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**COMMISSION STAFF WORKING PAPER**

**Assessment of the 2011 national reform programme and convergence programme for  
HUNGARY**

*Accompanying the document*

**Recommendation for a**

**COUNCIL RECOMMENDATION**

**on the National Reform Programme 2011 of Hungary and delivering a Council Opinion  
on the updated convergence programme of Hungary, 2011-2015**

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## **1. INTRODUCTION**

The Hungarian economy was severely hit by the crisis and underwent a sharp adjustment in 2008-2009. In view of the unsustainable fiscal position and the limited access to market financing, Hungary embarked upon fiscal consolidation in 2009-2010, supported by the international financial assistance provided by the EU and the IMF.<sup>1</sup> In order to support the economic recovery, significant tax cuts were implemented and further cuts are planned. To meet the headline fiscal targets, the government also decided to reverse the earlier pension reform and introduced extraordinary levies. In March 2011, the Government announced a structural reform programme to provide further impetus to the economy by tackling long-standing policy challenges and to achieve the deficit targets despite the phasing out of the extraordinary levies in 2013. The government's determination to carry through the reforms is confirmed in the National Reform Programme (NRP) and the Convergence Programme (CP) submitted to the Commission on 15 April 2011.

## **2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK**

### **2.1. RECENT ECONOMIC DEVELOPMENTS**

The crisis hit Hungary particularly hard.<sup>2</sup> During the autumn of 2008, financial market conditions in Hungary rapidly deteriorated to the extent that the financing needs of the government could no longer be met through market channels. The subsequent depreciation of the forint, a sudden decline in external demand and the lack of fiscal space for stimulus measures (further budget cuts were in fact necessary to stabilise the deficit) were contributing factors to a recession that saw GDP contract by 6.7% in 2009. In response to the loss of market access and fears of contagion in the region, Hungary became the first recipient of EU balance of payments assistance in October 2008. Access to the international financial markets was regained through successful international bond issues in July 2009 and January 2010. The programme expired in November 2010 after EUR 5.5 billion had been disbursed, and Hungary is now under post-programme surveillance.

The economy emerged from recession last year as GDP grew by 1.2%, supported by recovering exports reflecting better than expected global trade demand. The current account deficit, which had averaged over 7% in the decade preceding the crisis, had turned into a slight surplus owing to the healthy performance of the export sector coupled with still contracting domestic demand.

### **2.2. OUTLOOK**

The Hungarian economy is expected to consolidate its recovery and gradually move towards rebalancing its growth composition as domestic demand will start to contribute positively, with GDP forecast to grow by 2.7% in 2011 and by 2.6% in 2012. The current account is expected to remain in surplus in the near future.

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<sup>1</sup> The EU provided an assistance of EUR 6.5 bn, of which eventually 5.5 bn was drawn until the expiration of the loan agreement in November 2010.

<sup>2</sup> Hungary is the second most open economy in the EU-27. This, together with the high level of public and external debt owing in large part to loose fiscal policy in the years prior to mid-2006, contributed to the depth of the crisis in Hungary.

Opposing factors are at work in influencing private consumption developments. The personal income tax reform is boosting disposable income (although lower-income households who do not qualify for child tax credits and do not receive additional compensation are expected to be worse off as a result). Additionally, pension yield payouts may lead to an increase in precautionary savings, but may also boost consumption. Private consumption is on the other hand likely to be dampened by the effect of the financial sector levy on credit supply and (chiefly from 2012) by the fiscal consolidation measures, including the phasing out of the employment tax credit.

Corporate investment is expected to receive a boost from the significant FDI projects announced in the autumn of 2010, but domestically financed investment will be slower to recover. The sector will benefit from the corporate income tax cut, but the temporary sectoral levies, including the bank tax, may dampen investment. Several developments have raised institutional uncertainty, although the structural reform plan was generally well received.

The activity rate may rise further in response to measures such as the planned changes in social benefits, but this effect will be limited by the complexity of the existing structural challenges (see below) and measures such as the phasing out of the employment tax credit. Unemployment will start to decline over the course of 2011, with the expansion of employment in the private sector projected to pick up in 2012. Public works are expected to continue to play a considerable part in this. The new public works scheme envisages a switch to predominantly part-time employment, implying that in full-time equivalent terms, employment developments are likely to be considerably less positive.

Consumer price inflation in Hungary reached an annual average of 4.9% in 2010, with core inflation lower at 3%. In 2011 inflation is expected to start declining, although it will remain above target. The relatively weak wage pressure, given the changes to personal income tax (PIT) and the slow recovery of full-time equivalent employment, is expected to help keep core inflation low.

### **3. MONITORING, PROCEDURAL ISSUES AND GOVERNANCE**

The Hungarian government submitted its National Reform Programme and Convergence Programme to the European Commission on 15 April 2011. The NRP was subject to public consultation and was discussed in the Hungarian parliament. The two programmes are coherently drafted and form a single package.

Implementation of the NRP and the CP will be monitored at six-monthly intervals by the Ministry for National Economy, which reports directly to the government.

Hungary has set the following targets in its NRP, to be achieved by 2020. Details on these targets, especially in terms of financing, are available only until 2012. The NRP does not indicate mid-term objectives or describe a trajectory to reach these targets in the medium to long term.

**Table 1: Hungarian Europe 2020 targets**

<b>Europe 2020 targets</b>	<b>Current situation in Hungary<sup>3</sup></b>	<b>Hungarian Europe 2020 target in the NRP</b>
R&D investment (/ of GDP)	1 % (2008 data)	1.8 %
Employment rate (20-64) (%)	60.5 %	75 %
Early school-leaving (%)	11.7 %	10 %
Tertiary education attainment (%)	23.9 %	30.3 %
Reduction of number of people in or at risk of poverty or exclusion	2.9 million people (28.5 % of the total population)	Reducing the number of people at risk of poverty or social exclusion down to 23.5 %
Energy efficiency – reduction of energy consumption in Mtoe <sup>4</sup>		Reduction in primary energy consumption: 2.96 Mtoe
Reduction in greenhouse gas emissions (from sources not covered by the Emissions Trading System)	+8 % <sup>5</sup>	+10 % <sup>6</sup>
Renewable energy (% of total energy use)		14.6 %

\* as estimated by the Commission

#### 4. POLICY CHALLENGES AND ASSESSMENT OF POLICY AGENDA

##### 4.1. CHALLENGES

Hungary faces a number of deep structural challenges, which weigh on the speed of economic convergence. With regard to the labour market, one of the lowest employment rates among the 27 Member States and particularly unfavourable demographic projections pose a considerable challenge to raising the level of potential growth. The low employment rate of the low-skilled (36.8%) and women (55.0%) is particularly worrying. Moreover, the problem of the overall poor employment rate was aggravated by the crisis, with the risk of the new unemployment becoming permanent through the erosion of human capital.

Structural challenges in the labour market also include the high tax wedge on labour,<sup>7</sup> insufficient provision of child care, significant divergences among regions and specific groups (young and older jobseekers and disadvantaged groups such as the

<sup>3</sup> Eurostat figures (2009) unless stated

<sup>4</sup> As estimated by the Commission. Mtoe = Million tonnes of oil equivalent

<sup>5</sup> This quantity corresponds to the 2005-2008 evolution in emissions not covered by the EU Emissions Trading System. As the scope of the Emissions Trading System evolved between 2005 and 2008, these emissions are estimated on the basis of the main relevant UNFCCC source categories (as opposed to the difference between total emissions and EU ETS verified emissions).

<sup>6</sup> The national emissions limitation target defined in Decision 2009/406/EC (or 'Effort Sharing Decision') concerns emissions not covered by the EU Emissions Trading System. It is expressed as the minimum relative decrease (if negative) or the maximum relative increase (if positive) compared to 2005 levels.

<sup>7</sup> The personal income tax (PIT) reform will reduce the tax wedge globally, although social security contributions are to remain high and the tax paid by low earners (especially those without children) will in fact increase.

Roma face particular difficulties), as well as inadequate active labour market policies (ALMPs). The room for improvement in ALMPs is underscored by the persistently high number of vacancies (exceeding 10% of unemployment before the crisis). In spite of the extensive efforts in recent years to modernise the public employment service, it has failed to build sufficient capacity to deliver case-managed, integrated, high-quality services.

A further key issue is the oversupply of low-skilled workers and jobseekers, which reflect shortcomings in the education and training systems. At present, these systems are insufficiently aligned with the needs of the economy. Some 60% of vocationally trained workers are either unemployed or working in fields that do not correspond to their professional qualifications, pointing to a mismatch between the skills acquired during their education and training and the labour market requirements. The participation rates in vocational education and training and in lifelong learning (2.7% in HU in 2009, EU average: 9.3%) are among the lowest in the EU Member States, compounding the low occupational mobility of the labour force. In addition, the Hungarian education system deepens socio-economic inequalities instead of ameliorating them. According to the 2009 PISA survey, Hungary has the largest inter-school difference in school performance among the Member States.

Sustainable reduction of the public debt, which requires the permanent reduction of the budgetary deficit, is another key challenge. The public debt is not only high but also much higher than in neighbouring countries, which set the benchmark for financial investors active in the region. Interest expenditure is crowding out other government expenditure that could support growth. Concerning the private sector, the reduction of foreign currency loans in the household sector would also have a beneficial impact. Reducing external debt may facilitate a lower risk premium for the country.

The main problem requiring attention in the financial sector concerns credit supply constraints. Lending activity is currently hindered by the adverse economic environment, legal uncertainties and a sizeable financial sector levy extended to 2012. Moreover, the exchange rate depreciations and the high volume of loans provided earlier in foreign currency have greatly increased the financing burden of debtors, which may also translate into losses for banks. Furthermore, the heavy reliance on external funding creates a significant rollover risk, especially for short-term liabilities. Although parent bank funding is still widely considered to be a stable source of funds, some parent banks have lowered their exposure to Hungary and shortened maturities on their funding to subsidiaries.

