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HUNGARY IS THE FRONTRUNNER ONCE AGAIN - IT ALL STARTED WITH THE TAX REFORM

Available data suggest that, with an economic growth of 5 percent in the third quarter of 2019, Hungary heads the ranking of growth rates in the European Union. Hungarian economic growth exceeds growth rates in both the CEE region and in the euro area. As a result, real economic convergence is continuous. In a series of articles, we will present the economic policy reforms which paved the way for Hungary to become a frontrunner in economic growth, and, looking ahead, what types of competitiveness reforms are required for successful convergence to be maintained over the long term.

The fiscal consolidation and structural reforms after 2010 laid the foundation for economic growth starting in 2013. The Hungarian economy had to face the global economic crisis at a time of already stagnating growth, rising debt ratio induced by significant budget deficits and deep structural problems. Domestic employment and labour participation rates were among the lowest in the EU at the outburst of the crisis. Hungary was not able to cover its own financing need, thus was among the first countries to apply for an international financial assistance, and it had been under the excessive deficit procedure since 2004 due to the constantly high fiscal deficits. Consequently, in 2010 structural reforms and a major transformation of the tax system became necessary, as a result of which, 10 years after the crisis, Hungary's economic growth is one of the strongest in the EU, the labour market is close to full employment, the European Union's excessive deficit procedure was abrogated, the IMF loan was repaid early and the general government is now able to finance its needs mainly from internal sources.

In 2010, the government recognised that stimulating economic growth and maintaining fiscal balance are equally important, and the key factor to achieve those was the boosting of employment. The structural measures taken in line with the Széll Kálmán Plans and the tax reform aiming the necessary increase in employment, constituted the foundation of the fiscal reform. By introducing the flat rate, proportional personal income tax and establishing the family tax allowance, the focus of the tax system shifted from taxes on labour to consumption and sales taxes, which had a favourable impact on economic growth and the labour market as well. The number of employees has risen from 3.7 million to over 4.5 million persons since the turnaround in 2010. As a consequence, employment has risen by 800,000 persons since its lowest point after the crisis. Introduced in 2013, the targeted allowances of the Job Protection Action Plan supported the employment of people within disadvantaged groups. These allowances had reduced taxes on labour by HUF 740 billion for 900,000 employees by the end of last year. Over 1 million beneficiaries use family tax allowance, which has increased the disposable income of Hungarian families by HUF 1,900 billion since 2011.

The long-term sustainability of the fiscal balance was supported by successful measures aimed at reducing the size of the shadow economy after 2010. The introduction of online cash registers and subsequent measures for reductions in the size of the shadow economy led to fairer market competition, in addition to significantly widening the fiscal space of the government. As a result of these measures, the VAT gap indicating the difference between expected and actually collected VAT revenues declined from a previous level of over 20 percent to 9 percent, below the EU average, by 2018.

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The tax reform and further structural reforms may have contributed to long-term GDP growth by 6 percent.[2] Due to their favourable macroeconomic effects, growth-friendly tax measures have created a firm foundation for sustainable economic growth and subsequent tax cuts. However, economic growth seen since 2013 could not have been achieved without the turnaround in monetary policy in 2013, with the MNB providing a stable, supporting environment for the economy. The central bank's contributions to GDP growth will be described in detail in the next addition to the series.

[2] Szoboszlai, M. – Bögöthy Z. – Mosberger, P. – Berta, D. (2018): Assessment of the tax and transfer changes in Hungary between 2010 and 2017 using a microsimulation model. MNB Occasional Paper No 135, Magyar Nemzeti Bank, February 2018.