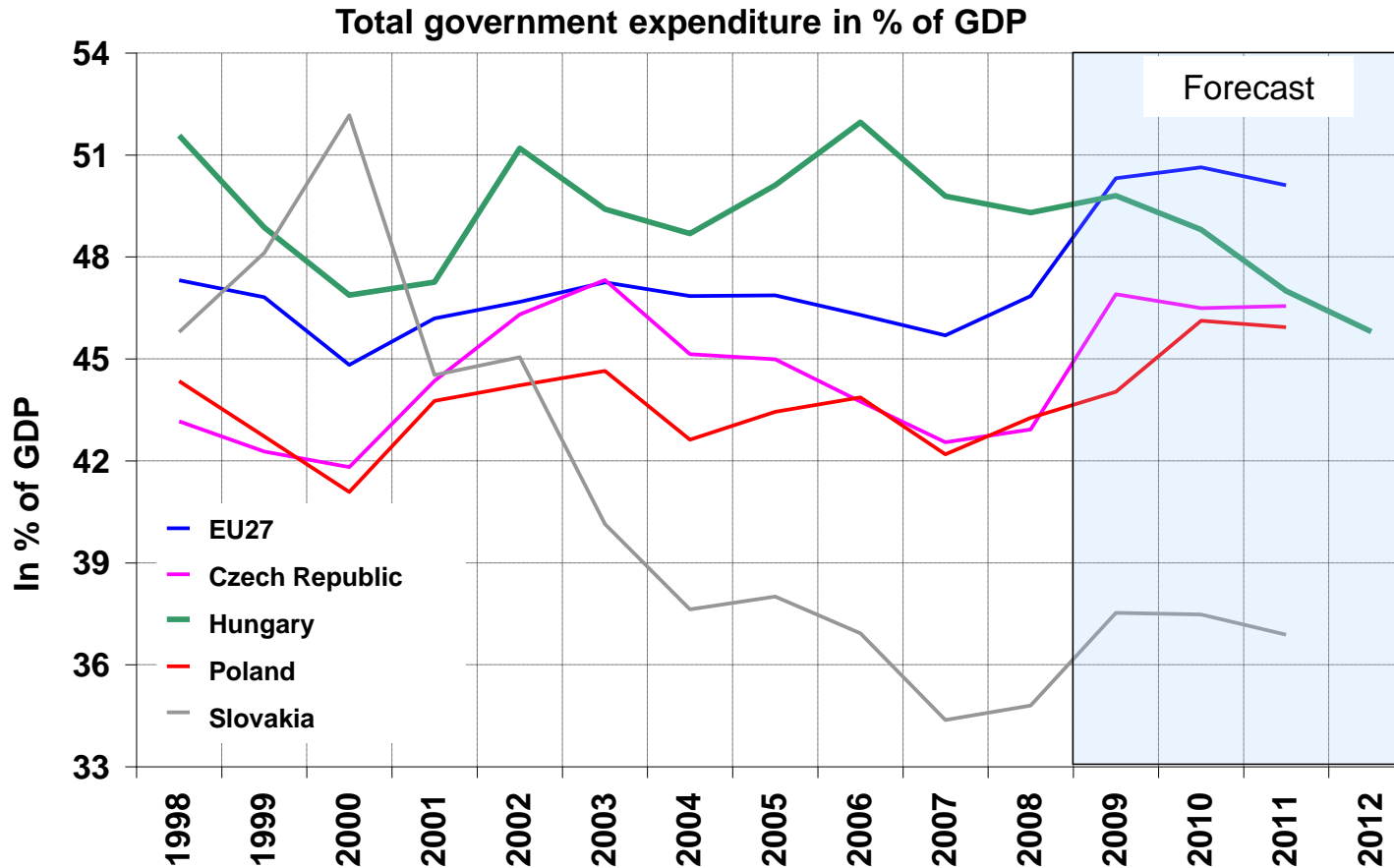


In two years we advanced from 17th to 5th position among EU member countries in terms of public finances

Public deficit as % of GDP (2010)



Results of measures taken to improve the balance: government operation of sustainable size



**GDP-proportional government expenditure may be kept permanently under 50%,
which is a sustainable level**

3. Stimulating Economic Growth

**Restarting the
engine of the
economy**

Reforming the tax system

*to simpler, more transparent and lower taxes,
for the regional competitiveness of Hungary*