There is scope for reaping substantial reform dividends from improving the business environment and promoting favourable conditions for research and development (R&D) and innovation activities. Small and medium-sized enterprises (SMEs) have been hindered by the complexity of the regulatory framework and a high administrative burden, as well as limited accountability and transparency in public administration and in business. Hungary's performance in the area of innovation and R&D is still relatively weak, with investment lagging behind the EU average (1.9% of GDP) at 1% of GDP. Knowledge transfer has been impeded by very low researcher mobility between research sectors. Finally, maintaining competitiveness remains crucial to avoid a return to unsustainable imbalances in the current account.

## **4.2. ASSESSMENT OF THE POLICY AGENDA**

### **4.2.1. Macro-economic policies**

#### **4.2.1.1. Public finances**

The programme presents both a conservative and a dynamic path. The former will be used as a reference scenario since the authorities' fiscal projections build upon it. In this reference scenario ('the programme'), GDP growth is expected to be 3.1% in 2011 and 3.0% in 2012, which exceeds the Commission's projections (2.7% and 2.6%, respectively). In addition, the recovery is more underpinned by domestic demand than in the Commission's forecast, where net exports play a more dominant role. Thus, the programme's budgetary path is underpinned by a more tax-rich macro-economic scenario than expected in the spring forecast, even though the latter expects a somewhat higher increase in the wage bill. Regarding the years beyond 2012, the growth expected in the programme exceeds the growth estimated by the Ageing Working Group by around 2 pp a year.

According to the programme, cyclical conditions will improve over time and negative output gaps, as recalculated by the Commission, based on the information in the programme and following the commonly agreed methodology, will gradually narrow and turn positive in 2015. This development is much more optimistic than the Commission forecast, which expects a lower potential growth rate and consequently more rapid achievement of the level of potential output (already by 2012). The most important factor behind the different estimates of the potential growth rate is the contribution of labour: while the Convergence Programme expects it to be around 0.5% of GDP and increase gradually, the Commission estimates it to be around -0.5% of GDP.

In 2010, the general government deficit was 4.2% of GDP, exceeding the target of 3.8% of GDP by 0.4 pp. This overrun is the result of: (i) expenditure slippages of 1.5% of GDP (including higher spending by the budgetary institutions and the public works scheme and higher subsidies to public transport companies), (ii) revenue shortfalls of 1.5% of GDP (in particular lower income taxes), and (iii) tax cuts and court decisions increasing the deficit by more than 0.5% of GDP. On the other hand, there are counterbalancing factors: (i) the introduction of extraordinary taxes on selected sectors amounting to 1.25% of GDP, (ii) the elimination of budgetary reserves of almost 1% of GDP, and (iii) savings measures of 0.75% of GDP and the diversion of pension contributions from the private to the public pillar amounting to 0.25% of GDP. Although the economic recovery was faster than expected, it did not result in higher revenues since the structure of the GDP turned out to be less tax-rich.

Regarding 2011, the Commission's spring 2011 forecast projects a surplus of 1.6% of GDP instead of the deficit of 2.8% of GDP anticipated in the previous Convergence Programme, i.e. an improvement of 4.4% of GDP. The most important factor in the better than expected budgetary balance this year is the abolition of the mandatory private pension pillar, which results in (i) a huge net one-off revenue of around 9% of GDP<sup>8</sup> and (ii) (permanently) higher pension contributions of 1.25% of GDP

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<sup>8</sup> The one-off revenue reflects the transfer of assets from the private to the public pension pillar based on the return of people following strong incentives provided by the government.

channelled from the mandatory private pension pillar to the public pillar.<sup>9</sup> Moreover, the government has adopted savings measures (such as reducing the operational appropriations of the budgetary institutions) amounting to 0.5% of GDP in net terms. In addition, the extraordinary sectoral taxes of 1.25% of GDP introduced in 2010 have been maintained along with the bulk of the savings measures implemented in 2010 to reduce the budgetary institutions' appropriations by 0.5% of GDP.

However, these deficit-decreasing factors amounting to 12.5% of GDP are expected to be partly offset by several deficit-increasing factors amounting to 8% of GDP: (i) most expenditure slippages and revenue shortfalls observed in 2010 are likely to be carried over to 2011 as is the revenue impact of the tax cuts implemented in 2010, together with some recent slippages of 0.25% of GDP, they are expected to result in a higher deficit of 3.75% of GDP; (ii) debt assumption for two state-owned public transport companies and the buy-back of several investments in private-public partnerships will increase the deficit by 2% of GDP; (iii) the cut in personal income tax complemented by more generous child allowances and the full-year effect of the corporate income tax will increase the deficit by 2.25% of GDP.

The update aims to correct the excessive deficit by the 2011 deadline set by the Council in July 2009 and to keep the deficit in 2012 below the threshold of 3% of GDP. After a surplus of 2% of GDP this year thanks to one-off revenues from pension assets, the budget should go into a deficit of 2.5% of GDP in 2012 and thereafter gradually reach a deficit of 1.5% of GDP. The update confirms the country's medium-term objective (MTO) for the budgetary position in structural terms, a deficit of 1.5% of GDP. While it aims to comply with the MTO in 2015, it will not do so based on the structural balance recalculated by the Commission (-1.8% of GDP).<sup>10</sup>

Regarding the consolidation profile, the temporary surplus in the headline balance due to the one-offs (which also explain the improvement in the deficit target for 2011 in the current programme compared to the previous programme) will be followed by a gradual improvement beyond 2012 of 0.3%-0.4% of GDP per year. In structural terms the consolidation will start only in 2012, based on a large set of consolidation measures necessary because of the significant tax cuts adopted by the new government since last summer and the worse-than-expected revenue developments (e.g. in corporate profit tax). These new measures are planned to support a deficit target of 2.5% of GDP for 2012, set in the previous update.

In 2012, filtering out the temporary factors of 2011, the programme foresees a decrease in the expenditure ratio, while the revenue ratio is expected to be broadly unchanged. The decrease in the expenditure ratio mainly reflects the impact of the structural reform programme, aiming to save 1.5% of GDP (Table 2 shows the main reform areas). In addition, the programme includes a nominal wage freeze in the public sector and the nominal freeze on expenditure on goods and services by central government. Moreover, the bulk of the savings measures implemented in 2011 in

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<sup>9</sup> The temporary diversion of contributions decided in 2010 became largely permanent following the almost full reversal of the pension reform.

<sup>10</sup> The previous (January 2010) update envisaged the achievement of the MTO already in 2011. However, according to the structural balance recalculated by the Commission, the structural deficit was estimated at that time to be still 2.25% of GDP in 2011 i.e. 0.75% above the MTO.

creating the stability reserve will serve as a basis for the 2012 budget. However, the new form of the public works scheme and the increase in the supplementary wage to compensate for the reduction in the employment tax credit are expected to somewhat offset the above-mentioned savings. Regarding revenues, the further cut in personal income tax will be almost entirely offset by the additional reduction in the employment tax credit. Finally, the increase in excise duties and some green taxes is expected to somewhat raise the revenue ratio.

Beyond 2012, strict expenditure restraint is projected to more than offset the expected revenue decreases, securing the envisaged further deficit reduction. In 2013, the structural reform programme is expected to result in savings of more than 2% of GDP, around 0.7% more than in 2012. Moreover, the nominal wage bill will not increase in the public sector throughout the entire programme period. On the revenue side, the introduction of the electronic road toll and the postponement of the earlier enacted corporate income tax cut will generate more income compared to a no-policy change scenario. These measures are officially expected to offset the phasing out of the extraordinary taxes on selected sectors while meeting the programme's deficit targets.<sup>11</sup>

As mentioned above, there are significant one-offs over the programme period, especially in 2011 but also in 2012. Apart from the assets obtained from the abolition of the mandatory private pension pillar, amounting to a net 9% of GDP, and the temporary part of the extraordinary sectoral levies, amounting to 1% of GDP, there are also the outlays on the debt assumptions and the review of selected PPP investments, amounting to 2% of GDP. No one-offs are foreseen for the later years of the programme.

The deficit path presented in the Convergence Programme is associated with significant deficit-increasing risks. First, according to the calculations in the spring 2011 forecast, macro-economic developments may result in lower than expected revenues. Second, the savings measures may have significant indirect effects, i.e. lower revenues and higher expenditures (e.g. higher social outlays), which, based on country-specific empirical studies, cannot be expected to be fully offset by the possible emergence of non-Keynesian effects. Third, significant implementation risks can be identified in certain reform areas, such as local government and the public transport sector. These factors were explicitly incorporated in the spring forecast. Beyond these elements, further positive and negative risks can be identified. Implementation risks of 0.5% of GDP were already included in the spring forecast, but these could be even higher than projected, notably regarding the nominal freeze of the public wage bill and operational expenditures. However, the possibility that the government may take further steps to implement the consolidation package in full also cannot be excluded. Furthermore, corporate income taxes may increase faster than currently projected.

The fiscal policy effort, as measured by the change in the structural balance, is expected to be a cumulative 2.5 percentage points of GDP from 2012 until the end of the programme (1.75% and 0.75% of GDP in 2012 and 2013, respectively, and negligible in the later years). The improvement in the structural balance is explained

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<sup>11</sup> Regarding the extraordinary levy on financial institutions, the Convergence Programme assumes it will be halved in 2013.



by the consolidation measures, which are expected to offset the budgetary impact of the recently enacted tax cuts and to replace the extraordinary sectoral levies. At the same time, the progress towards the MTO appears insufficient beyond 2013 since the structural deficit will exceed the MTO even at the end of the programme period. In addition, according to the Commission's estimate, the structural effort in 2012 and 2013 is less than the cumulative structural deterioration of more than 3% of GDP over 2010 and 2011, which was masked by one-off revenues. It hence does not comply with the Council recommendation for an improvement of at least 0.5% of GDP over that period.

