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Orbanomics, or unfulfilled dream of the Hungarian economic power

Synthesis

After winning the 2010 elections, Prime Minister V. Orban questioned the existing socio-economic model of Hungary, where the central place was given to the democratic system of political power and the free market economy with the dominant role of private property. In 2014 he stated explicitly that for Hungary exemplary models to follow are Russia, Turkey, and China, that is authoritarian countries with a high proportion of enterprises controlled by the central government.

Many actions implemented by V. Orban's government are, in the light of international experience, detrimental to the long-term growth of the economy. These include, above all, the imposition of new taxes on selected sectors of the economy, mainly those dominated by companies with foreign capital; the increase of state ownership in enterprises; the dismantlement of the funded pension system, restriction on market competition and reduction of predictability and enforcement of law. Since the beginning, these changes have been motivated by the belief of Fidesz leadership that a strong state authority that monitors selected sectors of the economy (e.g. banking, energy) and favors chosen domestic enterprises, preferably those most sympathetic to the ruling camp, promotes the rapid growth of the economy. The sole source of this belief was their ideology. Results of numerous studies and experiences of other countries show that countries with a dominant private sector, with transparent and steady conditions for the development of a competitive market for all operators irrespective of the country of origin of their owners and with stable and predictable legal rules, develop on average faster than countries where these principles are limited. Under V. Orban, Hungary recorded an alarming decline in quality assessment of institutions affecting the competitiveness of the economy, such as the protection of property rights, the scope of competition on the domestic market, the independence of the judiciary, or government favoritism in the economy.

Beside many harmful economic decisions, the government of V. Orban took care to maintain a limited public finance deficit, and in result to gradually decrease the amount of public debt in relation to GDP. The achieved reduction of the deficit, however, would not be possible without the reforms introduced by his predecessor, i.e. the government of G. Bajnai. Despite harsh criticism of his predecessor, after winning elections, V. Orban upheld and continued his most important reforms (for example increase of the retirement age for both sexes to 65 years, the elimination of thirteenth pension and thirteenth salary in the public sector). Moreover, although the economic policy of Fidesz is often described as unconventional,

mainly due to the introduction of new sectoral taxes, it is in many ways no different from standard recommendations on economic policy formulated by international institutions.

As an example may serve lowering direct taxes (PIT and CIT), offset by higher revenue from taxes on consumption (VAT). Although major changes in the structure of tax revenue in Hungary were implemented by the government G. Bajnai (increase of the VAT rate from 20% to 25% and reduction of non-wage labor costs from 43.9% to 36.7% for families with children, receiving average salaries), nonetheless, Fidesz continued this direction of reform. In 2011 the VAT rate was raised from 25% to 27%
At the same time, the tax wedge for families with children was reduced from 36.7% to 33.0%. This decrease in non-wage labor costs was the result of the introduction in 2011 of tax-free amount dependent on the number of children. As a result, the tax benefit produced by the first and second child increased in Hungary by approx. 140 zł per month, and tax savings from the third and subsequent children by approx. 470 zł per month. Pro-family policy in Hungary reinforces the incentives for legal work because only officially earned income allows to take advantage of the preferential tax-free amount. Unlike in Hungary, pro-family benefits paid in Poland under the program 500+ weaken incentives to work.

The tax reforms of the Bajnai government, continued and supplemented later by V. Orban, helped to reduce the deficit and public debt. In 2012 the public finance deficit fell to 2.3% of GDP compared to 5.5% of GDP in 2011, which allowed the European Commission to lift the excessive deficit procedure. According to the recent forecasts of the European Commission (November 2016), the public finance deficit in Hungary is to remain at approx. 2.0% of GDP up to 2017. For comparison in Poland the public finance deficit in the years 2017-2018 - despite the projected economic prosperity - is expected to increase to approx. 3% of GDP.

In 2010-2015, Hungary's public debt fell from 80.0% to 75.8% of GDP, and a significant impact on this decline was made by the acquisition of private capital savings from capital pension funds in 2011. However, while Fidesz inscribed in the constitution the debt rule, which obliges the parliament to adopt budgets which reduce public debt to 50% of GDP, after winning the elections PiS dismantled expenditure rule that would limit spending in good economic times.

Despite the above-mentioned favorable changes in the structure of tax revenues and despite taking care of fiscal discipline in Hungary, in 2016 - that is after more than six years in power - there is no reason to believe that the government's economic policies of V. Orban are a success.

Firstly, from 2008 (the last year before the outbreak of the global financial crisis) until 2015 GDP in Hungary increased in real terms by only 3.2% - it is the lowest product growth among the countries of the Visegrad group. For comparison in Poland in the same period GDP grew in real terms by 23.7%, in Slovakia 12.2%, and in the Czech Republic by 5.3%. Admittedly in the years 2013-2015 the Hungarian economy grew at an average rate of 3.0% per year, but the major impact on this recovery had public investments co-financed from EU funds. During this period, public sector investment grew at a rate of approx. 25% per annum and its value in 2015 was more than twice higher than in 2008. With the completion of the EU projects in 2016, the growth rate of total investment in Hungary strongly slowed down: in the quarters Q1-Q3 of 2016 the gross fixed capital formation fell by an average of 12%.

Secondly, in 2015 the value of private sector investment was as much as 24% lower than in 2008, and this was also the biggest decline among the countries of the Visegrad group. In Poland during this period private sector investment increased by a total of 19.7%, while in Slovakia fell by 12.8%, and in the Czech Republic by 8.6%.

Thirdly, although Hungary under V. Orban recorded a strong improvement in the labor market (the employment rate increased from 60% to 69% among people aged 20-64 years), it was mainly due to lower non-wage labor costs introduced by the government of G. Bajnai, as well as the strong growth of employment in public works, which are a very inefficient way to permanently increase chances of employment. Counting subsidized employment, in 2015 employment rate in Hungary for persons aged 20-64 years would be 65.6%, that is more than three pp(percentage points) lower than official statistics.

The disappointingly low rate of growth of the Hungarian economy since V. Orban came to power, in particular the deep collapse in private sector investments, and only short-term economic recovery in the years 2013-2015 driven by EU funds, should be a strong warning signal for PiS to avoid the mistakes made by Fidesz. Unfortunately, up to now PiS government has been replicating harmful decisions of Fidesz (e.g. it increases the control of politicians over enterprises, weakens the quality of institutions that are the key to the stability of the business environment and, consequently, to the growth of investments), without repeating solutions that are beneficial for the growth of the economy (e. g. the extension of the retirement age).

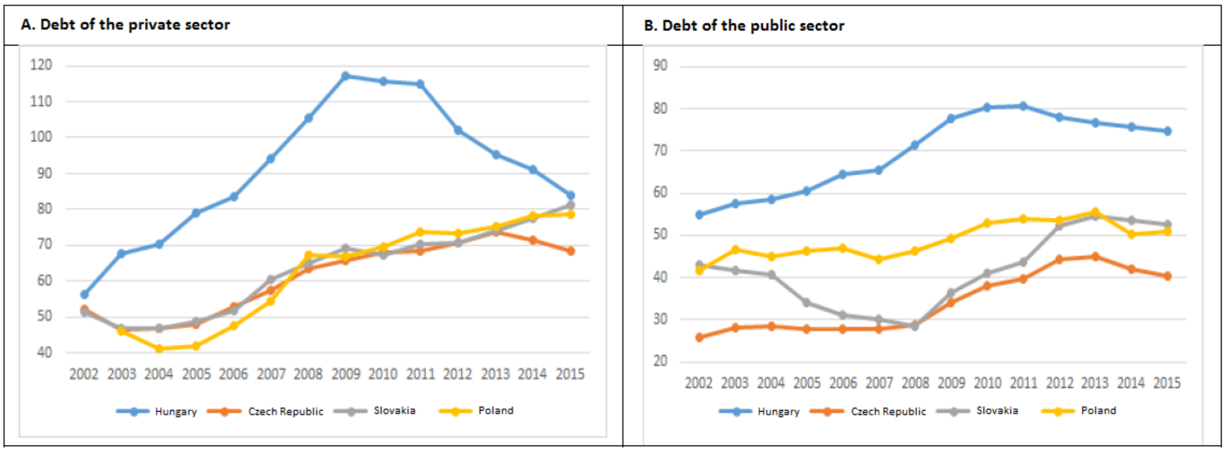
1. The initial conditions of the economy, that is, what V. Orban inherited from his predecessors?