Measures to increase activity

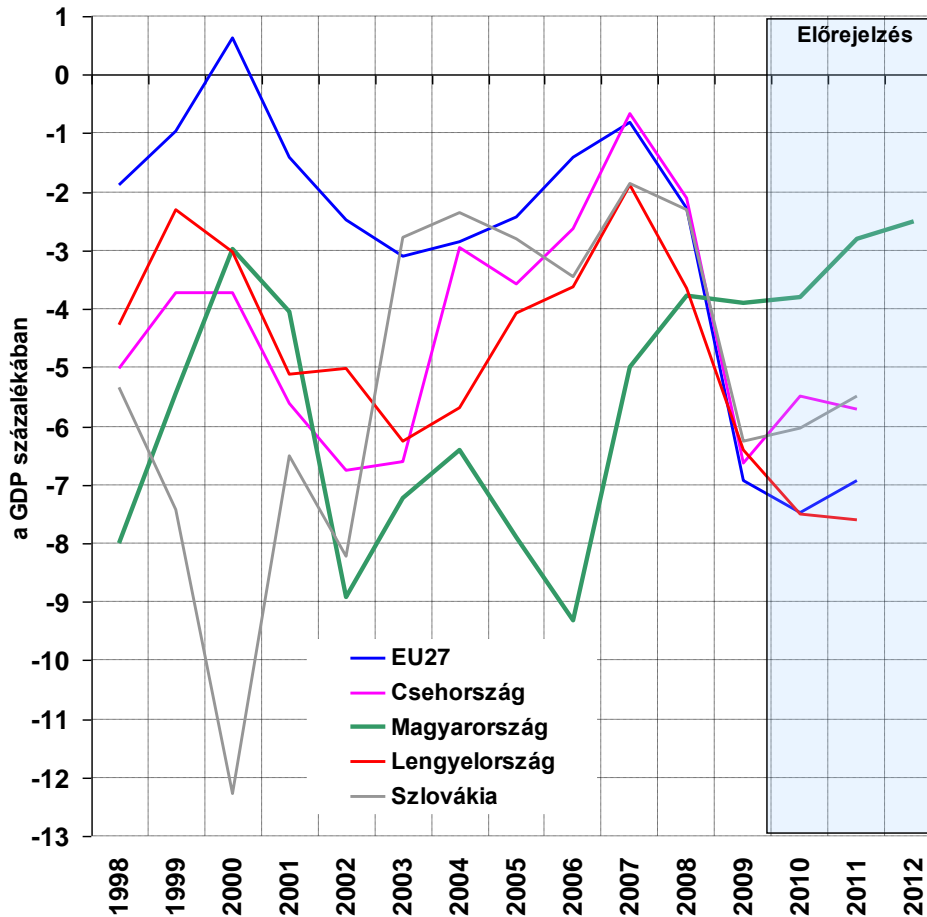
*helping people of working age back into the labour market,
making it worthwhile to work instead of living on social benefits*

Extra-budgetary regulations

*state regulations to boost the economy, reducing
red tape, deregulation*

We can become top of the class from being one of the worst performers in the primary balance of the budget, if we persist with our stringent economy

