

Consensus

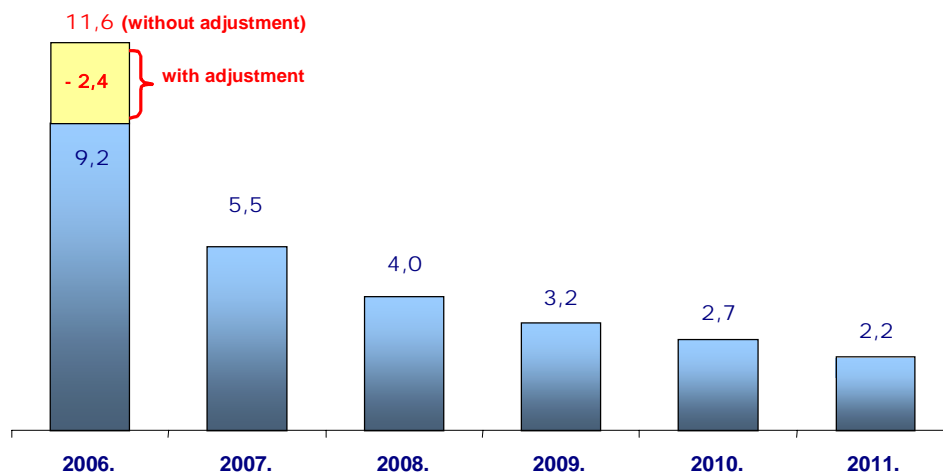
on the feasible direction of the reforms in Hungary

The following paper proposes a new direction for Hungary to follow in the next few years. It is not just a plan proposing action, it is more than that. I shall also describe the thoughts and values behind the individual measures. Since the autumn of 2007, when the government's action plan summarised in 48 points was announced, I have been arguing that, parallel with restructuring, we should focus more intensively on the reform of the social culture. Continuing the very same idea, we put the values of work, knowledge and property into the centre of our messages and communication at the beginning of 2008. The proposals contained herein follow the same process. Below I shall argue for the continuation of the reform policy. I wish to propose no less but more than we did before. More, but in a different way. I can do so because during the last two years both the possibility and the need have emerged to ask ourselves the question almost twenty years after the systemic change: what kind of Hungary would we like to have? My answer begins with this paper.

Let me start with a short overview.

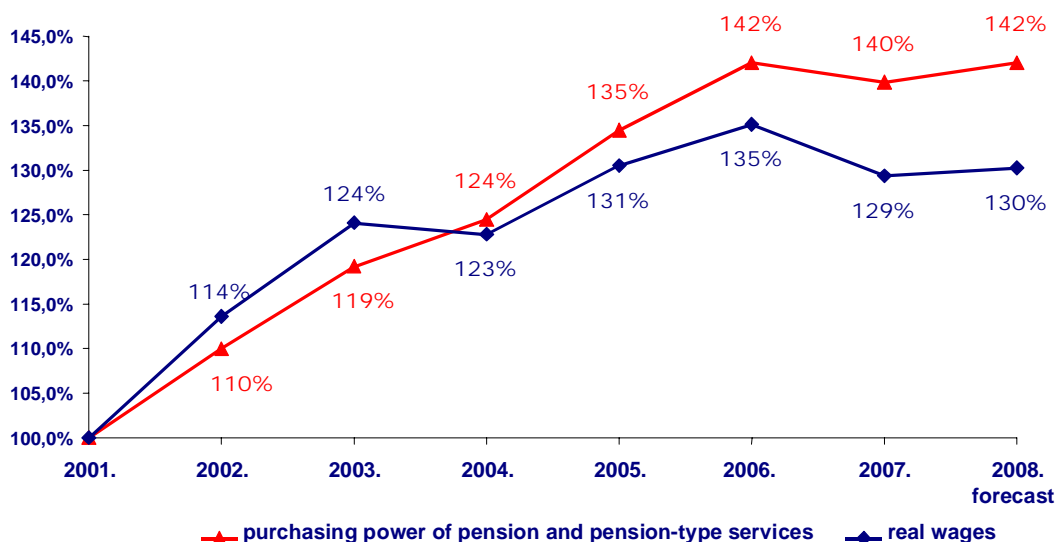
The policy followed since the turn of the millennium could not be continued after 2006 due to reasons explained and described many times, and adjustment has now become unavoidable. We did what we had to do in the last two years and, as a result of our governing efforts, the country's economy has almost recovered its balance. As the head of government and the president of the Hungarian Socialist Party, I must express my gratitude to all those who carried the burden, as without the performance and support of many people we would not be in the position of planning our actions for the future now.