When assessed against the projected medium-term potential output growth, and taking into account discretionary revenue measures, expenditure plans in the programme do not seem to ensure an appropriate adjustment path towards the MTO. The calculated deviation is significant in 2013 (+0.75 pp expenditure growth above the reference rate for medium-term potential GDP growth), while the gap is smaller in the later years.

### Main budgetary measures (% of GDP)

Revenue	Expenditure
<b>2011</b>	
<ul style="list-style-type: none"> <li>• Net one-off effect of abolition of the mandatory private pension pillar (9%)</li> <li>• Permanent effect (higher pension contributions) of abolition of the mandatory private pension pillar (1.25%)</li> <li>• Personal income tax cut, partially offset by reduction in employment tax credit (-1.8%)</li> <li>• Additional (full-year) effect of the corporate income tax cut (-0.3%)</li> </ul>	<ul style="list-style-type: none"> <li>• Review of the public works scheme (-0.2%)</li> <li>• Creation of stability reserve, which broadly becomes permanent savings (close to -1%)</li> <li>• Debt assumption for public transport companies (1.25%)</li> <li>• Buy-out of earlier PPP investments (0.75%)</li> </ul>
<b>2012</b>	
<ul style="list-style-type: none"> <li>• Keeping unchanged the size of the extraordinary levy on financial institutions (0.3%)</li> <li>• Reduction in the tax base for personal income tax (-0.6%)</li> <li>• Reduction in employment tax credit (0.6%)</li> <li>• Increase in excise duty (0.1%)</li> <li>• Increase in green taxes (0.1%)</li> </ul>	<ul style="list-style-type: none"> <li>• Nominal freeze of wages in the public sector (-0.2%)</li> <li>• Wage compensation in the public sector (0.2%)</li> <li>• Widening of the public works scheme (0.2%)</li> <li>• Nominal freeze of expenditure on goods and services by central government (-0.1%)</li> <li>• Review of disability benefits (-0.3%)</li> <li>• Nominal freeze and capping of selected social benefits (-0.1%)</li> <li>• Restructuring of labour market benefits (-0.5%)</li> <li>• Reduction in price subsidies (-0.3%)</li> <li>• Restructuring of the public transport sector (-0.15%)</li> <li>• Streamlining of public administration (-0.1%)</li> </ul>
<b>2013</b>	
<ul style="list-style-type: none"> <li>• Postponement of the further cut in corporate income tax (0.4%)</li> <li>• Introduction of the electronic road toll (0.3%)</li> <li>• Phasing out of the temporary part of the extraordinary levies on selected sectors (-0.9%)</li> </ul>	<ul style="list-style-type: none"> <li>• Extension of the impact of the structural reform programme (-0.7%)</li> </ul>
<b>2014</b>	
n.a.	<ul style="list-style-type: none"> <li>• Nominal freeze of the wage bill in the public sector (-0.2%)</li> </ul>
<b>2015</b>	
n.a.	<ul style="list-style-type: none"> <li>• Nominal freeze of the wage bill in the public sector (-0.2%)</li> </ul>

Gross public debt increased from 78.4% of GDP in 2009 to 80.2% in 2010, which reflects the depreciation of the exchange rate, the adverse denominator effect due to low growth and the slightly higher than expected deficit resulting in a marginal primary deficit. In 2011, gross public debt is expected to decrease by 4.75% of GDP. The improvement mainly reflects the significant primary surplus of almost 6% of GDP, generated by the one-off revenue from the abolition of the mandatory private pension pillar. This is partly offset by (i) the deteriorating underlying budgetary developments, (ii) debt assumption for two public transport companies, and (iii) the buy-out of selected Private Public Partnership (PPP) investments. The economic recovery and the expected appreciation of the exchange rate will also reduce the gross debt ratio by more than 1% of GDP. As part of the transferred assets (2.4% of GDP) is assumed to increase public financial assets, they are accounted as gross public debt increasing stock-flow adjustment.

Regarding 2012, the programme foresees a further reduction in the debt ratio by more than 3 pp in view of the positive primary balance, the higher than potential economic growth as well as the assumed sale of the bulk of accumulated public financial assets. By 2015 the programme projects the debt to fall to around 64% of GDP mainly as a result of (i) the surplus in the primary balance, but also because of (ii) the further sale of public financial assets and (iii) the reduction in state foreign exchange deposits in the central bank.

The Convergence Programme foresees a somewhat faster reduction in the debt ratio by 2012 than expected by the Commission in the 2011 spring forecast. It forecasts a lower budget deficit and faster economic growth, partly counterbalanced by a weaker exchange rate and less sale of public financial assets.<sup>12</sup>

There are negative and positive risks related to the debt path in the programme. In the light of the spring 2011 forecast, economic growth may turn out to be lower than expected in the update, resulting in slower debt reduction. The reduction in the foreign currency deposits in the central bank could be more front-loaded and extended than expected. However, the current plans for their reduction should also be assessed against the backdrop of macro-stability considerations. The exposure of the debt level to exchange rate developments is significant in view of the large share of debt denominated in foreign currency (currently 45%).

The abolition of the mandatory private pension pillar, which accounts for a large part of the sharp debt reduction in 2011, significantly increases the long-term implicit liabilities of the budget. While debt assumption for two public transport companies somewhat increases transparency by turning the implicit debt into explicit debt, it still masks the worse underlying budgetary developments in the past (though reported in line with the standard methods).

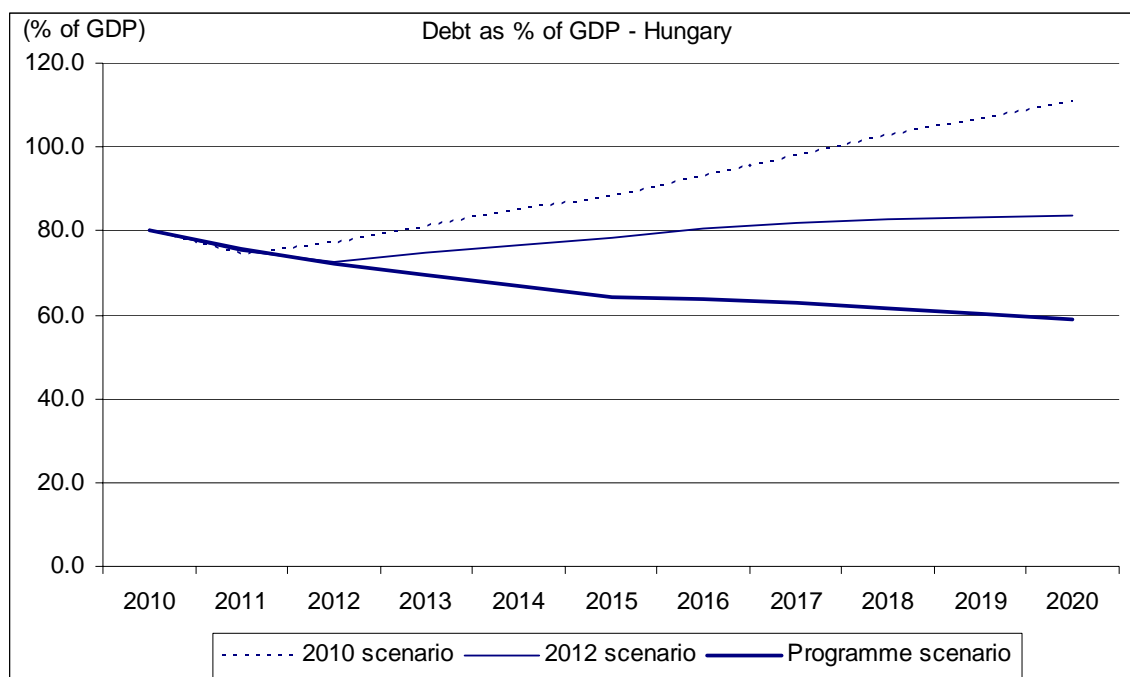
Hungary is at medium risk with regard to the long-term sustainability of public finances. The long-term cost of ageing is below the EU average. The current budgetary position compounds the cost of ageing for the sustainability gap. Based on the current fiscal position, debt would increase to 110% of GDP by 2020. However, the full implementation of the programme would be enough to put debt on a

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<sup>12</sup> The Commission assumes that the buy-out of selected PPP projects will be financed by the sale of part of accumulated public financial assets instead of by issuing new sovereign securities.

downward path by 2020. Ensuring higher primary surpluses over the medium term, as already envisaged in the programme, would contribute to reducing the medium risks to the sustainability of public finances.

**Figure 1. Medium-term debt projections for Hungary**



A new fiscal framework was adopted in November 2008 (also in the context of the EU-IMF assistance of EUR 20 bn), which stipulates that the determination of future primary balances in a medium-term perspective should be consistent with a real debt rule.<sup>13</sup> Although some problems with the new set-up were palpable (e.g. the complexity of the rules, the weak statutory base), both its overall high quality, including the multi-annual nature of the numerical rules as well as the establishment of an independent three-person Fiscal Council (FC) equipped with its own 30-strong analytical staff, and its relatively successful first year pointed to its potential to become an effective anchor for fiscal policy. In the second half of 2010, the new government took a number of steps that effectively weakened this framework. In particular, in December 2010, it abolished the technical staff of the FC and replaced its members.<sup>14</sup> Moreover, while the adopted 2011 budget complies with the discretionary balance requirement, the FC had considered the medium-term targets to be looser than the requirements (by some HUF 200-300 bn).

The current update presents the public finance chapter of the recently adopted new Constitution. The new set-up aims to renew the budgetary framework by establishing a constitutional debt brake at 50% of GDP as well as by enshrining the Fiscal Council

<sup>13</sup> The rule stipulates that the medium-term budgeting process should be carried out — based on conservative assumptions and technical projections — to ensure that the real value of the central government debt stock must not increase from the year after the budget year to the second year after the budget year, and at the same time must not be larger than the real debt had been two years before the budget year.