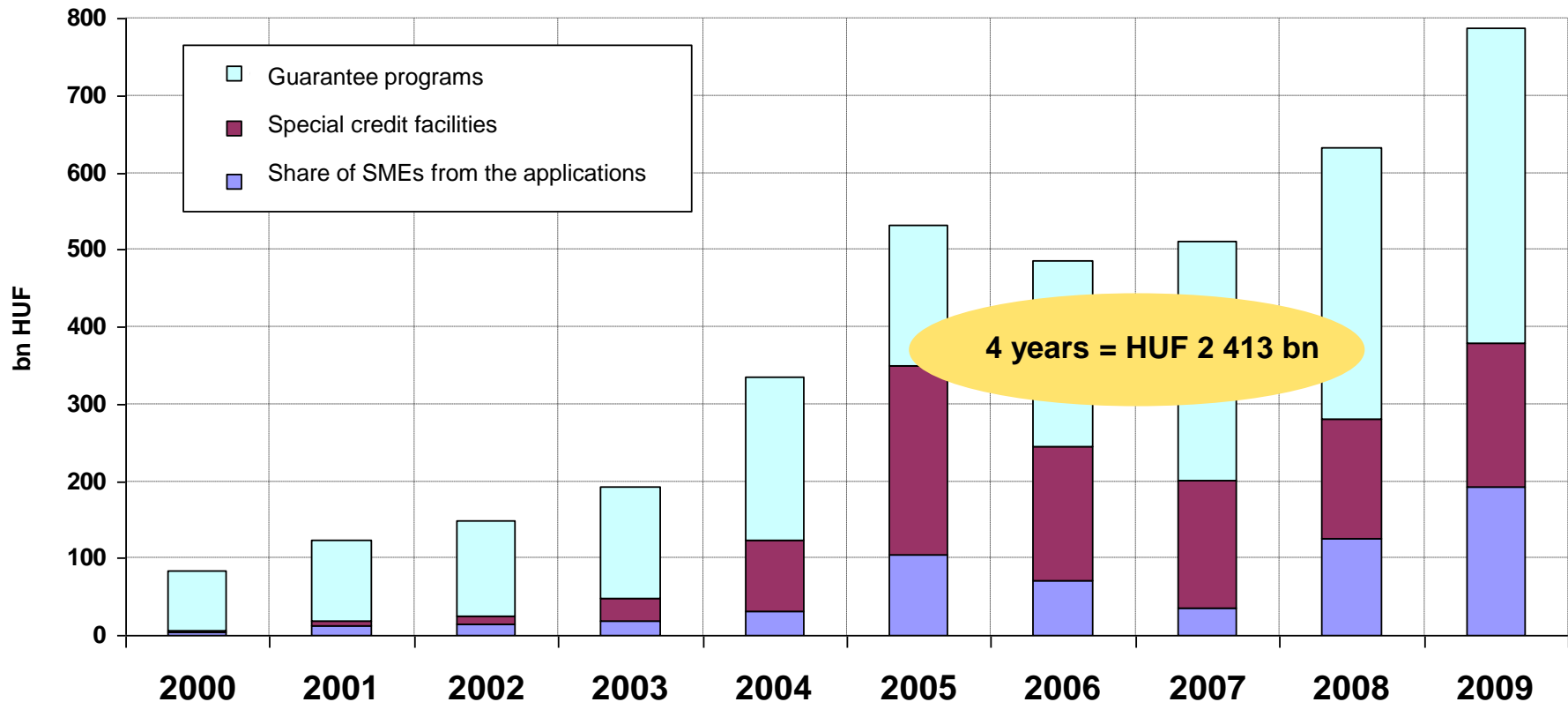
Primary balance of the budget in % of GDP



Thanks to stabilisation measures, we overspend only as much as we are still able to finance in the long run

Since 2006 we have spent around HUF 2,5 thousand billion on boosting Hungarian SMEs

By way of capital, guarantee and loan programmes, as well as tendering procedures, financial support to the SME sector has grown substantially