Budget deficit as a percentage of GDP



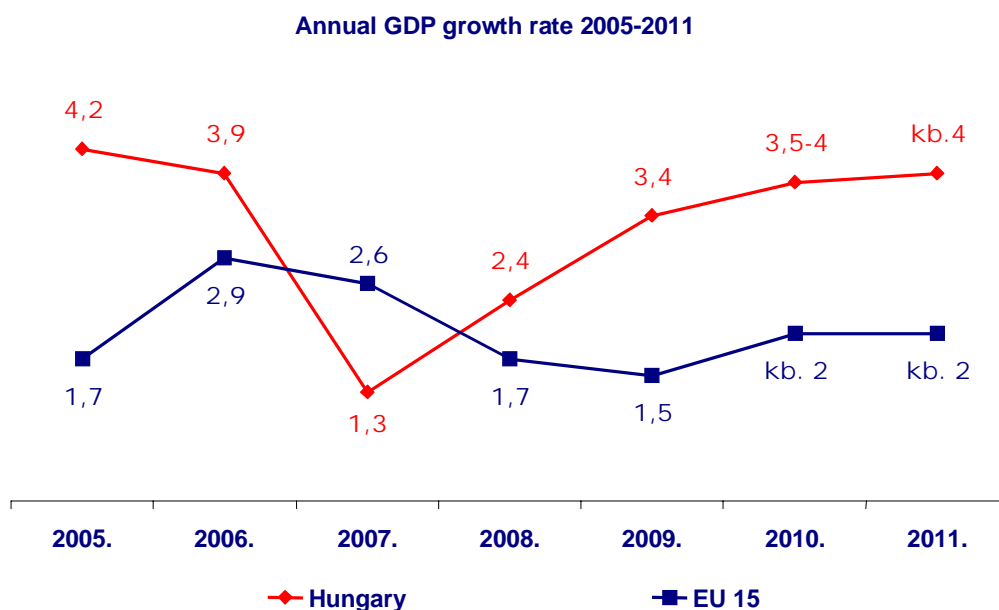
Correction is an investment with a long-term return, and we had to pay a high social and political price for it on the short term. The growth of national income has decelerated, income and pensions fell for a year and inflation broke away. In the process of balance recovery, we went to the farthest limits to protect those who lived in the most difficult situation, while the majority of the burden was carried by people with a higher income.

Purchasing power of incomes (as a percentage of the 2001 figure)



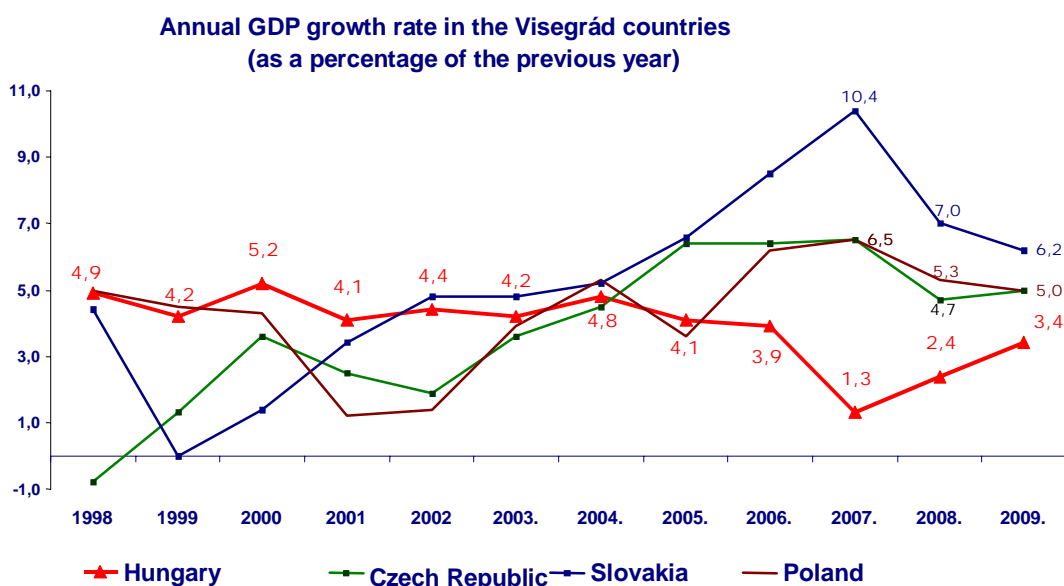
The restructuring proposed in public administration, education and especially the health sector has also caused a lot of conflicts. Some of the political disputes exceeded the democratic constitutional framework, extreme right radicalism appeared in public life and on the streets with unprecedented power and

violence, supported from the background. The governing coalition broke up this spring, and since May, we, the Socialists have been governing the country alone. There is also no doubt that this year will already bring a lot of important events. Growth and inflation figures are on the mend, wages and pensions are increasing faster than prices, motorways are built, and schools, hospitals, city and village centres are reconstructed.



