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Weekly Briefing

Hungary economy briefing: Adjustment of the Hungarian economy to new world economic conditions

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Adjustment of the Hungarian economy to new world economic conditions

According to Pigou, the classical economist, economics is to be regarded as an art, knowledge of economics being the science and action the art. It is uncertain whether we should interpret economics as an art or not, but we can be sure that a good economic strategy must also be adapted to new conditions resulting from internal and external changes and trends. Today, external changes are more pressing and require the Hungarian government to change. This briefing discusses the elements of the Hungarian government's additional measures and the potential economic impact of these measures.

Introduction

As we reported last week, the Hungarian government has introduced new sector taxes to keep utility prices low and to finance the costs incurred by the war in Ukraine. As a result of the measures, two separate and earmarked funds will be established to achieve the two objectives mentioned above.

According to the government's announcement, additional tax revenues of 815 billion forints will be collected from eight sectors over the next two years (2022-2023). Credit institutions and financial companies will pay the additional tax based on their net turnover, and the additional tax will be 10 percent in 2022 and 8 percent in 2023. Manufacturers of petroleum products will also have to pay a surtax in 2022 and 2023. The rate will be 25 percent and will be based on the price difference between a certain world market price and the purchase price of crude oil from Russia. Renewable energy power plants will also be taxed at a rate of 65 percent. In addition to these measures, the financial transaction tax will also be extended to the purchase of financial instruments, with a maximum amount set at HUF 1,000 per transaction. The airlines' contribution follows a different logic, it is a fixed tax, HUF 3,900 per passenger in the EU and other European countries and HUF 9,750 per passenger in all other cases. The company car tax will almost double, while the tax on pharmaceutical goods will increase from 20 to 28 percent for prices above HUF 10,000. Simplified employment regulations will also be changed, and applied fees will increase from HUF 500 to HUF 1,000 per capita per day in seasonal agriculture and tourism, and from HUF 1,000 to HUF 2,000 in all other cases. Companies that are to pay the telecommunication tax will also have to pay the additional tax, which is based on net sales. The tax will be levied progressively. An additional tax is introduced for insurance companies, the surtax is gradually increased, the tax base is the amount of the insurance premium, the same applies to companies subject to retail sales tax and mining tax.

In addition to the sectoral measures, state-subsidized gas and gasoline can now only be purchased and refueled by cars with Hungarian licenses, and the excise tax is also increased. Excise taxes on tobacco and alcohol will be raised and some public investments will be postponed.

It is expected that most of the additional tax revenue will come from the energy sector, about HUF 300 billion of the HUF 800 billion will be paid by this sector, according to the government. 40 billion forints in additional tax revenue is expected to come from Magyar Telekom, the dominant telecommunication company on the Hungarian market. These two large companies will account for almost 42 percent of the additional taxes.

Arguments for the introduction of additional taxes and reactions

The Hungarian government argued that the additional measures were necessary because of the prolonged war, the energy crisis and EU sanctions from Brussels, which caused inflation in the economy. Mr. Gulyas, Minister for the Prime Minister's Office, stressed in a press conference that the war between Russia and Ukraine does not pose a direct threat to Hungary, but a humanitarian disaster is looming, and the country's economic development will be affected. For this reason, the government has decided to expect an additional financial contribution from those who particularly benefit from the exceptional situation. It is important to emphasize that the additional tax revenue will allow the budget deficit target, originally set at 4 percent of GDP, to be met. The budget for next year is about to be approved in the coming weeks. In the budget, the government forecasts GDP growth of 4.1 percent, inflation of 5.2 percent, and a budget deficit of 3.5 percent of GDP.

The government is sticking to the budget deficit targets for 2022 and 2023 because the resilience of the Hungarian economy can only be maintained if the budget deficit and public debt are under control, argued Mr. Nagy, Minister of Economic Development. Responding to the weakening of the Hungarian currency, he also claimed that it was caused in part by concerns about a U.S. recession, in part by the deterioration of Hungary's current account and the fact that markets had been expecting a fiscal adjustment in the Hungarian economy. (In recent days, more than 400 HUF had to be exchanged for one euro, signaling a psychological red line at a 400-to-1 exchange rate).

While the Hungarian government is trying to put the public budget on a solid footing through the additional tax measures, it also seems to be aware of the importance of multinational companies for the Hungarian economy. For this reason, the Hungarian government seems to have changed its stance regarding the introduction of the global corporate tax. The chairman of the Hungarian Parliament's Economic Committee argued that Hungarian competitiveness would suffer if the European Union adopted a directive on a global corporate tax, while the Hungarian foreign minister spoke with his American counterpart, Mr. Blinken, and shared Hungarian concerns with him. They agreed to continue dialog on the issue.

The airlines' reaction to the surtaxes has not been positive. So far, three low-cost airlines operating in Hungary have announced that they will raise their prices and that customers will have to pay for the additional tax. The government reacted and said that the tax is levied on extra profits and for this reason price increases cannot be accepted, so consumer protection proceedings will be initiated against airlines with this business practice. The reaction of the CEO of the low-cost airline Rynair was harsh, and he argued that airlines do not currently generate extra profits, so imposing taxes on extra profits does not make sense from an economic point of view.

Another reaction came from the GKI Research Institute, which argued that the new taxes will create an additional wave of inflation in an economy that can already be described as a highly inflationary environment. The GKI Research Institute estimates that of the 815 billion forints, about 475 billion forints will appear in the economy in the form of price increases. This will add 1.6 percentage points to the already high inflation rate. A look at Table 1 shows that inflation in the European Union is not only increasing in general, but that the Central and Eastern European countries of the EU are doing worse than the Western part of the European Union. Moreover, if we analyze the table, we can easily see that the closer the country is geographically to Ukraine, the higher the inflation measured in May 2022.

Table 1. Inflation rates in Central and Eastern countries (2022, May, %)

Country	Inflation rate (%)
Estonia	20.0
Lithuania	18.9
Latvia	16.9
Czech Republic	16.0
Romania	14.5

Bulgaria	14.4
Poland	13.9
Slovakia	12.6
Hungary	10.7
Croatia	9.4
Slovenia	8.1
European Union	8.1
Euro zone	
Source: Trading Economics, retrieved from: https://tradingeconomics.com/country-list/inflation-rate?continent=europe	

Summary

From this briefing, it appears that the Hungarian government is trying to balance the public budget and raise additional revenue by introducing temporary additional taxes. Improving the public deficit seems to be crucial in the short and medium term, as financial investors are more cautious about Hungary than they were a year ago. These concerns can be seen in the fluctuations of the domestic currency. Another aspect that makes improving public finances important is the fact that the Hungarian government has not yet made progress in allocating EU transfers. Since the deal involves a political debate between the Hungarian government and the European Commission, the outcome cannot be predicted, although the funds are urgently needed. Not only have energy prices risen and it is difficult to subsidize low energy prices, but the global food crisis will most likely trigger a new migration crisis that will impose additional costs on Hungary.