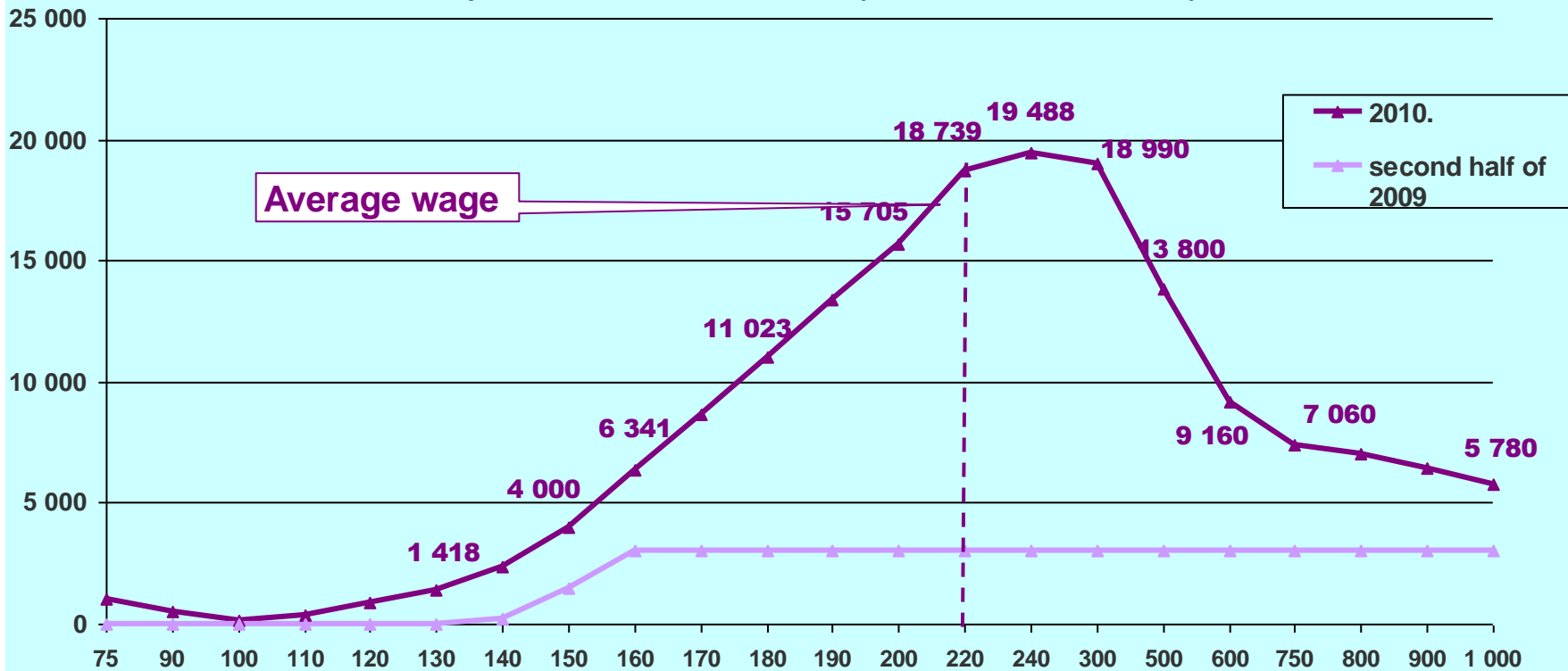
3.1 Reform of the tax system

	2009	2010
Reducing the burdens on live labour	<ul style="list-style-type: none"> ▪ 5 % point reduction of employers' contributions up to twice the minimum wage ▪ Extending the threshold of personal income tax to HUF 1, 9 m 	<ul style="list-style-type: none"> • 5 % point reduction of employers' contributions for the total income • Elimination of the itemized health care contribution • Introduction of the super gross wages • Tax brackets lowered to 17 and to 32 % • Lowest bracket: HUF 5 m
Combating tax evasion	<ul style="list-style-type: none"> • The amnesty ended as of December 31, 2009 	<ul style="list-style-type: none"> • Off-shore revenues and assets to be included in tax base • Introduction of a 30% resource tax
Ensuring resources Taxes burdening consumption	<ul style="list-style-type: none"> • VAT increased to 25%, • Preferential rate: 18% → milk, dairy products, bread, district heating • Excise tax rate raised by 8-10% 	
Streamlining		<ul style="list-style-type: none"> • Uniform corporate tax with the elimination of the extra tax • Limitation of tax benefits and tax exemptions • Reducing duties

- ✓ Enterprises to keep HUF 400 bn more
- ✓ The reduction of VAT on district heating decreases the burden on 650 thousand families
- ✓ In 2009, 1 350 000 people benefited from raised brackets in the personal income tax
- ✓ In 2010, due to further decrease in tax rates, a citizen earning the average wage will receive HUF 188 thousand more
- ✓ In 2010, 90% of the employees, 3 million taxpayers will fall into the lowest tax bracket

Average wages will increase by net HUF 15.000 /month in 2010, while contributions, burdening the wages, will decrease.

Changes of the net wages in 2009-2010 compared to the first half of 2009 (in thousand HUF/month)



In 2010, 3.000.000 taxpayers will have a larger income by paying HUF 250 bn less in taxes and contributions, while the burdens of the richest will increase

3.2. Measures to increase activity

Reform of the child support system

- Nursery school and kindergarten building projects in 7 regions, in HUF 20 bn
- Simplifying the rules of childcare (family day-care, etc.)
- More targeted, complex employment programmes to promote the return of women to the labour market, helping approx. 1200 people to work

Increasing the activity of the elderly

- Gradual increase of the retirement age (from 2012)
- Increasing the age centre (malus)
- Abuse of the system has been minimised by rationalising the conditions for disability pension
- Maintaining subsidies that promote the employment of elderly workers: in 2010, 1000 persons over the age of 50 shall return to work through training and mentoring; in 2011, their number will be 2200