<sup>14</sup> The new FC is without any direct support staff and consists of the president of the State Audit Office *ex officio* and the governor of the central bank, while the new head has been appointed by the President of the Republic.

in the new base law with a right of veto over the annual budget. Providing a constitutional basis for rule-based fiscal policy-making is a very promising step, as evidenced by both the analytical and empirical literature. However, important details of these key initiatives will only be specified in the subsequent ‘cardinal’ laws (e.g. what are the temporary numerical rules until the debt ratio declines to 50%, the precise interpretation of the escape clause, etc.). Therefore, it is not yet possible to make a thorough assessment of the revised framework. It is worth pointing out that the imposition of a nominal debt cap, if used as an all-purpose device, could easily lead to a pro-cyclical fiscal stance. In addition, under the current legislation, the remit of the revamped fiscal body appears to be too narrow (preparing an opinion on the draft budget), so does not cover the entire budgetary cycle (e.g. through real-time assessments of new policies with major budgetary implications). Finally, there are also questions as to how the government would like to take forward its reform plans for other aspects of fiscal governance, such as the medium-term orientation of fiscal policy and transparency issues.

#### **4.2.1.2. Ensuring stability of the financial sector**

The NRP focuses on the real-estate market risks, social risks and financial risks arising from mortgage-backed lending to households. In order to address these challenges, a comprehensive agreement (focusing on mortgage loans) is currently being negotiated with the financial sector and is scheduled to be adopted this spring. Three programmes are envisaged to support distressed mortgage borrowers, and all are officially estimated to have limited fiscal costs: (i) fixing of the exchange rate through a government guarantee scheme, thus making the monthly repayment sums predictable; (ii) a market-based clean-up of mortgage portfolios incentivised by an interest rate subsidy to promote orderly foreclosures; (iii) establishment of a Social Asset Management Company by the end of 2011, which would buy homes at book value and rent them back to distressed borrowers. Although these measures could mitigate some risks related to the FX loans provided to households, some other challenges that endanger a stable and well-functioning financial sector are not addressed.

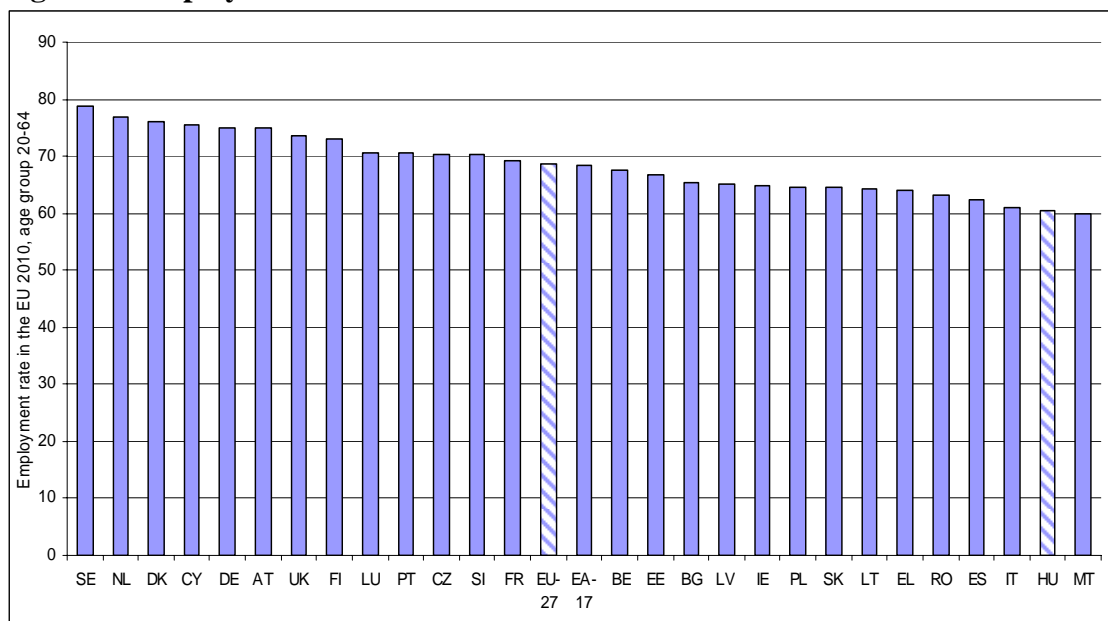
In particular, from a financial stability perspective, and also in the light of the potential boost to the economic recovery, removing credit supply constraints and thereby stimulating lending in a prudent fashion is warranted. Firstly, tightening the existing rules for loan-loss provisioning would inspire banks to clean up their portfolios. Secondly, following the withdrawal of the current moratorium on foreclosures and evictions, consideration needs to be given to a coordinated and regulated market framework to allow banks to clean up their mortgage portfolios in an orderly fashion without causing major disturbances to the real-estate market. Thirdly, a lower bank levy would help the banking sector to regain a higher return on equity, thereby strengthening its ability to attract capital. Finally, the implementation of a new regulation requiring lenders to extend new mortgage loans would serve to enhance price competition among banks and improve market transparency.

## 4.2.2. Labour market reform and job opportunities

### Making work more attractive

The Hungarian national employment target of 75% by 2020 can be characterised as highly ambitious in the light of the 2009 employment rate of 60.5%. The unemployment rate reached 11.2% in 2010, and half of the total are long-term unemployed. The youth employment rate is one of the worst in the EU-27 (51.5% vs the EU average of 63%). The medium-term target of creating 400 000 new jobs by 2015 also illustrates the magnitude of the challenge. The need for deep structural reforms is recognised in the CP and the NRP, which state the government's intention to coordinate all relevant sectoral policies in order to reach the overall employment target.

**Figure 2: Employment rates in the EU**



Source: Eurostat

The recent personal income tax (PIT) reform may have a positive impact on the employment of higher earners. However, the tax burden of low earners — which is most relevant for the low-skilled, for whom raising employment remains a particularly important challenge — increases in the new system, especially when taking into account the phasing out of employment tax credits, although the effect is mitigated in the case of those eligible for child tax allowance. The tax wedge will therefore remain a barrier to increasing formal employment among the low-skilled. The sizeable tax allowance introduced for families could motivate second earners to enter the labour market to make use of the tax credit on a higher family income (further underscoring the need for access to affordable, quality child care).

Offering wage subsidies as a partial replacement for the public work scheme, as announced in the NRP, could also temporarily reduce the tax wedge for those affected and thus support labour demand, but the details of such steps, beyond the existence of the current *Start Plusz* card scheme (which reduces employers' contributions for e.g. the long-term unemployed), are lacking. Recently introduced measures allow mothers still receiving childcare allowance to work part-time under certain conditions, while

employees returning from parental leave in a part-time position and the persons who had substituted for them are eligible for a social contribution allowance of up to 7 pp.

The gap between the employment rates of women with and without 0-6 year-old children is the second largest in the EU at 33.6 pp (the average is 12.1 pp). This is partly due to the traditionally generous family allowance system, which provides for three years of parental leave backed by cash benefits. Parents taking parental leave also risk skills depreciation and difficulties in returning to the labour market. Among the measures listed in the NRP, increasing the availability of childcare facilities, may have a beneficial effect on labour supply by facilitating the participation of mothers in the labour market. Empirical studies suggest that this may also be a more effective and cost-efficient tool to raise fertility rates than child tax credits.<sup>15</sup> The provision of facilities outside the larger cities and in regions with very high unemployment is particularly scant. Given the recently announced plan to lower the age limit for compulsory attendance of pre-school education from 5 to 3 years of age, the capacities of kindergartens (requiring some 30-40 thousand new places) will be strained further.

Opportunities to make use of flexible working arrangements, such as part-time work or atypical forms of work, for women with small children remain limited. Only 5.4% of total employment is part-time employment, as against 17.9% in the EU. The new Labour Code, to be adopted in September 2011, aims to improve the flexibility of the labour market, including revision of the regulation of atypical forms of work.

Capping the amount of benefits available to adults below the income provided by public employment (cf. the Convergence Programme), which in turn is to remain under the effective minimum wage, is likely to have a positive effect on the activity rate. However, if the cuts are too far-reaching they may entail a significant increase in poverty, affecting children as well. Poverty in childhood often proves to be a determinant of future prospects for disadvantaged people. Reductions could be pursued in a budget-neutral manner by moving to a means-tested system for providing social benefits. Beyond the possible impacts of the revision of the social benefit system on increasing the activity rate, a significant reduction in early retirement (the NRP aims for its abolition as a general rule) and disability pension schemes may also increase labour supply. A general point that does not feature in the NRP is that improving the predictability of the policy environment also tends to be beneficial for increasing the labour supply.<sup>16</sup>

According to estimations, the size of the black economy in Hungary is 15–20% of GDP. Addressing this issue is closely dependant on strengthening labour inspection and further reducing administrative and financial burdens on labour, especially in the lower wage ranges.

### **Getting the unemployed back to work**

The Széll Kálmán Plan, on which the NRP builds, contains significant reductions in passive labour market support, which would see the duration of the jobseeker's allowance cut to 3 months (the lowest in the EU for low and average wage earners,

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<sup>15</sup> e.g. Blaskó, Cseres-Gergely, Reszkető, Scharle and Váradi (2009), Sacerdote and Feyrer (2008).

<sup>16</sup> e.g. OECD (2003) Low Fertility Rates in OECD Countries: Facts and Policy Responses.

with the average being around 12 months)<sup>17</sup>. Jobseeker's benefits (already 40% of the minimum wage) are to be abolished, and total claimable social benefits capped. While this is an important component of fiscal consolidation, the benefits of the cut in unemployment benefits for labour supply may be limited (see box 1), and could be considered as too drastic or even counterproductive if the lack of adequate unemployment protection discourages active job-seeking. In addition, an undue shortening of the allowance period may contribute to the growth of the informal economy and drastically increase the flow of unemployed into public work schemes.

### **Box 1. Unemployment benefits and the labour market**

The low employment rate in Hungary is a significant bottleneck to growth. Two further facts provide important pointers for charting a course to redress this.