After Fidesz won parliamentary elections in 2010, V. Orban's government took over the Hungarian economy, whose meager prospects for development were primarily the result of excessive indebtedness of the private and public sectors.

In the years 2003-2009, the debt of the private sector in Hungary has increased from 67.6% to 117.0% of GDP, that is by nearly 50 pp. (Figure 1a). For comparison, in the same period, the increase in private sector debts of other countries of the region was more than twice smaller: in Slovakia the ratio of private debt to GDP ratio increased by 22 pp (from 47% to 69.2% of GDP), in Poland by 21 pp (from 46.3% to 67.1% of GDP), in the Czech Republic by 20 pp (from 46.5% to 66.0% of GDP).

In the years 2002-2009 the increase in public debt in Hungary was also much stronger than in other countries of the region: from 55.0% to 77.8% of GDP, which was 22.8 pp. In Poland, in the same period, the ratio of public debt to GDP ratio increased from 41.8% to 49.4% of GDP, or nearly 8 pp, in the Czech Republic from 25.9% to 34.1%, an increase of 8.2 pp, while in Slovakia, public debt fell from 42.9% to 36.3% of GDP, by 6.6 pp. (Figure 1b).

Figure 1. Debt of the private sector and public debt in the period 2002-2015 (% of GDP)

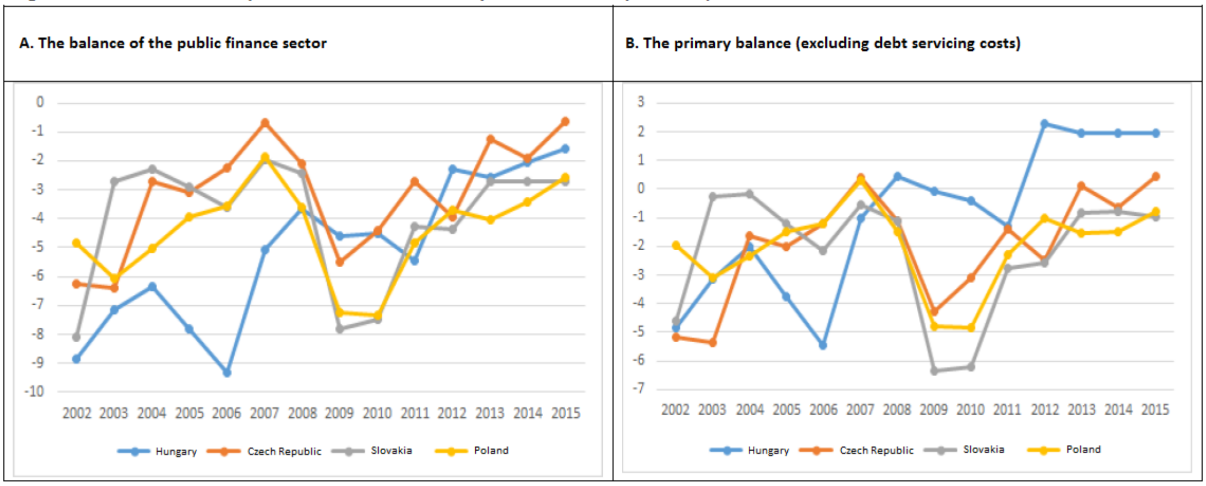


Source: own research, data: Eurostat

Strong growth of public debt in Hungary up to 2010 was a consequence of deep deficits in public finances, occurring since the beginning of the century. It is worth noting that V. Orban is responsible for the growth of that debt because in 2001 he initiated stimulation of the Hungarian economy by expansionary fiscal policy. The government that he headed pushed for a strong increase in public spending, as well as in the minimum wage (up to 60%!) hoping that will it give him victory in parliamentary elections in 2002. Although Fidesz lost these elections, nevertheless being in opposition it supported further increase in public spending proposed by the socialist government. For instance, in 2002 the salaries of people working in the public sector increased by more than 50%, and additionally they started to receive 13th salaries, and pensioners - 13th pensions. As a result, the public finance deficit increased by quite abruptly from 3.0% of GDP in 2000 up to 8.9% of GDP in 2002, and in 2006 it remained at a level exceeding 7.5% of GDP.

After the next parliamentary elections in 2006, which were won again by the socialist party, the new government began to balance public finances. For this purpose the tax on corporate income (CIT) was increased from 16% to 20%; preferential VAT rate was raised from 15% to 20%; state subsidies to the prices of electricity and gas were drastically reduced. Actions taken by the government of F. Gyurcsány managed to reduce the public finance deficit from 9.3% of GDP in 2006 to 3.6% in 2008.His government began to prepare additional reforms, among others of health care and higher education, introducing fees for doctor's appointment and college tuition. While in opposition, Fidesz constantly criticized the need to consolidate public finances, as well as questioned additional reforms proposed by the socialist government.

Figure 2. The balance of the public finance sector in the years 2002-2015 (% of GDP)



Source: own data: Eurostat

However, improvement of the state of public finances in Hungary in 2007-2008 was accompanied by only negligible economic growth. After the period 2002-2006, when the Hungarian economy grew by an average of 4.3% per annum, in 2007-2008 GDP growth slowed down to less than 1%. The reasons for the strong slowdown in economic activity was, among others, a significant reduction in public investment (by 14.2% in 2007 and 22.5% in 2008 versus the growth of 25.8% in 2006) but also a slowdown in private consumption (from 2.9% in 2006 to an average of 1.3% between 2007 and 2008).

A positive sign was, however, that the strong reduction of public sector investment was accompanied by a revival of investment in the private sector (approx. by 9% in 2007 and 6% in 2008). This suggests that initiated repairs of public finances lowered uncertainty and strengthened the incentives for companies to increase production capacity. The global financial crisis that began in the fall of 2008 halted the recovery of the Hungarian economy. In November of 2008, Hungary escaped bankruptcy thanks to the loan of 20 000 mln EUR, granted by the IMF, EU, and World Bank. The program of macroeconomic stabilization that the Hungarian government, led since the spring of 2009 by a new prime minister G. Bajnai, included a number of important reforms reducing the imbalance in public finances.

The most important measures, aimed at a rapid decrease in current public spending, were:

- elimination of 13th pensions (mid-2009);
- wage freeze and the elimination of the 13th salaries in the public sector;
- reduction of indexation of pension benefits to the amount of inflation (since 2010).
- increase in the basic VAT rate from 20% to 25%;
- elimination of subsidies from the budget to the cost of mortgage interest;
- elimination of subsidies for gas bills for low-income families;
- reduction of sickness benefits from 70% to 60% of salary.

In addition, the government G. Bajnai launched important structural reforms aimed at strengthening the incentives to work and consequently raising the very low employment rate (60.1% vs. 69.0% on average in the EU countries in 2009 for people aged 20 -64 years).

The most important were reducing non-wage labor costs and starting to raise the retirement age to 65 for both sexes.

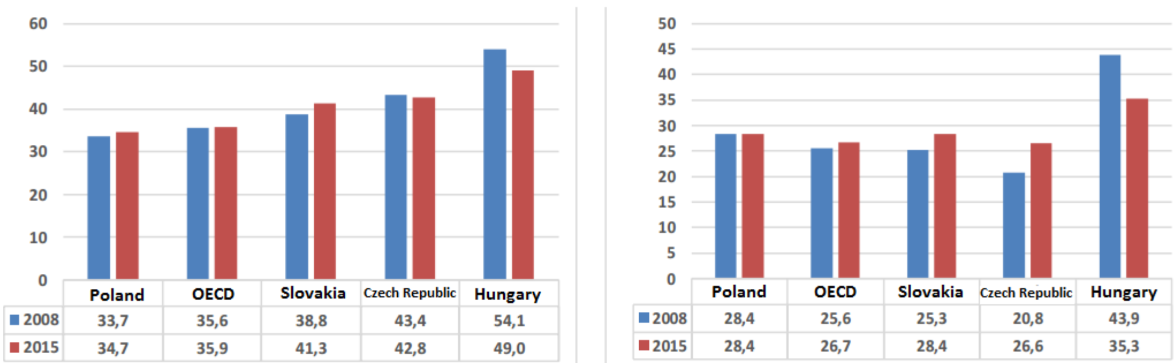
Reducing non-wage labor costs

The reduction of non-wage labor costs, pushed through by Mr. Bajnai, came into force at the beginning of 2010, just before the parliamentary elections that were won by Fidesz.