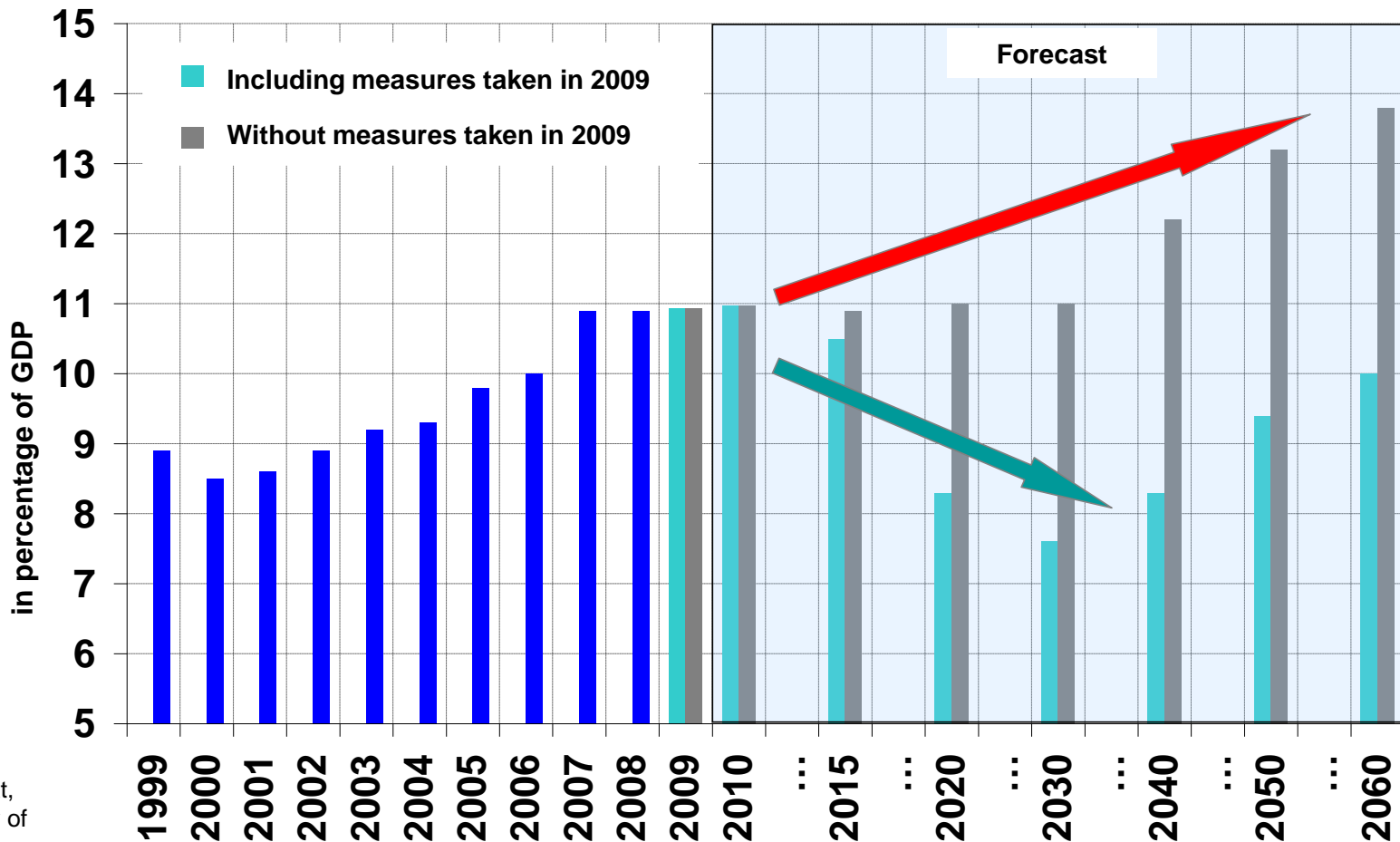
Subsidiary measures

- Helping the disadvantaged back to the labour market; 43 000 persons during the past two and a half years through the Start+ and the Start Extra programmes
- Helping people with low qualifications, first time employees, elderly employees, and people, previously caring for family members back to work; help offered to 42 400 people
- Extending the „Road to work” programme, HUF 52 billion to preserve 100 000 jobs
- Launching the „Road to the world of work” programme from HUF 7.5 billion
- Creating around 1000 jobs by supporting distance work.

- ✓ 15 000 new places in nurseries and kindergartens
- ✓ 100 000 jobs preserved through the „Road to work” programme
- ✓ Establishing a pension system that is sustainable until 2030
- ✓ 5400 new jobs based on Individual Government Decisions

By changing the parameters of the pension system, pension provision was stabilised and made sustainable for 30-40 years

In 2010, HUF 2900 billion will be spent on pensions from state revenues, representing 11% of the GDP. Without the 2009 reform measures, the pension system would have cost close to 50% more by 2040, when young people of today will retire, compared to the impact of the reform measures.