- Employment did not expand in line with economic growth even before the recession.
- Employment did not expand when unemployment benefits were previously reduced.

In assessing the likely effects of the current measures in comparison to previous cuts in benefits, the entire policy environment of course needs to be taken into account, including coherence with other policy areas such as taxation. Still, one implication of the above observations is that a reduction in benefits in itself has hardly had any positive effects beyond improving the fiscal balance. This is because the unemployment trap does not appear to be a particular problem: expenditure on unemployment benefits is already below the EU average. The drop in benefits is particularly steep: while for example in the second month of unemployment the replacement rate for a single person earning the average wage is 59%, both in Hungary and in the EU on average, in the seventh month of unemployment this becomes 50% in the EU on average and 33% in Hungary.

Under some conditions, reductions in unemployment benefit may even be counterproductive from the point of view of raising labour supply. Such reforms must therefore be designed carefully. Commission services simulations at EU level<sup>18</sup> suggest that reducing benefit duration has a stronger positive effect on unemployment than a comparable reduction in the replacement rate. This may be on account of the intensity with which the unemployed conduct their job searches, relaxing their efforts when benefits are generous. The positive effect on the labour market from reducing passive labour market support depends on the extent to which benefits provide enough liquidity for a sufficient time<sup>19</sup> to: (i) facilitate better matches between jobseekers and vacancies than would otherwise have occurred, and (ii) keep the unemployed in the labour market, while (iii) minimising further job losses due to the contraction in aggregate demand<sup>20</sup>.

<sup>17</sup> Some experts recommend the provision of unemployment benefits for around 6 months if the economy is healthy and longer if the economy is 'depressed' E.g. Christopher Pissarides (11 March 2011) Future of European Labour Markets Conference.

<sup>18</sup> Arpaia et al (2007) Quantitative Assessment of Structural Reforms: Modelling the Lisbon Strategy.

<sup>19</sup> See e.g. Shimer and Werning (2008) Liquidity and Insurance for the Unemployed.

<sup>20</sup> See e.g. Council of Economic Advisors (2010) The Economic Impact of Recent Temporary Unemployment Insurance Extensions.



It follows that keeping unemployment benefits low may be helpful in avoiding a potential impediment to raising the activity rate, but this is not sufficient to achieve a significant improvement in employment. Raising the employment rate in the 'white' economy may be pursued through a mixture of further policy measures. Some of these measures cannot be financed under the current and projected budget constraints — such as cutting social contribution rates — but others could be achieved without additional expense, such as reallocating funding to relatively more effective active labour market programmes.

The public employment services (PES) cater to a low number of registered persons among the non-working population, and suffer from insufficient administrative capacity. Prior injections of funding and steps such as the establishment of an integrated data processing system have not translated into clearly improved success rates or higher efficiency in integrating the unemployed into the labour market. In the context of the measures described above with the potential to significantly increase labour supply, considerable strengthening of the capacity and effectiveness of the PES seems to be called for. Appropriately trained staff and case-managed, tailor-made services should enable the PES to cope with a possible increase in the number of jobseekers.

The government plans to transform the system of ALMPs, including increasing the share of support for direct employment, revising wage and employment cost support, and reducing and reforming training support. Domestic sources are to be replaced by EU funds (European Social Fund), but achieving this would require a rapid increase in absorption capacity. Strengthening the follow-up and evaluation of ALMPs, along with linking the funding of employment organisations and programmes to results, appears even more crucial against this background. Specific measures to boost employment without an adverse impact on the public sector deficit include the possibility of reallocating funding to relatively more effective ALMPs. Around HUF 60 billion is spent every year on supporting organisations that help find employment for people with disabilities. Most of this goes towards supporting 'protected organisational employment', while so-called 'rehabilitation providers', who aim to help their clients secure employment in the open market, receive less than a tenth of this budget. Yet recent studies<sup>21</sup> have shown that the latter category of providers is 30 to 50 times more successful in placing their clients in competitive employment.

### **Investing in education and training**

Hungary is one of two countries where stimulus measures have not been implemented in the education sector<sup>22</sup>. Investment in higher education is low, as is the tertiary attainment rate (in 2009: HU: 23.9%, EU average: 32.3%). The number of students entering higher education is high (69% in the age group 20-24 years old), but they take a long time to graduate and many do not reach graduation. Budgetary planning is likely to remain a constraint under the ongoing fiscal consolidation programme. Consequently, part of the financing could come from adequate absorption of EU funds (ESF funds were also drawn on during the crisis), although budgetary planning may also have to compensate for the additional financing needs of this sector with savings in other areas.

<sup>21</sup> Budapest Intézet (2011) A foglalkoztatási rehabilitáció hatékonysága.

<sup>22</sup> Damme and Karkkainen (2011) OECD Education today Crisis Survey 2010.

**Figure 5: Early school-leavers by employment status in 2009 (%)**



Source: Eurostat

The planned higher education reform seeks to strengthen the link between higher education output and the needs of the labour market. At overall European level, Hungary has the lowest participation in vocational education and training. The country has already introduced measures to modernise its vocational education and training (VET) system, including the more structured involvement of chambers of commerce in redesigning features of vocational training. The performance of educators may be unfavourably influenced by the relatively low prestige and rewards of the teaching profession. Research universities are also lacking, and the corporate sector does not play a significant role in financing. Furthermore, there is currently no independent quality measuring system in place to provide a basis for improving the link between financing and performance.

Although the percentage of early school-leavers (at 11.7% in 2008) is below the EU average, the number of unemployed and inactive early school leavers is high in Hungary compared with other Member States. In addition, according to the PISA 2009 study, the Hungarian education system shows a particularly strong relationship between the socio-economic background of pupils and their performance at school. An individual's home and family background, as well as the size of the locality, have a large influence on the performance of school children. Hungary is targeting a further reduction in early school-leaving to 10% by 2020, in line with the proposed EU-wide target.

### **Combating poverty and promoting social inclusion**

In Hungary, the percentage of people at risk of poverty or social exclusion stood at 29.9% in 2009, above the EU average (23.1%). There is a strong correlation between

joblessness and poverty or exclusion. The number of people living in households with zero or very low work intensity is one of the highest in the EU and growing (2005: 9.5%, 2009: 11.3%). A significant proportion of this population also lives under the poverty threshold. Accordingly, the achievement of the poverty target will greatly depend on employment developments. While the planned transformation of the social benefit system is desirable with a view to strengthening work incentives, it is important to maintain a sufficient level of support for those most in need. Poverty factors like joblessness or low education level continue to characterise some disadvantaged groups, particularly the Roma. The multifaceted problems of disadvantaged groups, particularly the Roma, can only be addressed by complex interventions in fields such as employment, education, social services, housing and health care.

### **4.2.3. Growth-enhancing structural measures**

#### **The business environment**

As noted in the NRP, SMEs are likely to have an important role to play in translating any increase in the labour supply into employment. Sustainable job creation would need to be driven by market requirements, and SMEs tend to absorb more unskilled workers in market economies. However, the Hungarian SME sector has remained relatively weak. Their operating model, based partly on the shadow economy, is one of the factors likely to have hindered the expansion of SMEs. Accordingly, the efforts by the authorities to further 'whiten' the economy, including simplification of the tax system, are fully welcome. The effectiveness of prior programmes to support the sector has not been evaluated systematically, so any lessons learned can only inform policy to a limited extent.

Hungary scores below the EU average on business environment indicators such as the legal and regulatory framework.<sup>23</sup> Moreover, public administration does not operate cost-efficiently, a factor singled out as one of the most problematic for doing business by the Global Competitiveness Report 2010-2011<sup>24</sup>. The regulatory framework is too complex and instable due to frequent and sometimes ad-hoc changes. The high administrative burden on enterprises, the wide range of reporting obligations and other requirements (taxation, employment, environment, statistical, etc.) have negative effects, especially on SMEs. In Hungary, the time it takes to prepare, file and pay corporate income tax, value added tax and social contributions is 277 hours per year, while the OECD average is 199 hours<sup>25</sup>. Other studies<sup>26</sup> report that administrative costs account for more than 10% of GDP, while the costs of tax administrative tasks may reach 10% of the total turnover of small enterprises. In addition, limited accountability and transparency in public administration and in business has proved a hindrance.

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<sup>23</sup> See Member States Competitiveness Performance and Policies (EC, Enterprise and Industry, 2010).

<sup>24</sup> On the indicators for burden of government regulation and efficiency of the legal framework in challenging regulations, Hungary ranked 134 and 114, respectively, in the world list of 139 countries.

<sup>25</sup> World Bank Doing Business 2011.

<sup>26</sup> Hétfő Kutatóintézet (2010): Adminisztratív terhek Magyarországon.

The reduction in administrative burdens and the new Act on Simplified Employment are steps in the right direction. As also reflected in the NRP, the government has recently announced a comprehensive programme in this field, expected to secure a 25% reduction in administrative burden by 2012. These measures are going in the right direction, and their full and rigorous implementation is essential in order to achieve the target. A new public procurement law is also planned to simplify and streamline contract award procedures and improve access for SMEs.

One of the priorities of the Enterprise Development Programme of the New Széchenyi Plan is to increase entrepreneurship activity. However, no detailed information is available on the plans to improve entrepreneurial skills, competences and attitudes. According to the Global Entrepreneurship Monitoring Report 2010, the willingness to start up companies has deteriorated significantly, and entrepreneurial attitudes and perceptions were found to be weak in Hungary in international comparison. The Report also indicates that, besides the regulatory framework, entrepreneurship education in primary and secondary schools is the key negative factor holding back entrepreneurship in Hungary.<sup>27</sup> Non-governmental organisations offer some programmes to make young people aware of the possibility to start an enterprise, but these are of limited scope. Knowledge-related problems are considered by experts to be a critical issue as well for existing SMEs<sup>28</sup>.