For employees without children, receiving average salaries, the tax wedge fell from 54.1% in 2008 to 46.6% in 2010 (by 7.5 pp.). Although in 2011 their non-wage labor costs increased to 49.5%[1], their overall reduction in Hungary over the years 2008-2011, was the highest among OECD countries[2]. Despite this, in 2015 the tax wedge in Hungary for people without children earning the average wage in the economy, was the fourth highest among the 34 OECD countries and surpassed the average for those countries by more than 13 ppt.

A significant decrease in the tax wedge in Hungary was also reported in the case of families with children. In 2008-2010, in families with one person working and two children, it had been reduced from 43.9% to 36.7% (i.e. by 7.2 pp), and it was also the biggest decline among all OECD countries. After the introduction by Orban in 2011of tax-free amount dependent on the number of children (see section 2.1), the tax wedge in such families fell by a further 3.7 pp to 33%. Despite this vast improvement (total decrease amounted to 10.7 pp!), in 2015 the tax wedge for families with children in Hungary was still more than 8 pp higher than the average in OECD countries.

Figure 3. Non-wage labor costs in 2008 and 2015 (% of total labor costs)



Source: OECD

Raising the retirement age

G. Bajnai government initiated a gradual increase of the retirement age. According to the law adopted in 2009, the retirement age for men and women increased from 62 years in 2012 to 65 years in 2022. In addition to the increase of the retirement age, they began to gradually raise the minimum age for early retirement and reduced their amount.

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[1] The increase in the tax wedge was due to the increased pension contributions, deducted from the employee's gross wage, from 9.5% to 10% and reduction of the tax-free allowance.

[2] The same decrease of the tax wedge for people without children earning the average wage in the economy was reported in 2008-2011 also in New Zealand, where the wedge fell from 20% in 2008 to 15.9% in 2011.

It should be noted that in 2009, Fidesz party, being in opposition, has consistently voted against all the reforms the government G. Bajnai that were socially unpopular, although beneficial for the growth of the economy and thus also for the growth of income.

But when in the spring of 2010 V. Orban became the head of the government, he upheld fundamental reforms introduced by the criticized predecessor, that is the raise of the retirement age to 65 years, the liquidation of 13th salaries in the public sector and 13th pensions. These reforms have had a significant impact on improving the state of public finances in Hungary, which occurred during the rule of V. Orban. Despite the recession in 2009 (a fall in GDP of 6.6%) and only a slight increase in 2010 (0.7%), the deficit of public finances in Hungary (4.6% and 4.5% of GDP) was among the lowest in the EU. In 2010 the public finance deficit adjusted for cyclical effects amounted to 2.7% of GDP and was 2 pp lower than in 2008 (4.7% of GDP).

Economic policy in Hungary after the victory of Fidesz in 2010.

After the elections, which took place in spring 2010, Fidesz party led by V. Orban, won a majority of seats in parliament, which allowed it to establish an independent government. In coalition with Christian Democratic People's Party (KNDP), Fidesz had the sufficient number of votes to change the constitution.

Fidesz's rule is the time in which the Hungarian parliament in an express mode, usually without any public consultation, implemented a number of significant legal changes. In the years 2010-2014 there were nearly 90 cases where the whole legislative process from introducing a draft bill to its adoption lasted no longer than a week[3]. In thirteen cases bills were adopted not later than on the next day.

Fidesz popularized a special kind of legislation in the legal system of Hungary, known as cardinal acts, whose adoption and - most importantly - subsequent change require the support of at least 2/3 of the Members of Parliament. In 1981 Orban openly admitted that the cardinal acts are to prevent or at least significantly hinder future governments from reversing the changes that he intends to implement. Fidesz enacted more than 30 such cardinal laws. Although initially they were to relate only to economic issues, in fact only six cardinal laws regulate economic issues, while as many as 15 of them relates to political and legal matters(Kornai, 2015). Cardinal acts changes have been made, among others, in the tax and pension systems, in family policy, but also in the electoral system. Before the parliamentary elections in 2014 Fidesz had reduced the number of deputies from 386 to 199, which was an opportunity not only to redefine the electoral districts but also to reduce the proportionality of the electoral system. As a result, despite obtaining in the election of 2014 8 pp fewer votes than in 2010 (44.9% vs. 53.1%), the share of Fidesz in parliament decreased only by 1.3 pp and amounted to 66.8% vs. 68.1% in 2010 (see Kornai, 2015 or the OSCE, 2014). Legal changes introduced by V. Orban are therefore maintaining a high share of Fidesz deputies in the Hungarian parliament even if it loses the support of society.

[3] Sceppele 3, 2012 after: Kornai, 2015.

The following are the most important changes in the economic policy of Fidesz since 2010 from the point of view of their impact on the balance of public finances and growth rate of the Hungarian economy.

Changes to government revenues

The reduction of direct taxes (PIT, CIT) and social security contributions

One of the key elements of the economic plan of Fidesz government was, as announced in the election campaign, reduction of income taxes. In this way, V. Orban wanted to increase household consumption and business investment spending and, consequently, to restore the growth of the Hungarian economy.

In 2010 in place of a uniform 16% corporate tax rate two rates were introduced: 10% for companies whose annual income does not exceed HUF 500 million (approx. PLN 7 million) and 19% for income above this threshold. In practice, this meant that the lower rate related to income generated by small and medium-sized, mostly domestic companies, in turn, a higher rate was paid by large companies, often owned by foreign investors. Since 2017, a uniform CIT rate 9% is to be introduced.

In 2011, in place of the two income tax rates (17% and 35%) there was introduced only one at 16%, and in 2016 it was further reduced to 15%.

In parallel with the lowering of income tax rates, the government introduced tax-free amount, depending on the number of children. For the first and second child this concession is HUF 62,500 (approx. 890 zł) per month, while for the third and subsequent child is more than three times higher and amounts to 206,250 HUF (approx. 2930 zł) per month. These amounts are deducted from the tax base, which means that increase in net income for the first and second child amounts to 10,000 HUF / month (approx. 140 zł), and for the third child and subsequent 33,000 HUF / month (approx. 470 zł). This tax credit applies since the fourth month of pregnancy. The introduction of tax-free amount dependent on the number of children aimed to strengthen the incentives to work legally, to make a decision about having a first or subsequent child, and at the same time to support household consumption. **This tax credit applies only to those who receive taxable income, which reduces the tendency to work in the informal economy**. Since 2014, families whose total income tax is not sufficient to fully take advantage of the tax-free amount can deduct it from their social security contributions. **In the years 2016-2019 the Hungarian government plans to gradually double the amount of tax-free amount for the third and subsequent child.**

In addition to reducing income tax rates, the government of V. Orban in 2013 reduced by half the social security contributions paid by employers who employ people under 25 and over 55 years of age. This move aimed to increase the demand for labor from groups for whom it is hardest to find jobs. In addition, contributions were reduced for employers of long-term unemployed people, parents returning to work after maternity leave and those just starting their careers. For these categories employers do not pay the insurance premiums at all for two years, and only half of the amount in the third year.

The increase in indirect taxes (VAT)

The loss of revenue from PIT and CIT V. Orban's government planned to compensate for higher revenues from indirect taxes. **As a result, in 2011. VAT rate was increased from 25% to 27%.** It was another increase in the corporate tax rate, after the government G. Bajnai picked it up earlier from 20% to 25%.Both governments have made, including significant changes in the structure of tax revenue, reducing their share of direct taxes and at the same time increasing the share of indirect taxes. In the light of the experience of other countries, this type of change should contribute to increasing the price competitiveness of enterprises, especially export, as sales abroad of goods is exempt from VAT.

New sectoral taxes

While the above changes in the structure of tax revenues - by strengthening the incentives to work and price competitiveness of businesses - have a positive impact on long-term growth rate of the economy, Fidesz has also imposed new taxes on selected sectors of the economy: the financial industry, telecommunications, energy and retail trade. Initially, they were to be temporary (and even called crisis taxes), but eventually became a permanent part of the Hungarian fiscal policy. Revenues from new taxes have a significant impact on improving the balance of public finances: in 2010-2011 they provide approx. 1.4-1.5% of GDP of additional revenues, while in 2013 to 2014 more than 2.0% of GDP (Table 1). A detailed description of the various sectoral taxes is presented in the Annex.