Source: Eurostat, Ministry of Finance

3.3. Extra-budgetary regulations

Promoting market acquisition

- Export development programme
- Launching the supplier programme
- Diplomatic offensive in foreign trade

Simplifying the administration

- Simplification and acceleration of the payment of EU funds
- Acceleration of licensing high-value private investments
- Implementation of Acceleration I. and Acceleration II. packages, together with the „Safe hand programme"
- Limitation of chain-indebtedness
- Acceleration and simplification of payment order procedures
- Reducing the administrative burdens of companies by HUF 43 billion per year

Developing sectoral strategies

- Preparing development strategies for sectors of national importance (car manufacturing industry, logistics, IT, pharmaceutical industry-biotechnology)
- Labour-intensive sectors: food industry, tourism, construction industry
- Promotion of R&D

Developing human and real-economy infrastructure

- Reorganising the public transport system, reducing subsidies, introducing the registration ticket
- Awarding the title of research university, facilitating additional subsidies
- As of 2010, vocational training is reduced (by 1 or 2 years) to help faster employment
- Scholarship options of HUF 10 - 30 000 per month to vocational school students who study trades in short supply

Energy efficiency, safety of supply

- Promoting energy efficiency, continuing the Green Investment System and „prefab" housing programmes
- Signing the agreement regulating the construction and operation of the Nabucco gas pipeline

- ✓ By widening the „prefab" housing programme, 284 thousand flats were refurbished between 2002 and 2009
- ✓ The total value of investments was close to HUF 180 billion
- ✓ Re-regulation of the loan-provision practices
- ✓ Limiting the maximum loan by a decree
- ✓ ITD Hungary contacted nearly 1000 companies to develop their export capabilities

4. Restoring confidence and safety

Restoring public order and confidence

Solidarity: state, politics, wealthy people

Anti-corruption measures

Establishing the Crisis Fund to help the most needy

Helping pensioners

Providing continuous information to the public on Government activities

Restoring confidence and stabilising the sense of safety and security among citizens

Restoring confidence and safety

Public order, confidence

- More policemen on the streets: 2400 retained after pension age, 1000 new policemen in April 2010, From March 2011, 1400 ex border-guard staff reassigned to law enforcement. This year, the number of village guards increased to 2200.
- The implementation of the Public Safety Network programme resulted in a 17% decrease in crimes committed in public areas.
- The civil guards got 132 patrol cars, the police plan to purchase 800 new cars this year
- In 2010, the subsidy granted to the civil guards tripled, reaching HUF 725 million
- More stringent measures against repeat offenders and armed criminals
- Crimes against minor value property (HUF 20.000), will again be investigated by police, in order to increase the efficiency of actions
- Extensive security camera systems will increase the sense of safety and security. 15 cities will launch the remote security system programmes
- Fighting hooliganism in sports, and introducing more stringent rules for the possession of firearms

Solidarity with the state, politics and wealthy people

- Saving HUF 50 million by reducing the salaries of ministers
- Reducing the per diem for the foreign visits of ministers and state secretaries by 50 %
- Disclosing to the public the salaries of CEOs of companies with majority state ownership, smaller fees for members of the Board and Supervisory Committee members, restricted allowance system, reducing the membership of different bodies

Anti-corruption measures

- The transparency agreement and the institution of transparency commissioners were established to limit corruption in public procurement
- Stricter and harsher punishment for those convicted of corruption
- Introducing a Code of Ethics in the public sector