### **Access to financing**

Access to finance and early-stage financing in particular, is tight. The role of non-banking funding mechanisms in the business sector, such as seed capital, business angels and venture capital, is lagging behind other European countries. Collateral requirements are often prohibitively high. Under the Structural Funds, Hungary has a vast JEREMIE (Joint European Resources for Micro to Medium Enterprises) Holding Fund (EUR 700 million) with major potential. So far, however, the JEREMIE instruments implemented in Hungary (essentially micro credit and small loans) have not had a sufficient leverage effect, i.e. have not raised sufficient private capital (in addition to the public funds at their disposal).

The problem is closely connected with the financing needs of R&D-intensive, innovative companies, which often face difficulties finding adequate sources of financing for their innovative projects. This weakens Hungary's performance in R&D and innovation, since many promising projects are not realised and are not turned into marketable products.

The Hungarian government has adapted its JEREMIE allocation plan, which now contains a series of new and modified financial products to be implemented, aiming to leverage more additional private funds than before. A new combined programme (refundable grants plus guaranteed loans) will bring about a shift from the traditional way of promotion. One risk is that considerable funding dedicated to direct grants to

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<sup>27</sup> SBA Factsheet 2009 also states that education is important to develop entrepreneurial attitude. The share of Hungarian people who agree that their school education helped develop an entrepreneurial attitude is 34% compared to 53% in the EU. See also: Strategy for Development of Small and Medium-sized Enterprises, 2007-2013; GKI (2009) A mikro-, kis és közepes vállalatok növekedésének feltételei.

<sup>28</sup> Cf. OECD (2008) Reforms for Stability and Sustainable Growth: An OECD Perspective on Hungary.

SMEs (under the same Operational Programme) can potentially crowd out the financial engineering measures under JEREMIE (because direct grants are likely to be more attractive to SMEs). The new financing system should ensure that this will not happen. The use of new combined instruments (such as the package of non-refundable grants plus loans, which is already available) will probably contribute to better leveraging of private capital.

### **Energy and climate change**

Hungary aims to cut its final energy consumption by 10% by 2020 compared to the 2005 level. This target seems rather ambitious, taking into account expected economic growth and the latest Commission projection for energy consumption, which assumes an annual average growth of 0.8% between 2010 and 2020.<sup>29</sup> The main channels for an increase in energy efficiency could be improving the insulation of private and public buildings, support for awareness-raising campaigns and increasing the contribution of waste heat from industry and thermal power production.

Beyond cutting energy consumption, Hungary also intends to increase the share of renewable energy sources in gross final energy consumption to 14.6% by 2020. This target slightly exceeds the share of 13% projected by the Commission.<sup>30</sup> This goal may be reached through full and timely implementation of the National Renewable Action Plan. In that context, the current mandatory power on-take system will be reformed in order to promote green heat generation. In addition, renewable power generation plants with lower capacity will be eligible to participate in the new scheme and higher efficiency thresholds will be set.

The recent trend in greenhouse gas emissions appears in line with the 2020 national target defined at the European level. Additional emissions reduction measures could be considered, especially if they bring co-benefits (energy savings, reduction of atmospheric pollution, increased security of energy supply, green jobs, revenues through the possibility to transfer unused emissions allocations to other Member States). Particular attention could be paid to the road transportation sector given its weight in the national emissions.

### **Research, development and innovation**

Hungary has committed to raising R&D expenditure to 1.8% of GDP by 2020 (from a 2009 level of 1.15% of GDP), while further increasing the share of the business sector. While the recent corporate tax cut may be helpful in this regard (although it does not necessarily affect the largest companies), the sectoral levies may in contrast have an adverse effect. R&D is primarily carried out by a small number of large foreign-owned enterprises, making investment growth relatively vulnerable. A venture capital programme launched in 2009 has so far had mixed results, with some indications that innovative companies (especially SMEs) may not have sufficient access to it.

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<sup>29</sup> For more details see: EU energy trends to 2030;  
[http://ec.europa.eu/energy/observatory/trends\\_2030/doc/trends\\_to\\_2030\\_update\\_2009.pdf](http://ec.europa.eu/energy/observatory/trends_2030/doc/trends_to_2030_update_2009.pdf).

<sup>30</sup> See EU energy trends to 2030.

Although the ratio of graduates in maths, science and technology has improved over the last decade, it is still far below the EU average (HU: 13.3%, EU average: 21.9% in 2008). The government's aim is to prioritise support for science and technology graduates, which may go towards enhancing human resources in this field, although it is unclear how the preferential treatment of these disciplines can be reconciled with the major cut announced in enrolment for state-financed higher education.

The institutional research system has recently undergone extensive reorganisation. The priority measures for 2011 consist in renewal of the research and innovation strategy, a unified system supporting research and innovation, and the restructuring of R&D institutions. A possible risk is the lack of a strong overall consensus among stakeholders and policy-makers on the desired objectives and instruments, leading to an unpredictable policy environment.

Hungary is well below the EU average in internet use. In 2010, only 52% of Hungarian households had access to broadband as opposed to the EU average of 61%. Mobile broadband can play an important role in ensuring full broadband internet coverage, boosting internet use in rural areas and increasing competition in the whole internet market. However, additional prime quality spectrum is currently lacking for mobile operators. On 28 October 2009, the European Commission adopted Commission Recommendation 2009/848/CE to switch off analogue terrestrial TV and free up a significant amount of radio spectrum (the 790-862 MHz band) for mobile broadband by 2012. Hungary is behind this schedule, and is currently likely to implement the digital switchover only at the end of 2014.

## **5. SUMMARY**

The budgetary situation in Hungary remains challenging. While extraordinary measures were taken in 2010, which contributed to approaching the deficit target of 3.8% of GDP in 2010 and will result in a surplus in 2011, the underlying budgetary position has significantly deteriorated. The measures in the Convergence Programme are expected to reduce the budgetary deficit in a structural way, in parallel with the phasing out of the extraordinary levies, and to start bringing debt downward. However, based on current estimates, the fiscal threshold of 3% of GDP may possibly be breached again in 2012 and 2013 unless further measures are taken. Moreover, in the later years the Convergence Programme does not secure further progress towards the MTO. The recently adopted constitution enhances the budgetary framework by establishing a constitutional debt brake at 50% of GDP as well as giving the Fiscal Council the right of veto over the annual budget. However, the details will only be specified in the subsequent 'cardinal' laws.

The main structural challenges presented in the Hungarian National Reform Programme coincide with those identified by the Commission services. The NRP recognizes that for some challenges, such as the low activity rate or improving the business environment, it will be necessary to have a strong reform momentum to address deep-seated issues. The complexity of some of the challenges, for instance the integration of disadvantaged groups, including the Roma minority, may require a more comprehensive approach. Increasing labour market participation, especially for women and those on low pay, remains a major challenge, and the employment

services face the need for substantial modernisation. Stimulating entrepreneurship and easing the burden on small firms would be important to encourage growth.

## ANNEX

Table I. Macro-economic indicators

	1995-1999	2000-2004	2005-2008	2009	2010	2011	2012
<b>Core indicators</b>							
GDP growth rate	3.0	4.3	2.1	-6.7	1.2	2.7	2.6
Output gap <sup>1</sup>	-1.7	1.2	2.4	-5.5	-4.6	-2.3	0.0
HICP (annual % change)	16.5	7.1	5.4	4.0	4.7	4.0	3.5
Domestic demand (annual % change) <sup>2</sup>	2.5	4.5	0.4	-10.8	-1.1	1.9	1.6
Unemployment rate (% of labour force) <sup>3</sup>	8.8	6.0	7.5	10.0	11.2	11.0	9.3
Gross fixed capital formation (% of GDP)	21.7	22.8	21.9	20.9	19.3	19.1	19.5
Gross national saving (% of GDP)	21.6	19.1	16.4	18.8	20.1	20.1	20.8
<b>General Government (% of GDP)</b>							
Net lending (+) or net borrowing (-)	-6.4	-5.9	-6.5	-4.5	-4.2	1.6	-3.3
Gross debt	67.7	56.0	66.5	78.4	80.2	75.2	72.7
Net financial assets	-28.1	-36.0	-50.7	-59.0	n.a	n.a	n.a
Total revenue	44.6	42.7	43.8	46.1	44.6	52.0	42.0
Total expenditure	51.0	48.6	50.3	50.6	48.8	50.4	45.3
<i>of which: Interest</i>	8.2	4.5	4.1	4.6	4.0	3.8	3.8
<b>Corporations (% of GDP)</b>							
Net lending (+) or net borrowing (-)	-2.3	-1.3	-1.8	4.6	n.a	n.a	n.a
Net financial assets; non-financial corporations	-102.8	-103.6	-109.7	-126.2	n.a	n.a	n.a
Net financial assets; financial corporations	-1.0	-2.5	-5.1	2.0	n.a	n.a	n.a
Gross capital formation	15.8	14.8	14.7	10.3	n.a	n.a	n.a
Gross operating surplus	17.5	20.4	22.1	22.8	n.a	n.a	n.a
<b>Households and NPISH (% of GDP)</b>							
Net lending (+) or net borrowing (-)	6.7	2.1	2.0	2.0	n.a	n.a	n.a
Net financial assets	57.9	61.7	61.8	64.2	n.a	n.a	n.a
Gross wages and salaries	33.1	35.2	36.7	36.2	n.a	n.a	n.a
Net property income	5.7	4.1	3.4	3.5	n.a	n.a	n.a
Current transfers received	16.3	16.9	18.7	19.3	n.a	n.a	n.a
Gross saving	11.6	7.3	6.5	6.5	n.a	n.a	n.a
<b>Rest of the world (% of GDP)</b>							
Net lending (+) or net borrowing (-)	-4.7	-7.3	-6.7	1.3	3.7	3.2	3.9
Net financial assets	74.2	81.2	103.9	120.3	n.a	n.a	n.a
Net exports of goods and services	-0.3	-2.7	-0.4	5.2	7.3	7.6	8.5
Net primary income from the rest of the world	-4.6	-5.0	-6.0	-5.0	-5.1	-5.6	-6.2
Net capital transactions	0.0	0.2	0.8	1.7	2.0	1.5	1.9
Tradable sector	46.2	43.7	42.9	41.8	42.7	n.a	n.a
Non tradable sector	39.4	42.1	42.9	42.9	41.6	n.a	n.a
<i>of which: Building and construction sector</i>	3.8	4.2	4.0	3.7	3.3	n.a	n.a
Real effective exchange rate (index, 2000=100)	98.3	120.2	141.5	131.9	130.6	133.8	135.9
Terms of trade goods and services (index, 2000=100)	101.6	101.1	98.8	98.7	98.7	98.3	98.3
Market performance of exports (index, 2000=100)	82.9	108.4	135.6	152.5	156.7	161.8	165.9
<b>Notes:</b>							
<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2000 market prices.							
<sup>2</sup> The indicator on domestic demand includes stocks.							
<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.							
<i>Source:</i>							
Commission services' spring 2011 forecast							