Sectoral taxes restrict the predictability of the tax system, as they provide a mechanism for politicians for "manual control" of the economy by influencing the decisions of companies from selected industries. For example, highly progressive tax on retail trade dependent on turnover (which finally was abandoned) was directed against large retail chains, most often owned by foreign investors, while at the same time favor small shops, usually run by local entrepreneurs. In turn, the tax on bank assets was a way to take over a portion of the profits from this sector. This tax, however, inhibits the willingness of banks to increase lending and, consequently, limits the growth of investments and long-term growth rate of the economy. As a result, long-term costs in terms of slower GDP growth outweigh the short-term benefits from the reduction of the deficit. The strategy of balancing public finances carried out by V. Orban resulted from political calculation. First, the EU's excessive deficit procedure focuses on the level of fiscal imbalance, rather than on the foundations of economic growth. Second, also the major rating agencies attach great importance mainly to short-term fiscal indicators.

Table 1. Sectoral tax receipts in Hungary in the years 2008-2016.

	2008	2009	2010	2011	2012	2013	2014	2015	2016 **
The financial sector	**0,05**	**0,05**	**0,71**	**0,70**	**0,33**	**1,47**	**1,48**	**1,17**	**0,92**
Tax on financial institutions	-	-	0,67	0,66	0,30	0,46	0,46	0,44	0,25
Additional tax from financial institutions	0,05	0,05	0,04	0,03	0,03	0,06	0,06	0,03	0,02
Financial transaction	-	-	-	-	-	0,86	0,86	0,61	0,57
Tax on insurance companies	-	-	-	-	-	0,09	0,09	0,09	0,08
Other sectoral taxes	**0,00**	**0,16**	**0,72**	**0,76**	**0,75**	**0,66**	**0,56**	**0,56**	**0,53**
Additional tax income from energy companies	-	0,09	0,06	0,06	0,02	0,18	0,11	0,12	0,12
Tax utility providers	-	-	-	-	-	0,18	0,17	0,17	0,15
Tax telecommunications	-	-	-	-	0,04	0,16	0,17	0,16	0,16
Tax on advertising	-	-	-	-	-	-	0,01	0,02	0,03
Other sectoral taxes sectoral	-	-	0,56	0,61	0,58	0,03	0,00	0,00	0,00
Tax on company cars	-	0,07	0,10	0,09	0,11	0,11	0,10	0,09	0,08
Total (% of GDP)	**0,05**	**0,21**	**1,43**	**1,46**	**1,08**	**2,13**	**2,04**	**1,74**	**1,45**

Source: Own calculations based on MSO.

Changes in public spending

Reducing social transfers

Among measures reducing the public finance deficit, V. Orban government decreased some social transfers, which was to strengthen incentives to work. The most important of them was reducing sickness benefits and social benefits to a level below the minimum wage.

An important change was the shortening of the right to unemployment benefits from 9 to 3 months while offering further financial assistance only under the condition of participation in public works. The remuneration of persons employed in these programs was lower than the minimum wage and at the same time higher than the social benefits (more on public works - see section 2.5).

Reducing early retirement

In 2012, V. Orban abolished the system of early retirement. The possibility of early acquisition of pension rights is allowed only to women with at least 40 years of pension contributions. A similar reform in Poland was implemented by the government of Donald Tusk in 2009.

Tightening of the pension system

V. Orban's government tightened the criteria for granting disability pensions and in result the number of newly granted disability benefits fell by almost half compared to the level before 2010. In addition, some pensioners lost the right to benefits, because after verifying their state of health they were proclaimed as able to work.

The introduction of constitutional rule on public debt

Although in 2010 V. Orban's government has restricted powers of the Fiscal Council, established in 2009 in order to consolidate the effects of the reforms introduced by the government G. Bajnai, in the same year it adopted a constitutional limit to public debt at 50% of the GDP (in force since 2012.). According to this rule, the parliament may not accept budget laws that would increase the ratio of public debt to GDP if it stands over 50%. In 2010, when this amendment was adopted, public debt in Hungary amounted to 80.5% of GDP.

The takeover of savings accumulated in the capital part of the pension system

In addition to these beneficial reforms, which contained public spending weakening the incentives to work, the government of V. Orban abolished the capital part of the pension system, which is detrimental to the collection of domestic savings and, consequently, also to the long-term growth of the economy. In 2010 those belonging to private capital pension funds received an offer they could not refuse: either they transfer the funds accumulated in the funded pillar to the PAYG state pension scheme, or they lose the right to a public pension guaranteed by the state. As a result, almost all employees (97%) have transferred their savings to the state system. It contributed not only to a decline in the public debt but also allowed to reduce current public spending on refund of contributions transferred to the pension funds by approx. 1% of GDP. The absence of that refund did not mean real savings, but only faster than ever increase of future pension obligations of the state, that is of hidden debt.

Although the value of the nationalized assets of the pension funds was the equivalent of approx. 11% of GDP, for the direct repayment of debt V. Orban government allocated only less than half of this amount (approx. 5% of GDP). The rest of the funds were used to finance current public expenditure (e.g., 2% of GDP was allocated to cover the current deficit in the pension system) or on the redemption of shares in several private companies from energy and banking sectors (see section 2.4). In 2012, because of the weakening of the forint and the increase in value of debt denominated in foreign currency, ratio of public debt to GDP decreased, comparing to 2011, by only 2.5 pp.

1.1 The deterioration of the institutional system

During the rule of V. Orban, Hungary recorded a strong drop in ratings of their protection of property rights. According to the Global Competitiveness Report (GCR), an annual ranking of nearly 140 countries compiled by the World Economic Forum, in the years 2008-2016 the position of Hungary in the field of protection of property rights decreased from 46th to

134th place (down by up to 88 places!) A sharp decline in ratings in this category was also recorded by Slovakia, ruled for decades - but for a short break- by populist R. Fico: it dropped down from 45th place in 2006 to 79th in 2016. (Figure 4a). It is worth noting that a decade ago Hungary and Slovakia were the regional leaders in the field of protection of property rights. Significant deterioration of the ratings of Hungary was also in the independence of the judiciary (Figure 4c). According to GCR rankings, in this category Hungary dropped from 55th position in 2008 to 102nd position in 2016. (A drop of 47 places!). It is significant that the assessment of the independence of justice has also strongly deteriorated in Slovakia (down from 76th to 120th position). In comparison to other countries in the region, Hungary and Slovakia are also evaluated less favorably in respect of favoritism of chosen enterprises by the government (Figure 4d).

Figure 4a. Protection of property rights in the new EU member states

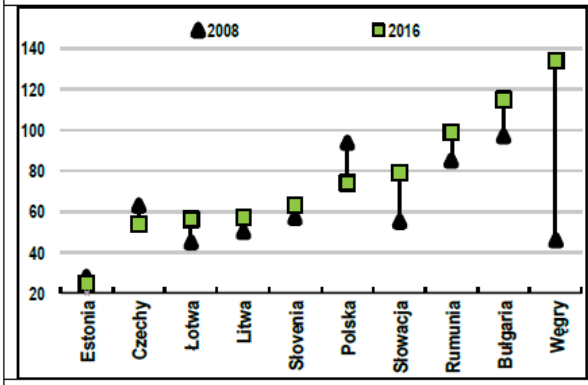


Figure 4b. The strength of competition in the domestic market in the new EU member states