Crisis Fund

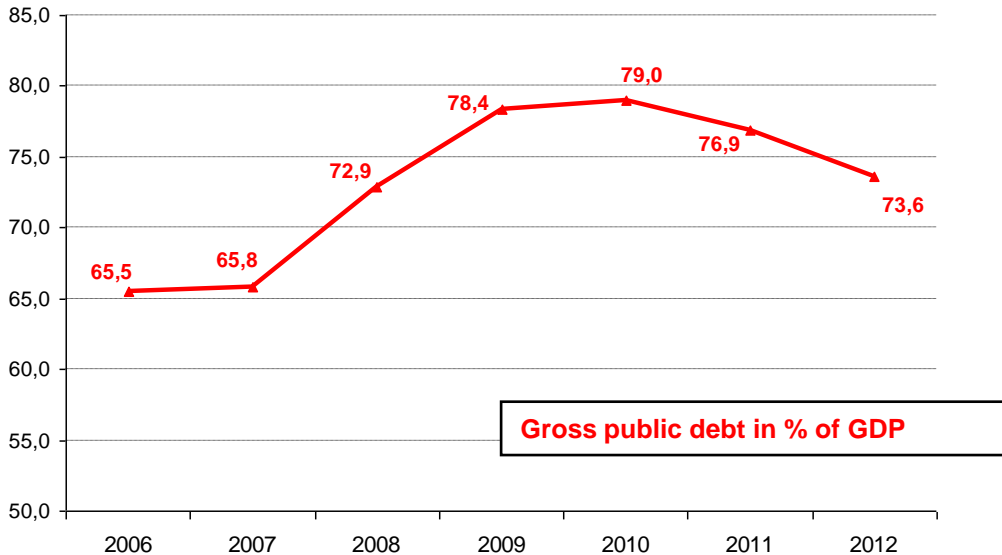
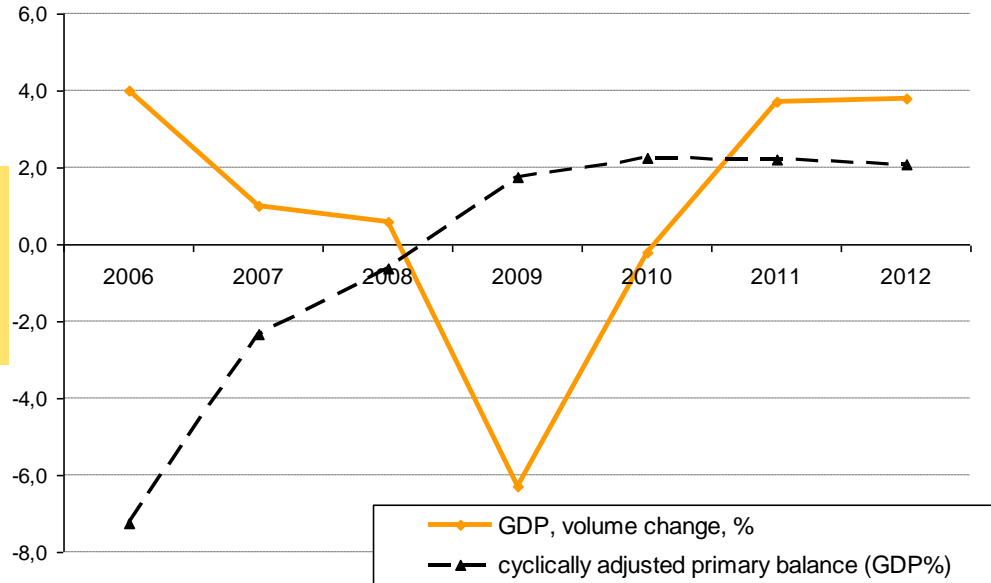
- Over 120 thousand families received an average of HUF 40 thousand, some of them HUF 100 thousand, from the HUF 5.2 billion of the Crisis Fund.
- From March 2010, the amount available shall be increased by HUF 500 million, and as a new title for subsidy, a maximum of HUF 300 thousand can be claimed for sub-renting.

Helping pensioners

- 20 thousand pensioners received a one-off subsidy,
- the pension of 36 thousand pensioners was increased on equity considerations and 866 people received equitable pension

Macro-economic indicators reacted quickly and sensitively to stabilisation measures