**Table II. Comparison of macro-economic developments and forecasts**

	2010		2011		2012		2013	2014	2015
	COM	CP	COM	CP	COM	CP	CP	CP	CP
Real GDP (% change)	1.2	1.2	2.7	3.1	2.6	3.0	3.2	3.3	3.5
Private consumption (% change)	-2.1	-2.1	2.7	3.1	1.0	2.2	2.4	2.5	2.7
Gross fixed capital formation (% change)	-5.6	-5.6	1.5	5.7	4.5	5.3	6.0	5.7	5.8
Exports of goods and services (% change)	14.1	14.1	9.6	9.7	9.2	10.5	12.1	11.6	11.7
Imports of goods and services (% change)	12.0	12.0	9.3	9.7	8.6	10.4	12.2	11.8	11.8
<i>Contributions to real GDP growth:</i>									
- Final domestic demand	-2.6	-2.6	1.6	2.2	1.5	2.2	2.4	2.6	2.7
- Change in inventories	1.6	1.6	0.2	0.2	0.0	0.0	0.0	0.0	0.0
- Net exports	2.2	2.2	1.0	0.7	1.2	0.8	0.8	0.7	0.8
Output gap <sup>1</sup>	-4.6	-5.1	-2.3	-3.2	0.0	-2.0	-0.9	-0.2	0.6
Employment (% change)	0.2	0.0	0.4	0.7	3.0	2.0	1.7	1.6	1.5
Unemployment rate (%)	11.2	11.2	11.0	10.9	9.3	10.5	9.9	9.3	8.7
Labour productivity (% change)	1.0	1.2	2.3	2.4	-0.3	1.0	1.5	1.7	1.9
HICP inflation (%)	4.7	4.7	4.0	4.0	3.5	3.4	3.0	3.0	3.0
GDP deflator (% change)	2.9	2.9	2.6	2.9	2.5	2.7	2.1	2.2	2.2
Comp. of employees (per head, % change)	-0.2	-4.8	2.6	1.7	2.0	1.9	4.0	3.1	2.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	3.7	3.9	3.2	4.2	3.9	5.6	5.8	4.4	4.4
<b>Note:</b>									
<sup>1</sup> In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.									
<b>Source:</b>									
Commission services' spring 2011 forecasts (COM); Convergence programme (CP).									

**Table III. Composition of the budgetary adjustment**

(% of GDP)	2010	2011		2012		2013	2014	2015	Change: 2010-2015
	COM	COM	CP	COM	CP	CP	CP	CP	CP
<b>Revenue</b>	<b>44.6</b>	<b>52.0</b>	<b>51.7</b>	<b>42.0</b>	<b>41.6</b>	<b>40.3</b>	<b>39.4</b>	<b>38.7</b>	<b>-5.9</b>
<i>of which:</i>									
- Taxes on production and imports	16.7	16.6	16.7	16.8	16.5	15.7	15.6	15.4	-1.3
- Current taxes on income, wealth, etc.	7.9	6.1	6.0	6.1	6.3	5.8	5.8	5.7	-2.2
- Social contributions	12.0	12.6	12.5	12.4	12.3	12.2	12.1	11.9	-0.1
- Other (residual)	8.1	16.8	16.5	6.7	6.5	6.6	5.9	5.7	-2.4
<b>Expenditure</b>	<b>48.8</b>	<b>50.4</b>	<b>49.7</b>	<b>45.3</b>	<b>44.1</b>	<b>42.5</b>	<b>41.3</b>	<b>40.3</b>	<b>-8.5</b>
<i>of which:</i>									
- Primary expenditure	44.7	46.6	45.8	41.5	40.3	38.8	37.7	36.9	-7.8
<i>of which:</i>									
Compensation of employees	10.7	10.2	10.1	9.9	9.5	8.9	8.4	8.0	-2.7
Intermediate consumption	7.7	7.5	7.0	6.9	6.8	6.6	6.3	6.1	-1.6
Social payments	18.3	18.1	17.7	17.0	16.2	15.5	15.0	14.6	-3.7
Subsidies	0.9	1.0	0.9	0.9	0.8	0.8	0.7	0.7	-0.2
Gross fixed capital formation	3.2	3.9	3.9	3.4	3.4	3.4	3.8	3.8	0.6
Other (residual)	3.8	6.0	6.2	3.5	3.6	3.7	3.4	3.7	-0.1
- Interest expenditure	4.0	3.8	3.9	3.8	3.8	3.7	3.6	3.4	-0.6
<b>General government balance (GGB)</b>	<b>-4.2</b>	<b>1.6</b>	<b>2.0</b>	<b>-3.3</b>	<b>-2.5</b>	<b>-2.2</b>	<b>-1.9</b>	<b>-1.5</b>	<b>2.7</b>
<b>Primary balance</b>	<b>-0.1</b>	<b>5.5</b>	<b>5.9</b>	<b>0.5</b>	<b>1.2</b>	<b>1.5</b>	<b>1.7</b>	<b>1.8</b>	<b>1.9</b>
One-off and other temporary measures	1.0	7.9	7.7	0.7	0.9	0.0	0.0	0.0	-1.0
<b>GGB excl. one-offs</b>	<b>-5.2</b>	<b>-6.3</b>	<b>-5.7</b>	<b>-4.0</b>	<b>-3.4</b>	<b>-2.2</b>	<b>-1.9</b>	<b>-1.5</b>	<b>3.7</b>
Output gap <sup>2</sup>	-4.6	-2.3	-3.2	0.0	-2.0	-0.9	-0.2	0.6	5.2
Cyclically-adjusted balance <sup>2</sup>	-2.1	2.7	3.5	-3.3	-1.6	-1.8	-1.8	-1.8	0.3
<b>Structural balance<sup>3</sup></b>	<b>-3.1</b>	<b>-5.2</b>	<b>-4.2</b>	<b>-4.0</b>	<b>-2.5</b>	<b>-1.8</b>	<b>-1.8</b>	<b>-1.8</b>	<b>1.3</b>
<i>Change in structural balance</i>		-2.2	-1.1	1.2	1.7	0.7	-0.1	0.1	
Structural primary balance <sup>3</sup>	1.0	-1.4	-0.3	-0.3	1.3	1.9	1.8	1.6	0.7
<i>Change in structural primary balance</i>		-2.4	-1.3	1.2	1.6	0.6	-0.2	-0.1	
<u>Notes:</u>									
<sup>1</sup> On a no-policy-change basis.									
<sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.									
<sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.									
<u>Source :</u>									
Convergence programme (CP); Commission services' spring 2011 forecasts (COM); Commission services' calculations									

**Table IV. Debt dynamics**

(% of GDP)	average 2005-09	2010	2011		2012		2013	2014	2015
			COM	CP	COM	CP	CP	CP	CP
<b>Gross debt ratio<sup>1</sup></b>	<b>68.9</b>	<b>80.2</b>	<b>75.2</b>	<b>75.5</b>	<b>72.7</b>	<b>72.1</b>	<b>69.7</b>	<b>66.7</b>	<b>64.1</b>
Change in the ratio	3.9	1.8	-5.0	-4.7	-2.5	-3.4	-2.4	-3.0	-2.6
<i>Contributions<sup>2</sup>:</i>									
<b>1. Primary balance</b>	<b>1.9</b>	<b>0.1</b>	<b>-5.5</b>	<b>-5.9</b>	<b>-0.5</b>	<b>-1.2</b>	<b>-1.5</b>	<b>-1.7</b>	<b>-1.8</b>
<b>2. “Snow-ball” effect</b>	<b>1.5</b>	<b>1.0</b>	<b>-0.2</b>	<b>-0.6</b>	<b>0.1</b>	<b>-0.4</b>	<b>0.1</b>	<b>0.0</b>	<b>-0.3</b>
<i>Of which:</i>									
Interest expenditure	4.2	4.0	3.8	3.9	3.8	3.7	3.7	3.6	3.3
Growth effect	0.0	-0.9	-2.1	-2.3	-1.9	-2.1	-2.2	-2.2	-2.2
Inflation effect	-2.7	-2.2	-2.0	-2.2	-1.8	-1.9	-1.5	-1.5	-1.4
<b>3. Stock-flow adjustment</b>	<b>0.4</b>	<b>0.7</b>	<b>0.7</b>	<b>1.9</b>	<b>-2.0</b>	<b>-1.8</b>	<b>-0.9</b>	<b>-1.2</b>	<b>-0.4</b>
<i>Of which:</i>									
Cash/accruals diff.	n.a.	n.a.							
Acc. financial assets	n.a.	n.a.							
<i>Privatisation</i>	n.a.	n.a.		0.0		0.0	0.0	0.0	0.0
Val. effect & residual	n.a.	n.a.							