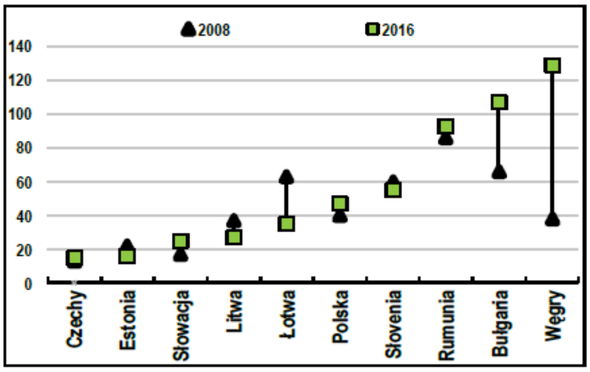


Figure 4c. Independence of the judiciary in the new EU member states

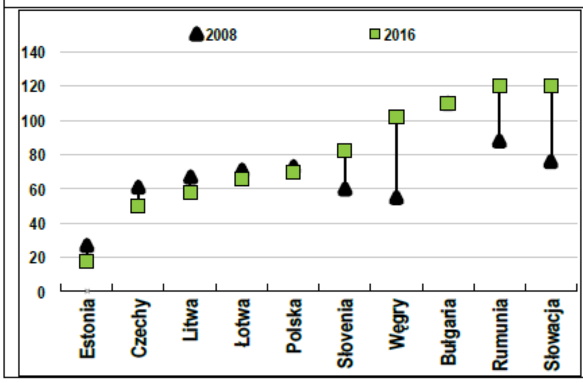
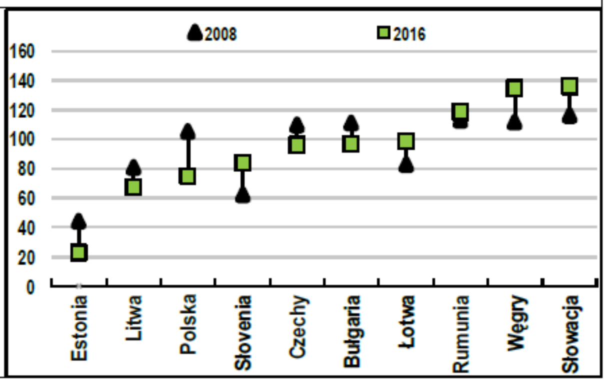


Figure 4d. Favoring certain operators in the decisions of the government in the new EU member states



*Figures represent the position of individual countries in the GCI rankings: the higher the value, the further in the ranking.
Source: Global Competitiveness Report, World Economic Forum

1.2 Growth of statism and state ownership in enterprises

Orban challenged the existing social and economic model, in which the central place occupied democratic system of political power and the free market economy with the dominant role of private property. In 2014 Orban stated that exemplary models for Hungary to follow are Russia, Turkey, and China, that is authoritarian countries with a high proportion of enterprises controlled by the central government.

Fidesz often justifies its policy as defending the traditional national values, but in practice it boils down to increasing direct control over companies, including the acquisition of companies that were already privatized. It includes energy companies, banks, and media. In many cases, private owners were put in a situation where they had virtually no other option but to resell their shares either to the state or people associated with Fidesz, often for less than market value.

Nationalization of companies was used by Fidesz for specific political purposes.

. The acquisition of shares in energy companies, previously sold to foreign investors (including MOL and E.ON) helped Orban in lowering in 2013 prices of electricity, gas and central heating for households by 20%. This price reduction had a significant impact on support for Fidesz in parliamentary elections in the spring of 2014.

. The acquisition of some banks, in turn, was aimed to support lending to Hungarian companies.

. Fidesz control over the media (e.g., the politicization of state radio and television stations) was a key tool for spreading government propaganda. State media are obliged to use the messages and materials produced by the national news agency. Private media can, of course, use the information supplied by independent agencies, but the materials of the agency controlled by Fidesz are available for free. It is to encourage the dissemination of information prepared by the government agency.

. To restrict independent media, in 2014 Fidesz adopted a progressive tax on advertising (from 0% to 50%), the main source of revenue for private media. In practice, due to the thresholds, the highest rate of this tax would apply to the station RTL, independent of the government, which had often criticized decisions of Fidesz. However, in 1981 the European Commission initiated a procedure for clarifying whether a tax on advertising does not infringe EU competition rules. Despite lowering its rates by Fidesz to a maximum of 5.3% in November 2016, the EC declared this tax incompatible with the EU regulations on competition and prohibited its collection.

Politicization of the Hungarian economy is also manifested by growing oligarchization of the state involving, among others, preferential treatment in public procurement of companies whose owners are favorable to the government. In practice, it is Fidesz leadership that decides who can be oligarch and enjoy certain privileges from the government and who can maintain this informal status obtained earlier (see Kornai, 2015). Worsening of equal treatment of tenderers in public procurement can provide a strong decline in ratings of Hungary regarding favoring some operators in the aforementioned ranking of the Global Competitiveness Report. In the years 2008-2016 the Hungarian position in this ranking has dropped from 112th to 135th in the world (Figure 4d).

1.3 Public Works

The government of V. Orban widely expanded public works program for the unemployed, especially long-term unemployed. It is estimated that in 2012-2014 the number of people employed in this form increased by approx. 150 thousand, which accounted for more than half of the total increase in the number of employees recorded in the period (270 thousand.)[4] In 2014-2015 on average approx. 180-200 thousand. people, or approx. 5% of total employment were employed in public works.The vast majority of these people were employed in the public sector (approx. 90%), but some also worked in companies with dominant state ownership.

Participation in public works only very weakly increases opportunities for the unemployed for stable non-subsidized employment. Only 13% of people who participated in this program were subsequently able to find unsubsidized employment. The rest relied on social security benefits or waited for the next job in public works[5]. It means that employment growth achieved in Hungary as a result of public works is only apparent.

2. What are the effects of the V. Orban government's economic policy?

Analyzing the impact of V. Orban policy on Hungarian economic situation since the takeover of power in 2010, one need to take into account the initial adverse conditions (see Chapter 2), especially the excessive indebtedness of the private and public sectors. In this evaluation, one must consider two issues of fundamental importance.

Firstly, while in opposition in 2002-2010, Fidesz members voted for the increase in many cases of public spending, which eventually led to a significant increase in public debt and the collapse of the growth of the Hungarian economy in 2007. V. Orban thus bears the political responsibility for economic stagnation, which occurred in Hungary in the early years of his rule.
Secondly, in 2009 Fidesz members voted against the reforms G. Bajnai government, which aimed to restore the sustainability of public finances. And although, already during the rule of V. Orban's, public finance deficit in Hungary decreased significantly, fundamental reforms, often socially unpopular, such as increasing the retirement age, the elimination of thirteenth pensions and salaries in the public sector, were adopted in the face of Fidesz' opposition and criticism.

The amendments adopted and implemented by the team of V. Orban after 2010 should be divided into two groups.

The first of them - positive - are reforms that stabilized public finances and at the same time strengthened the foundations of economic growth. To this group belong first of all:

- **lowering of PIT and CIT rates, compensated by increased revenues from VAT** - in the light of economic theory and international experience, such a change in the structure of tax revenues should contribute to the growth of labor demand and investment demand in countries like Hungary, which have a relatively small domestic market and are highly dependent on export demand;
- **introducing of pro-family bonuses dependent on the number of children** - which strengthened incentives to work legally in large families;

[4] Hungarian Labor Market 2015, (Fazekas K., J. Varga, eds) p. 10.
[5] Ibid.

- **reducing social transfers** - disability pensions, social and unemployment benefits;
- **reducing early retirement** - in addition to gradual raise of the retirement age to 65 years, inherited from the government G. Bajnai, this reform restricted exit from the labor market by those under the retirement age, and as a result complemented actions aimed at increasing the labor supply;
- **introducing of constitutional rule on public debt** - if the public debt exceeds 50% of GDP, the bill does not allow to adopt a budget that would lead to its increase.

The second group - harmful - comprises the changes, that - although improving the current balance in the public finances- also weakened the foundations of the long-term growth of the economy. It includes:

- **the takeover of savings accumulated in private pension funds** - this move did not decrease the state pension liabilities, but only reduced the current public spending, while increasing the rate of growth of hidden debt. After reducing current budget expenditure on the refund of pension contributions, the pressure was reduced on financial markets to permanently balance public finances. The takeover of private pension savings undermined confidence in the legal protection of private investment;
- **imposition of taxes on selected sectors of the economy**, usually those with a large share of foreign capital - these changes reduced readiness to invest in the private sector. Taxes imposed on banks limited their willingness to provide new loans.
- Other factors weakening the long-term growth rate of the economy are also:
- **increasing the power of politicians over enterprises** - increased state ownership in some sectors (e.g., banking, energy) due to purchase of shares in private companies distorts market competition and leads to a decrease in the efficiency of companies controlled by politicians. In the case of the banking sector, the growth of state property creates the risk of granting ill-considered loans and ultimately of a crisis in the financial sector;
- **public works** - subsidized employment program increased indeed the number of employees, but due to the low efficiency of public works, the observed improvements in the labor market is only apparent.

