Another non-austerity program, or who is going to pay HUF397bn?

The Hungarians, as we learnt from our prime minister, are difficult to govern. It is a difficult task mainly because people always doubt the government's words (and good intentions). This is the case again now as a new package is announced that will reduce expenses and increase revenues without hurting anybody's interests (except the 1 per cent richest). Can this be true? Or again, the sceptics are right who say that once again the common people pay at the end?

Currently, **income and consumption of households are decreasing, investments are plummeting, and many businesses are living from day to day**. As a result, there have been **huge cuts in employment** at businesses employing more than five persons.

The job protection action plan announced earlier by the Economy Minister would have reduced government revenues by around HUF300bn. As a result of recent adjustments, this amount is now HUF285bn. (According to GKI, the direct labour market effects of the plan are HUF215bn. The budgetary effects of other items may reach an additional HUF135bn deficit, thus **the total "bill" may amount to HUF350bn**. However, the published HUF285bn figure may be accepted as an optimistic estimate.) The main question: How can this be financed? This has been unclear until now but the set of new measures announced recently gives an answer.

The main source comes from freezing public sector wages. The partial salary increase of employees in healthcare is no more than a fig leaf. It is financed from hospital budgets, resulting in **longer waiting lists for healthcare** and more **unpaid hospital bills** (reaching HUF60bn by the end of the year) whose interests will be paid by supplier companies (**between HUF2bn and HUF3bn**). The **postponed pay raise for teachers (HUF73bn)** only deleted a fictitious item from the budget (anyway, they probably did not mean it seriously).

The so-called **EU Own Resource Fund is reduced by HUF20bn** (originally HUF50bn was allocated in September to stimulate EU co-financed projects with local governments). It is obvious that this measure will not accelerate the absorption of EU funds. The **reduction in the level of national co-financing (HUF55bn)** will decrease the amount of funds that can be drawn, as well as their potential effects of generating growth.

Mandatory retirement and a 3-year hiring freeze will be introduced in the public sector. In addition, pensioners in the public sector will not be entitled to receive both salaries and pensions if they are employed after retirement. The government hopes to save an additional **HUF30bn** by these measures. According to the Minister the **number of employees in the public sector will decrease by 22 thousand in 2013** (and by further 20 to 25 thousand per year subsequently). It is unlikely that these measures will affect the armed forces and the health profession. (The termination of early retirement in the army alone ensures that there are no retirees, whereas there are too many pensioners in healthcare, thus the supply would be threatened if they were forced to retire.) As a result, the number of employees can be reduced only in **public administration and education**. Reducing the number of employees in central administration has always failed. Thus only the number of those working at local governments (5-7 thousand people) and public education can be reduced. Raising the compulsory teaching hours, as well as the expected institution mergers in primary education can be considered as preparatory measures. Reducing the number of non-technical classes in the **vocational school system** (and raising physical education classes) **may lead up to 7 thousand**

redundancies. Employing retired teachers has been rare in public education if substitutes could be found. Finding substitutes could be difficult in many institutions in the case of science subjects, thus compulsory retirement is unlikely in this sphere. As a result, those teaching the humanities will be dismissed.

Of course, the consequences of the dismissals are not included in the costs. On the one hand, those leaving the (still free) teacher and civil servant training institutions will be unable to find jobs (and will become unemployed school-leavers); on the other hand, the lost consumption of the unemployed and their unemployment benefits are not taken into account. Consequently, **the additional expenditure can be expected to total at least HUF10bn**.

The **introduction of a cap on the aggregate amount of certain cash benefits** will not result in substantial savings, especially if child benefits will not be (rightly) included.

The abolishment of the cap on social security contribution (HUF662th per month) in the case of the 10 per cent individual pension contribution (HUF51bn) partly reverses the elimination of the super grossing-up and puts new burdens on future pension payments.

Increasing the financial transaction tax on cash withdrawal (and postal payments) to 0.3 per cent (HUF30bn) will also reduce consumption. Card use increases with income, partly for cultural, and partly for practical reasons (there are no card readers in smaller stores). **The state revenue shortfall due to declining consumption may amount to HUF8bn.** Not incidentally, this step and the drop in sales due to the monopoly on tobacco sale may lead to further job cuts in retail trade.

Increasing the payment obligation of the Hungarian State Treasury (currently **HUF30bn**) **represents substantial revenue only if it means that it will be taken from the resources available for local governments** (public sector wages, pensions, child and other benefits should not be affected.). The feasibility of gaining **HUF95bn** by connecting almost 400 thousand cash registers to the tax authority (NAV) is highly doubtful. The problem is not that VAT fraudsters are manipulating cash registers; the problem is that they do not enter items in the cash register. Thus, the expected whitening effect compared with the estimated black economy turnover (HUF2000bn) is exaggerated, especially within such a short period of time. No mention was made about the cost of construction (for example, new servers at the tax authority (NAV), data management staff), the time required, Internet connection to be established at businesses, or operational costs of the system. It is highly unlikely that the system could be established before the middle of next year, thus **HUF25bn-HUF30bn surplus can be generated at best**, with an additional annual expenditure of HUF2bn-HUF3bn for businesses.

GKI estimates that **net savings can be HUF100bn less than the planned HUF397bn**. However, there is a chance that the expenses of the job protection action plan will exceed the estimated HUF285bn. As a result of the above the fiscal balance will be worse by HUF150bn than the government hoped.

However, the number of jobs is unlikely to increase substantially due to tax and benefit measures. The composition of employment may change, or slightly more money may be left in some companies. **80 per cent of the measures to improve the balance will have direct negative impacts on households due to rising redundancies, reduced job opportunities or additional payment obligations to the state.** In addition, a further decrease in quality can be expected in healthcare and education as well. **And it is no consolation whatsoever that these measures are called a “balance improving program” instead of “austerity program”.**

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