**Notes:**<sup>1</sup>End of period.<sup>2</sup>The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.**Source :***Convergence programme (CP); Commission services' spring 2011 forecasts (COM); Commission services' calculations.*

**Table V. Sustainability indicators**

Hungary	Baseline scenario (2010)			Programme scenario		
	S1	S2		S1	S2	
Value	2.2	3.0		0.7	1.8	
<i>of which:</i>						
Initial budgetary position (IBP)	0.5	0.7		-0.6	-0.5	
Debt requirement in 2060 (DR)	0.4	-		0.1	-	
Long-term change in the primary balance (LTC)	1.2	2.3		1.2	2.3	
	2010	2015	2020	2010	2015	2020
Debt as % of GDP	80.2	88.0	110.7	80.2	64.1	58.7

*Note:* The 'baseline' scenario (2010) depicts the sustainability gap under the assumption that the 2010 budgetary position remains unchanged over the medium term (until the end of the period covered by the programme). The 'programme' scenario depicts the sustainability gap under the assumption that the budgetary plans of the programme are fully implemented.

**Table VI. Financial market indicators**

	2006	2007	2008	2009	2010
Total assets of the banking sector (% of GDP)	96.0	102.7	117.1	135.4	131.3
Share of assets of the five largest banks (% of total assets)	53.5	54.1	54.4	55.2	...
Foreign ownership of banking system (% of total assets)	56.4	57.4	60.3	56.3	...
Financial soundness indicators:					
- non-performing loans (% of total loans) <sup>1)</sup>	2.6	2.3	3.0	6.7	9.1
- capital adequacy ratio (%) <sup>1) 2)</sup>	11.0	10.4	11.2	13.1	14.1
- profitability - return on equity (%) <sup>1) 3)</sup>	23.8	18.4	11.6	9.4	1.3
Private credit growth (annual % change)	15.0	18.9	19.1	-1.2	-1.2
Residential property prices (y-o-y % change)					
Exposure to countries receiving/repaying official financial assistance (% of GDP) <sup>4)</sup>	...	...	...	...	...
Private debt (% of GDP) <sup>5)</sup>	58.3	58.9	64.7	70.3	67.5
Gross external debt (% of GDP)					
- Public	33.9	34.2	38.5	45.7	45.4
- Private	51.0	55.3	76.5	82.8	67.6
Long term interest rates spread versus Bund (basis points)*	335.3	252.8	425.4	590.1	453.8
Credit default swap spreads for sovereign securities (5-year)*	...	53.1	205.8	338.3	288.3

*Notes:*

<sup>1)</sup> 2008-2009 figures include foreign bank branches.

<sup>2)</sup> The capital adequacy ratio is defined as total capital divided by risk weighted assets. Basel I and Basel II being applied simultaneously.

<sup>3)</sup> Net income to equity ratio.

<sup>4)</sup> Covered countries are IE, EL, PT, RO, LV and HU.

<sup>5)</sup> Due to data gaps on debt securities in 2007, only the loans to GDP ratio is provided for this year.

\* Measured in basis points.

*Source:*

*Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission services (long-term interest rates), World Bank (gross external debt), Eurostat (residential property prices) and ECB (all other indicators).*

**Table VII. Labour market and social indicators**

<b>Labour market indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Employment rate (% of population aged 20 - 64)	62.2	62.6	62.6	61.9	60.5	60.4
Employment growth (% change from previous year)	-0.2	0.6	-0.3	-1.3	-2.8	0.2
Employment rate of women (% of female population aged 20 - 64)	55.6	55.7	55.5	55.1	54.4	55.0
Employment rate of men (% of male population aged 20 - 64)	69.2	69.9	70.2	69.0	67.0	66.0
Employment rate of older workers (% of population aged 55 - 64)	33.0	33.6	33.1	31.4	32.8	34.4
Part-time employment (% of total employment)	4.1	4.0	4.1	4.6	5.6	5.8
Fixed term employment (% of employees with a fixed term contract)	7.0	6.7	7.3	7.9	8.5	9.7
Unemployment rate <sup>1</sup> (% of labour force)	7.2	7.5	7.4	7.8	10.0	11.2
Long-term unemployment <sup>2</sup> (% of labour force)	3.2	3.4	3.4	3.6	4.2	5.5
Youth unemployment rate (% of youth labour force aged 15-24)	19.4	19.1	18.0	19.9	26.5	26.6
Youth NEET <sup>3</sup> rate (% of population aged 15-24)	12.9	12.4	11.3	11.5	13.4	:
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	12.5	12.6	11.4	11.7	11.2	:
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	17.9	19.0	20.1	22.4	23.9	:
Labour productivity per person employed (annual % change )	3.4	3.0	1.1	2.1	-4.0	1.0
Hours worked per person employed (annual % change)	0.0	-0.2	-0.2	0.0	-0.9	-0.4
Labour productivity per hour worked (annual % change; constant prices)	3.4	3.2	1.3	2.1	-3.1	1.3
Compensation per employee (annual % change; constant prices)	4.7	1.1	0.8	2.1	-6.3	-2.9
Nominal unit labour cost growth (annual % change)	3.6	2.3	5.6	4.8	1.9	-1.1
Real unit labour cost growth (annual % change)	1.3	-1.9	-0.3	0.0	-2.4	-3.9

**Notes:**

<sup>1</sup> According to ILO definition, age group 15-74)

<sup>2</sup> Share of persons in the labour force who have been unemployed for at least 12 months.

<sup>3</sup> NEET are persons that are neither in employment nor in any education or training.

**Sources:**

Comission services (EU Labour Force Survey and European National Accounts)

**Table VII. Labour market and social indicators - continued**

<b>Expenditure on social protection benefits (% of GDP)</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Sickness/Health care	5.97	6.43	6.34	5.60	5.57
Invalidity	2.08	2.13	2.16	2.12	2.09
Old age and survivors	8.58	9.13	9.28	9.64	10.11
Family/Children	2.45	2.53	2.82	2.81	2.84
Unemployment	0.59	0.62	0.67	0.76	0.82
Housing and Social exclusion n.e.c.	0.54	0.67	0.68	1.05	0.85
<b>Total</b>	20.2	21.5	21.9	22.0	22.3
of which: Means tested benefits	1.01	1.14	0.95	1.40	1.21
<b>Social inclusion indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Risk-of-poverty or exclusion <sup>1</sup> (% of total population)	32.1	31.4	29.4	28.2	29.9
Risk-of-poverty or exclusion of children (% of people aged 0-17)	38.4	37.7	34.1	33.4	37.6
Risk-of-poverty or exclusion of elderly (% of people aged 65+)	23.9	23.9	21.1	17.5	17.8
At-Risk-of-Poverty rate <sup>2</sup> (% of total population)	13.5	15.9	12.3	12.4	12.4
Value of relative poverty threshold (single HH per year) - in PPS	3336	3648	3900	3960	4104
Severe Material Deprivation <sup>3</sup> (% of total population)	22.9	20.9	19.9	17.9	20.8
Share of people living in low work intensity households <sup>4</sup> (% of people aged 0-59 not student)	9.5	13.0	11.3	12.0	11.3
In-work at-risk-of poverty rate (% of persons employed)	8.8	6.9	5.8	5.8	6.2
<b>Notes:</b>					
<sup>1</sup> People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).					
<sup>2</sup> At-risk-of poverty rate: share of people with an equivalised disposable income below 60% of the national equivalised median income.					
<sup>3</sup> Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone					
<sup>4</sup> People living in households with very low work intensity: Share of people aged 0-59 living in households where the adults work less than 20% of their total work-time potential during the previous 12 months.					
<b>Sources:</b>					
For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.					

**Table VIII. Product market performance and policy indicators**

<b>Performance indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Labour productivity <sup>1</sup> total economy (annual growth in %)	4.2	3.2	0.8	2.5	-4.3	1.2
Labour productivity <sup>1</sup> in manufacturing (annual growth in %)	6.1	7.1	6.0	-0.4	-6.3	12.1
Labour productivity <sup>1</sup> in electricity, gas, water (annual growth in %)	-2.8	-4.7	4.5	13.4	-12.0	n.a.
Labour productivity <sup>1</sup> in the construction sector (annual growth in %)	1.0	-0.8	-9.1	-4.2	-4.8	-4.7
Patent intensity in manufacturing <sup>2</sup> (patents of the EPO divided by gross value added of the sector)	0.9	0.8	0.2	n.a.	n.a.	n.a.
<b>Policy indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Enforcing contracts <sup>3</sup> (days)	n.a.	335	335	335	395	395
Time to start a business <sup>3</sup> (days)	n.a.	38	16	5	4	4
R&D expenditure (% of GDP)	0.9	1.0	1.0	1.0	1.2	n.a.
Tertiary educational attainment (% of 30-34 years old population)	16.4	19.0	20.1	22.4	23.9	n.a.
Total public expenditure on education (% of GDP)	5.4	5.4	5.2	5.1	n.a.	n.a.
	<b>2003</b>	<b>2005</b>	<b>2006</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Product market regulation <sup>4</sup> , Overall (Index; 0=not regulated; 6=most regulated)	1.9	n.a.	n.a.	1.3	n.a.	n.a.
Product market regulation <sup>4</sup> , Retail (Index; 0=not regulated; 6=most regulated)	1.3	n.a.	n.a.	2.1	n.a.	n.a.
Product market regulation <sup>4</sup> , Network Industries <sup>6</sup> (Index; 0=not regulated; 6=most regulated)	3.3	2.8	2.6	1.8*	n.a.	n.a.
<b>Notes:</b>						
<sup>1</sup> Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.						
<sup>2</sup> Patent data refer to applications designated to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.						
<sup>3</sup> The methodologies, including the assumptions, of this indicator is presented in detail at the website <a href="http://www.doingbusiness.org/methodology">http://www.doingbusiness.org/methodology</a> .						
<sup>4</sup> The methodologies of the Product market regulation indicators are presented in detail at the website <a href="http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html">http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html</a> . The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.						
<sup>6</sup> Aggregate ETCR.						
*figure for 2007.						
<b>Source:</b>						
Commission services, World Bank Doing Business (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).						