Deterioration of the quality of institutions relevant to investment decisions might have been largely responsible for the stagnation of private sector investment. During the rule of V. Orban, expenditure on fixed assets in the private sector rose only in 2013-2014 (by approx. 5% per annum), and their pace of growth was several times smaller than in the public sector (approx. 25% per year). Moreover, as early as 2015, private sector investment fell by 6%. In the years 2008-2015 the value of private investment in Hungary shrank by a total of 25%, while e.g. in Poland increased by 20% in the same period (Figure 5a). The increase in private investment in Poland at the time was, after Ireland (25%), the second largest in the EU. It appears, therefore, that despite the economic upturn observed in Hungary between 2013-2015, when the average annual GDP growth rate was approx. 3%, the private sector was not willing to increase investment. This recovery was driven almost exclusively by EU money and therefore had a fragile basis and as a result turned out to be short-lived. The inflow of EU funds for Hungary in relation to GDP was in those years the largest among the new EU member states[6]. The result was a significant increase in public investment, whose share in GDP increased from 4.4% in 2013 to 6.6% in 2015. In the period 2013-2015, public investment grew in real terms at an average rate of approx. 25% per annum and their value in 2015 was more than twice higher than in 2008. (Figure 5b).

The instability of the recovery of the Hungarian economy, which was not accompanied by an increase in private sector investment, may be attested by the fact that in 2016, when projects co-financed from the old financial perspective were completed, total investment recorded a sharp fall. In the period of January-March 2016 total investment shrank in Hungary at an average rate of approx. 12% y/y.

Figure 5a. Public investment in Hungary and in Poland in the years 2008-2015 (2008 = 100)

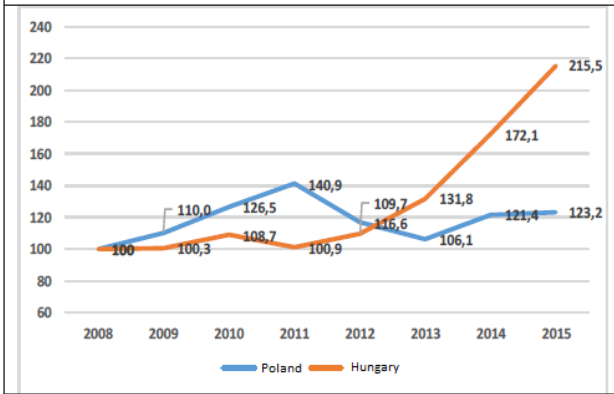
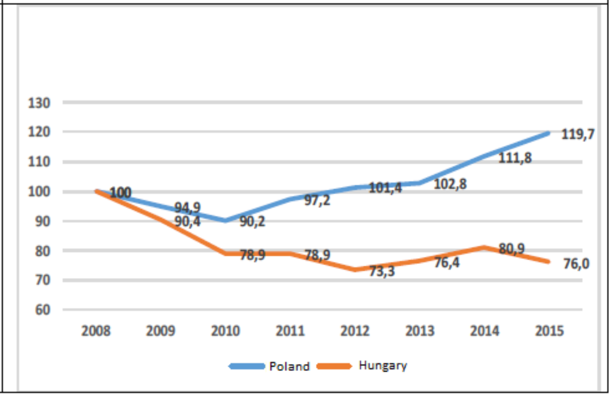


Figure 5b. Private investment in Hungary and in Poland in the years 2008-2015 (2008 = 100)



Source: own data: Eurostat

Contrary to Fidesz propaganda, the condition of the Hungarian economy, especially the short-term economic recovery observed there in the period 2013-2015, does not give grounds to assert that economic policy V. Orban has succeeded in restoring sustainable growth of the economy. GDP growth in Hungary in 2008-2015 was the lowest compared to other countries in the region. In 2015 the real size of GDP was only 3.2% higher than in 2008 (the last year before the outbreak of the global financial crisis). For comparison, in Poland in the same period real GDP increased by 23.7% and in Slovakia 12.2% (Figure 6a). Also, labor productivity in Hungary in 2008-2015 grew slowly, compared to other countries in the region. It increased merely by 3.7%, while e.g., in Poland productivity grew by 13.7%. (Figure 6b).

[6] European Commission, Country Report Hungary 2016 SWD (2016) 85, p.14.

Figure 6a. GDP in the CEE countries in the years 2008-2015 (2008 = 100)

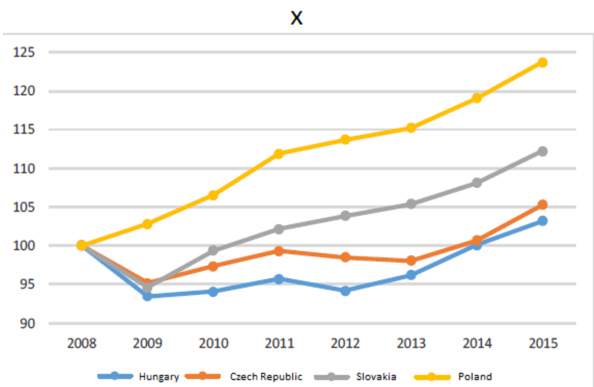
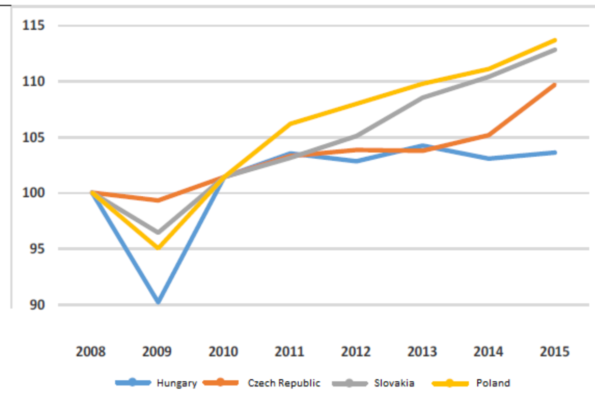


Figure 6b. Labor productivity - per hour worked in years 2008-2015 (2008 = 100)



Source: own, data: Eurostat

During the government of V. Orban in Hungary there has been a clear improvement in the labor market. In 2010-2015, the employment rate of men aged 20-64 increased from 65.5% to 75.8% (i.e., by 10.3 pp), and women in the same age group from 54.6% to 62.1% (i.e., 7.5 pp.). In 2015 the employment rate for people aged 20-64 was as (68.9%) of almost the same as the average in Western Europe (70.5% in the EU-15). The increase in the employment rate in Hungary has several causes.

- Firstly, it is the result of the reduction of non-wage labor costs and extending the retirement age, that is moves which have been prepared and adopted by the Hungarian Parliament in 2009 in the face of opposition from Fidesz. Fortunately after winning the election, V. Orban did not abandon these reforms.

- Secondly, employment growth was also stimulated by the reforms introduced by the government Orban, mainly reducing unemployment benefits from 9 to 3 months, making tax-free amount dependent on the number of children in the family (which strengthened incentives to work in large families), as well as elimination of early retirement and tightening of conditions for disability pensions.

- Thirdly, the growth rate of employment in Hungary was also supported by large-scale public works. In this case, the observed increase in the employment rate is not permanent, because the effectiveness of public works in increasing the chance of a worker to find unsubsidized employment is very low. The strongest increase in the employment rate of people aged 20-64 took place in Hungary in 2013-2015 (by 7.3 pp), so during the period of the greatest deployment of public works. Excluding subsidized employment, in 2015 the employment rate in Hungary for persons aged 20-64 years would be 65.6%, that is more than 3 pp lower than official statistics.

The greatest achievement of V. Orban's government was to reduce the public finance deficit below 3% of GDP and to maintain fiscal discipline. This success would not have been possible without fiscal reforms introduced by the former government of G. Bajnai, upheld afterward by Fidesz.The decrease in the deficit was also supported by the changes of V. Orban. Among them, there were the reforms limiting social transfers, which strengthened the long-term growth rate of the Hungarian economy. But Orban has also introduced sectoral taxes and abolished the capital portion of the pension system, which indeed helped to balance state finances, but also weakened the growth prospects of the economy in the long run. These unconventional moves improved the current balance of public finances by a total of approx.2.5% - 3.0% of GDP, which reduced the deficit from 5.5% of GDP in 2011 to 2.3% of GDP in 2012. As a result, in mid-2013 the European Commission lifted its excessive deficit procedure from Hungary. According to recent forecasts of the European Commission (November 2016), up to 2017 the public finance deficit in Hungary is to remain at approx. 2.0% of GDP.