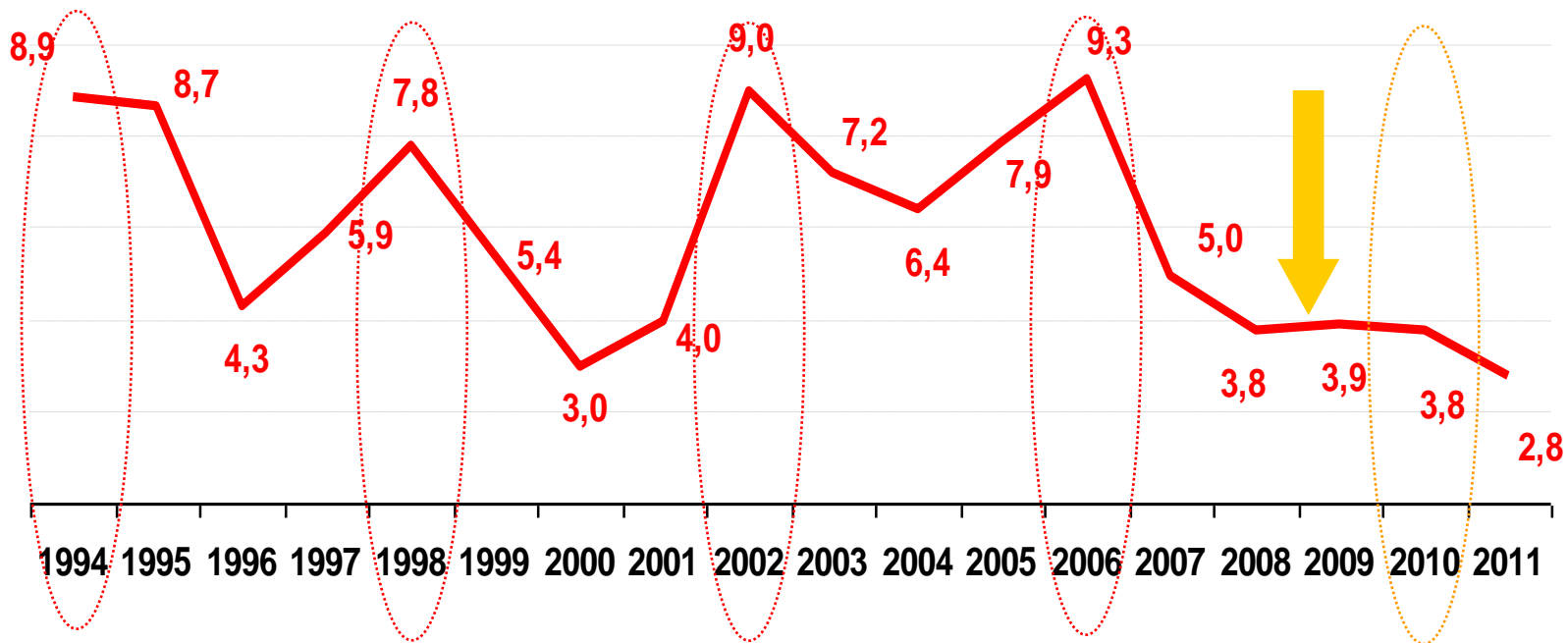
Structurally adjusted, GDP proportional primary balance shows a considerable increase in 2009-2010 by 2 percentage points



**Reduced need for state financing,
more room for economic players
Better long-term sustainability**

Badly managed central budget with unrestrained budget deficit during election years

Ratio of central budget in percentage of GDP



Automatic over-spending in political terms: extremely high deficits typical in election years, always need to be counter-balanced with budget constrains instead of well-balanced economics

The measures of the Bajnai-government helped to restore the stable, affordable and foreseeable operation of the central budget

Social effects

Employees

- ✓ In 2009, over 1 million employees received salaries HUF 36 thousand higher than before
- ✓ In 2010, a Hungarian employee earning the average wage shall receive HUF 188 thousand more, due to lower tax brackets
- ✓ Preserving 100 000 jobs with HUF 52 billion state subsidy
- ✓ Re-grouping more than HUF 20 billion from EU funds to help the unemployed back to work

Companies

- ✓ Due to the reduction of tax and contribution rates, HUF 400 billion more could be kept by the companies
- ✓ Due to lower administrative burdens, company spending is reduced by HUF 43 billion a year
- ✓ Loan and guarantee programmes, HUF 1400 billion
- ✓ Construction acceleration programme
- ✓ Launching the „Safe hand” program to reduce chain-indebtedness
- ✓ Working capital loans, development loans

Families

- ✓ Targeted programmes to help women return to the labour market
- ✓ Mandatory part-time employment of women with small children in the public sector
- ✓ Moratorium on evictions in the case of disadvantaged families
- ✓ More places in nurseries, kindergartens and day-care
- ✓ The VAT of basic dairy and bread products were lowered to 18 %
- ✓ The lives of 650 thousand families were made easier with the reduction of district heating prices
- ✓ Protection of 1 700 000 families with foreign currency loans

Pensioners

The pension system has become sustainable for the next 30 years, facilitating pension payments not only for current but also future pensioners. The price of keeping the 11th and 12th months pensions was the elimination of the 13 month pension.

Increasing, but fragile confidence

Before April 2009

The downturn of the Hungarian economy can be higher, than expected, mainly due to the performance of the main export markets
→ - 5-6%

According to market estimations the impact of the steps announced in 2009 is much less than necessary. A program of this nature makes the impression that the government's assessment of the gravity of the problem is false

The feasibility of the steps announced, due to the missing trust of the markets is doubtful

The opinion of the analysts is steady; the only way out of the trap situation is to stimulate the growth

April 2010

Hungarian economic policy has regained its credibility: it is on the mend and macro-economic data are better than expected

• **Le Monde:** „Hungary has shown the way out of recession.”

• **J.P. Morgan:**

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