During the rule of Orban, Hungary's public debt fell from over 80% of GDP in 2010 to 75.8% of GDP in 2015. Although Fidesz limited the powers of Fiscal Council established in 2009, it also introduced the rule reducing public debt to the Hungarian Constitution. As long as the public debt exceeds 50% of GDP, the parliament cannot adopt the budget, the implementation of which would lead to the growth of the ratio of public debt to GDP. Among the positive changes one can also mention the gradual withdrawal of Hungary from the taxation of bank assets, started in 2016.

3. Comparison of economic policy of Fidesz in Hungary and of PiS in Poland

On the basis of statements, initiatives, and specific decisions presented by representatives of PiS it can be concluded that the economic policy pursued by V. Orban in Hungary since 2010 is an important source of inspiration for the current ruling team in Poland. Careful analysis shows that despite many similarities, in many critical areas economic decisions of V. Orban fundamentally differ from those pushed in Poland by the government of B. Szydło. Below are the main similarities and differences between the economic policies of Fidesz and PiS.

3.1 The similarities in the economic policies of Fidesz and PiS

Liquidation of capital pension funds

In 2011 V. Orban's government in 2011 introduced forcible transfer of savings accumulated in private pension funds to the state PAYG system. It is worth recalling that although the first stage of OFE (Open Pension Funds) marginalization in Poland was done by the PO-PSL government, PiS did not oppose the change[7]. The proposal of Deputy PM M. Morawiecki is a de facto announcement that the dismantling of OFE launched by the PO-PSL government will be completed.

In mid-2016 Deputy PM M. Morawiecki announced the final liquidation of private equity funds: in 2018 25% of pension fund assets will be moved to the Demographic Reserve Fund (DRF), which will de facto reduce the amount of budget subsidies to the Social Insurance Fund, while the remaining 75 % of assets will be temporarily taken over the management of the Polish Development Fund (PFR). Although these funds are to become fully private, for two years they will be invested by the politicized PFR. There is, therefore, a serious risk that investment decisions will be taken according to political criteria (e.g., of investing in mining companies or energy) rather than on the basis of the expected long-term returns.

[7] Votes of PiS deputies in 2013 against changes in the OFE were an expression of their opposition to the PO-PSL government, not a protest against the reduction of the capital part of the pension system in Poland. They strongly criticized the system of funds in the debate on these changes.

The increase of state ownership in the economy (take-over of private companies)

V. Orban's government increased the state's participation in selected sectors of the economy. In 2012 he stated that at least 50% of the assets of the banking sector should be in Hungarian hands, while at that time the share was approx. Within less than three years the Hungarian government bought shares in four banks from their foreign owners, as a result of which the share of the Hungarian capital in the banking sector assets exceeded 50%.

A twin strategy of bank repolonizations is also implemented by PiS. Acquisition of shares in foreign banks by the institutions dependent on politicians began during the rule of PO-PSL. Even since before the election, in mid-2015 PZU has signed a letter of intent for the purchase of 25% shares of Alior Bank. In 2016 Alior took over part of BPH bank and negotiated the purchase of Raiffeisen Bank. At the end of 2016 talks ended about an acquisition by PZU and Polish Development Fund of a controlling stake in Bank Pekao from the Italian Unicredit. International experience shows that the politicization of the banking sector usually leads to serious turbulence in the financial sector. That happened for example in Lithuania (1995-1996), Bulgaria (1996-1997) and most recently in Slovenia (after 2012).

The increase of the impact of PiS politicians on the
functioning of enterprises also applies to state-controlled energy companies, which are forced to rescue unprofitable mining sector. It results in a strong decline in the share prices of energy firms and reduces their possibility of obtaining financing for necessary investment, which ultimately will most likely lead to higher electricity prices.

Attempts to introduce a tax on retail trade

So-called food chain inspection fee, with a progressive structure for FMCG shops, introduced in Hungary early 2015, was in July 2015 challenged by the European Commission as state aid for small traders. The EC recommended that Hungary suspends collection of this tax until the investigation is completed. The Commission alleges in particular that the cost of food control increases with the increase in the turnover of shops, which was considered illogical. A similar argument concerned the progressive charge on the sale of tobacco products, the amount of which increased with the amount of cigarette sales. Officially, it was a charge introduced as a contribution to redressing harmful effects of tobacco. The Commission pointed out, however, that the harmfulness of smoking cannot be greater when you buy them in big stores. In October 2015 V. Orban's government prepared amendments to the Act, which replaced the strongly progressive tax on trading, disputed by the EC, with a flat rate of 0.1% of net sales for all stores.

Although in September 2016 Poland introduced a progressive tax on retail trade (0.8% of revenue from 17 to 170 million zł per month and 1.4% on income above 170 million zł per month), it was almost immediately challenged by the EC. As a result, the collection of this tax was deferred in Poland until 2018.

3.2 The differences in the economic policies of Fidesz and PiS

Fidesz maintains a relatively low public finance deficit

After the EU's excessive deficit procedure was lifted in 2013, in the subsequent years Hungary maintained a general deficit of approx. 2% of GDP, and thus significantly lower than 3% required by the EU.

In Poland, however, after lifting the excessive deficit procedure in 2015, an increase fiscal imbalance is forecast. According to recent government estimates, the public deficit in Poland in 2017 will amount to 2.9% of GDP, staying only symbolically below 3%, required by the EU regulations. The European Commission estimates that in 2017 fiscal deficit in Poland will grow to 3.0% of GDP and in 2018 to 3.1% of GDP (European Commission, Autumn 2016).

Fidesz is committed to continuous reduction of public debt in relation to GDP

V. Orban's government in 2010 entered the debt rule into the amended constitution, which obliges the parliament to legislate the budget that will reduce the public debt to 50% of GDP.

Meanwhile, in Poland, just after the elections at the end of 2015, PiS government significantly weakened the spending rule. The projected growth rate of inflation, which, in accordance with the original version of the rule was to limit the growth of public spending, has been replaced by NBP inflation target (2.5%). Under the conditions of deflation or inflation, which in the coming years will probably fall below the NBP inflation target, such a change de facto switched the rule off. And it is now, during the still relatively good times, that this rule should reduce the rate of growth of public spending.

Fidesz starts to reduce the tax on financial institutions

Although the government of V. Orban in 2011 introduced a tax on financial institutions at a very high level (0.53% of assets), since 2016 it began to decline it gradually (to 0.24% in 2016 and 0.21% from 2017 onwards). The main argument for the reduction is the need to stimulate lending in Hungary.

In Poland, meanwhile, in 2016 PiS introduced the tax rate on bank assets, at the rate of 0.44% of the assets per year, the highest in the EU[8]. This is twice higher than in Hungary.

It is worth pointing that some EU countries also impose bank tax but at rates much lower than in Poland. For example, in Germany, the rate of its bank tax is 0.02% to 0.06% of total assets less the value of equity and deposits. In practice, the base of taxation in Germany are therefore assets that finance loans. XXX The maximum value of the asset tax cannot exceed 15% of net profit. Importantly, the income of the bank tax in Germany does not contribute to the state budget, but to the bank restructuring fund.

8 More information: FOR Analysis: http://www.for.org.pl/pl/a/3784,Analiza-32016-Podatek-bankowy-rzad-szuka- finansowania-obietnic-wyborczych.

Fidesz continues to raise the retirement age

V. Orban's government continues gradual raise of the retirement age for women and men to 65 years, started by its predecessor G. Bajnai. Moreover, in 2012 it abolished early retirement, with the exception of women who have at least 40 years work experience as well as significantly tightened up the rules of the pension system. Meanwhile, PiS stopped the gradual extension of the retirement age to 67 years introduced by the government of the PO-PSL and restored the existing retirement age of 60 for women and 65 for men.

Fidesz made the children tax benefit dependent on professional activity of parents

Pro-family benefits introduced by Orban's government favors those families with children, whose parents are economically active. Meanwhile in Poland, family benefits paid under the program 500+ do not dependent on the parents' income from work. This creates a serious risk of withdrawal from the labor market of those poorly educated or living in economically underdeveloped regions.

Fidesz withdrew from the ban on Sunday trading

The introduction in 2015 ban on Sunday trading for stores with an area of over 200 m2 was justified by Fidesz by the fact that Hungarians will spend Sunday in a different way than in shopping malls. This ban, however, was very unpopular and opposed by the trade unions and employees of large stores. Just after a year, Fidesz withdrew from this regulation at an express pace in order to avoid defeat in the impending referendum on this issue. In Poland, meanwhile, the government supports the idea of a ban on Sunday trading. However, unlike in Hungary, the trade unions in Poland are in favor of this limitation.

* * *

Comparing the most important elements of economic policy in both countries shows that PiS replicates harmful decisions made in Hungary, such as the marginalization of the capital pension system, increasing political control over enterprises, or attempting to introduce a trade tax. At the same time, the PiS does not follow Fidesz in taking care of public finance discipline. In particular, in contrast to Fidesz, PiS government restored the low retirement age and dismantled the rule that limited the growth of public spending. Moreover, in contrast to Hungary, where the taxation of bank assets is gradually withdrawn, Poland imposed such a tax at the beginning of 2016. After a few months, it is clear that in result of this new tribute banks significantly increased the involvement in government bonds, which are exempt from tax, while reduced lending to the private sector.

The disappointingly low rate of growth of the Hungarian economy after V. Orban came to power, in particular a deep collapse in private sector investments, should be a strong warning to PiS.

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Appendix 1. Taxes sector in Hungary

Taxation of Financial Institutions

The biggest additional budget revenue was received by V. Orban government from the tax on bank assets and financial transactions.

In the years 2010-2015 the assets of banks up to 50 000 mln HUF (approx. 700 mln zł) were taxed at the rate of 0.15% per annum, while above this threshold at the rate of 0.53%. **Since the beginning of 2016 top bank tax rate was reduced to 0.24% per year, and since 2017 is to be 0.21% per annum.** In the years 2010-2015 the tax base was the size of the bank assets in 2009. It was important for the income generated from this tax because due to excessive lending in the past and the unfavorable prospects for growth of the economy, both businesses and households limited demand for credit, which resulted in a decrease in bank assets. Additional taxation of bank assets also could contribute to the deepening decline in their volume. In 2016 the base of bank tax is the size of banks' assets in 2014.

In 2012 the tax due on the bank assets could be reduced by losses incurred as a result of the early repayment of foreign-currency mortgage loans, repayable on preferential terms. **In 2013 insurance companies have been released from the tax on financial institutions, but immediately covered by a new, separate tax on insurance companies.**

In 2013 a tax on financial transactions was introduced in Hungary covering primarily transfers and cash withdrawals. Originally, it was to replace the tax on the assets of financial institutions existing since 2010, but eventually it became another tribute, which was to compensate for the loss of public revenue due to the reduction of PIT and CIT. Initially, all financial transactions are taxed at the rate of 0.2% of their value, and cash withdrawals at the rate of 0.3%. There was, however, the upper limit on the tax for each transaction in the amount of HUF 6,000 (approx. 85 zł). Due to very low receipts from this tax, as compared to previous assumptions, since August 2013 the basic rate of tax on financial transactions was increased from 0.2% to 0.3%, and on cash withdrawals from 0.3% to 0.6%. The upper limit of the tax on cash withdrawals was abolished (but maintained for other transactions). Strict taxation of cash withdrawals was intended to reduce the shadow economy. In addition, banks were obliged to a single annual fee amounting to 75000 mln HUF (approx. 1000 mln zł). **Analyses of the Hungarian central bank indicate that banks put the burden of additional costs associated with the tax on financial transactions on their customers** (MNB, 2013). Since this tax was assumed to be borne by the banking sector, not its customers, since February 2014, Hungarians can make two withdrawals in a month to a total amount of 150 thousand HUF (approx. 2100 zł), which free for from taxation, which is payable the bank itself.

Taxation of the energy sector

The tax on electricity producers (so-called Robin Hood tax) was introduced in Hungary in 2009 that is before the parliamentary elections won by Fidesz. It was to be in force only for two years until 2010, however it became permanent, like the tax on the assets of financial institutions. The basis for calculating this levy is the profit of energy companies before CIT tax. The rate of this tax in 2009-2012 was 8%, and was increased to 31% from 2013; those investments of power companies that increase the level of employment can be deducted from the tax basis. From 2013, this tax also covers companies distributing electricity and gas.

In 2013 a tax on distribution networks of electricity, gas, heat, water and sewage (the rate is 125 HUF per meter of the network), was introduced in Hungary, as well as telecommunication networks (the rates are progressive and range from 25 HUF to 125 HUF per meter of the network). **These levies are imposed only on private companies. Companies belonging to the state or local governments are exempted.**

Taxation of the telecommunications sector

In the middle of 2012, Hungary introduced a tax of HUF 2 per minute for all calls, and every SMS/MMS. Initially, the limit of these charges was set at HUF 400 per month for individuals and HUF 1,400 from companies. At the beginning of 2013 the monthly limit was increased to 700 HUF for individuals and HUF 2500 for the companies, and then from mid-2013 the rate for companies was increased from 2 to 3 HUF per minute for calls and SMS/MMS and the limit from 2500 to 5000 HUF.

Taxation and new regulations in retail trade

Since 2012 administrative restrictions were introduced concerning the construction or expansion of stores larger than 300 m2. However these restrictions do not apply to companies that received individual approval of the Minister of the Economy. **In practice this means that the construction of any major store in Hungary currently requires the consent of the Minister, which is an example of manual control of the economy.** In May of 2014, the European Commission launched the procedure for checking the conformity of this law with European law. Despite the intervention of EC, the law is still valid, but at the end of 2014 limit of store area covered by this regulation was raised from 300 to 400 m2.

In mid-March 2015 Hungary introduced a ban on Sunday trading, from which small shops run by the owner or members of his family were excluded. After a year, i.e. in April 2016. Hungarian parliament withdrew from this prohibition.

In 2012 sales tax on retail trade was introduced in Hungary, which provided for the progressive - dependent on turnover - tax on net turnover of shops, with rates from 0.1% to 2.0% (Table A1).

Table A1. The rates and thresholds of turnover tax applicable to trade in Hungary since 2012.

The rate of turnover tax	Thresholds net turnover
0.0%	To 500 000 mln HUF (70 mln zł)
0.1%	0.5 - 30 000 mln HUF (70 000 mln - 420 000 mln zł)
1.0%	30-100 000 mln (420 000 to 1 4000 mln zł)
2.0%	Above HUF 100 000 mln (1 400 mln zł)

From 2015, in place of the current tax on trade, there was introduced a fee for the so-called official control of food. This tax was to be highly progressive: the rates ranged from 0.1% to 6.0% of annual turnover. In parallel, since 2015, Hungary also introduced a fee for trade in tobacco products - progressive rate ranged from 0.2% to 4.5% of turnover (Table A2).

In July 2015, the European Commission launched the official procedure to check compliance of these progressive charges for food control, and of tax on trade in tobacco products with European competition law. These fees are designed in such a way as to charge the highest rates for the largest supermarket chains, owned mostly by foreign investors. For example, it was estimated that the German Spar, which - under the current tax on trade - paid annually approx. 320 mln HUF (approx. 45 mln PLN), in 2015 - under the new charge for the control of food - had to pay 30 times higher tribute of HUF 9 000 mln (approx. 1200 mln PLN).

Following the intervention of the European Commission in October 2015, Hungarian Government prepared amendments to the Act, which replaced the highly progressive tax on the food control with a flat rate of 0.1% of net sales for all stores.

Table A2. The rates and thresholds of food chain inspections fee in Hungary, which were to take effect from 2015.

The rate of so-called the fee for inspections of food	Thresholds of net turnover
0.1%	0.5 – 50000 mln HUF (7 mln – 700 mln zł)
1.0%	50-100 000 mln HUF (700- 1400 mln zł)
2.0%	100- 200 000 mln HUF (1400 – 2800 mln zł)
3.0%	200-250 000 mln HUF (2800 – 3500 mln zł)
4.0%	250 - 300 000 mln HUF (3500 – 5200 mln zł)
6.0%	300 000 mln HUF or more (5200 mln zł and more)

In 2015 a law was adopted which provides that, from 2018 large stores with an annual turnover of over 163 mln euro, that for two consecutive years record a loss, will be closed by law. This provision is intended to prevent a situation in which large retailers (e.g., Tesco, Lidl) show accounting losses and at the same time provide strong competition for small shops.

<u>Tax on advertising</u>

In the middle of 2014 Hungary introduced progressive taxation of income from advertising (without any deductions), with the highest rate of tax of 50%. In practice, this increase was to push the largest commercial television station RTL Klub (based in Luxembourg) to withdraw from Hungary. In March of 2015 the EC launched a procedure to control whether the strongly progressive taxation of income from advertising is compatible with EU competition rules, particularly as it is especially disadvantageous for the largest enterprises.

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