Is the worst now over? Concerning the former, short-term challenges and risks, we can say so. There is no need for any further painful budgetary adjustments, and we do not have to make decisions on the transformation and restructuring of large public systems either to cause a lot of deep conflicts. Focus will be shifted more and more on construction instead of demolition of old structures.

However, the picture, which is favourable in many aspects, also includes signs indicating widely known, long-term risks. The most important of these signs are the economic growth and employment figures, which are lower than the average figures in our region. According to the majority of the analyses, these do not represent short-term, so-called boom and bust problems. In other words, the unfavourable figures are not only the results of a single shock effect of budgetary adjustment, or the temporary shrinking of our European export markets. We are facing a deeper and more complex challenge.



In the applicable analyses, I shall write also about many contradictions, difficulties and weaknesses. But in order to avoid any misunderstanding or misinterpretation, let me briefly clarify something.

Despite all our torments and unforgettable national tragedies, I think of Hungary as a successful country in a historical perspective. Based on our democratic relations, everyday safety, size of income, education, health sector, the development of our transport, telecommunications and IT networks, and many other similar factors, Hungary is the thirty-fifth most developed country in the world. As a free, independent, democratic state, Hungary is a member of the European Union, the strongest political, security and economic association of the world, and the NATO.

Amid the daily problems, we seem to forget that for many centuries millions of Hungarians only dreamt of what we achieved by the end of the 20th century. We have a good reason to love and appreciate this country, and to be proud of its achievements. We must not forget these things before we start preparing a fair list of our problems and raising criticism.

There is something else that I wish to state if advance: this paper does not intend to cover the results of the actions of the government in the last few years. I shall not try using the words “on the one hand – on the other hand” either. When I am critical, it does not mean that I cannot see our successes, and positive consequences of the actions of our government. On the contrary. However, as I wish to talk about the actions primarily, I must focus on the problems that need solutions instead of the results of the former period.

What makes a country competitive?

The issues of longer term social and economic competitiveness and economic growth are covered in literature that could easily fill a library. Various theories, occasionally arguing with each other, are trying to find an answer to the question of what decides which country advances in a competition between nations and which lags behind. I wish to refer to only one of the theories explaining success. This theory acknowledges the importance of factors, such as taxation, justice or education, but also adds something to them. The addition is that these factors do not carry or lead to competitiveness on their own, as they are also consequences only. They are the consequences of the dominant social, communal and individual mentality and culture, i.e. the way we are, the way we think and the values we believe in. They determine the rules we create, the institutions we establish, the school system reform, our health sector and the judicial system. Of course, we could also reach a conclusion that there is nothing to do because it is not worth changing the social culture on a short term. In my opinion, this is a wrong conclusion. On the other hand, I think that two things follow from those described previously. First, that the institutions and rules cannot be arbitrarily changed independently from the reigning social culture, and recipes working elsewhere in a different cultural environment cannot be imported simply either. Secondly, if we wish to make Hungary more successful, then we must implement a programme, which has an impact on the interests and decisions, and, ultimately, the choice of values of the social actors, the people, institutions and companies, which altogether represents the entire Hungarian social culture.

Nobody argues with the fact that the economic success of a country is fundamentally influenced by the attitude of the society towards risk assumption, enterprise, individual initiatives and success. Some nations are more adventurous and more competition-oriented, others are more reserved. We, Hungarians, belong more to the second group, often looking at the world of business with suspicion, often mixed with some prejudice as well.

Without going into a lengthy historical, sociological and social psychological analysis, one or two short remarks should be made. The suspicion about the world of business is not a new phenomenon. The undeclared social agreement between the groups described as the historical Hungarian middle classes and the emancipating groups, rapidly rising to middle classes, not classified as Hungarian, including primarily the Jews living in Hungary, concluded at the end of the 19th, beginning of the 20th century, is a well-known example. According to this agreement, the representatives of the historical Hungarian middle classes retained their rights for almost exclusive control over public life, political representation and public administration, staying away from the key positions of business life, and opening them to non-Hungarian but Austrian, German, Czech and Jewish businessmen living primarily in large cities. It is bluntly obviously

that according to the dominant social mentality “a true Hungarian gentleman” did not have anything to do with business.

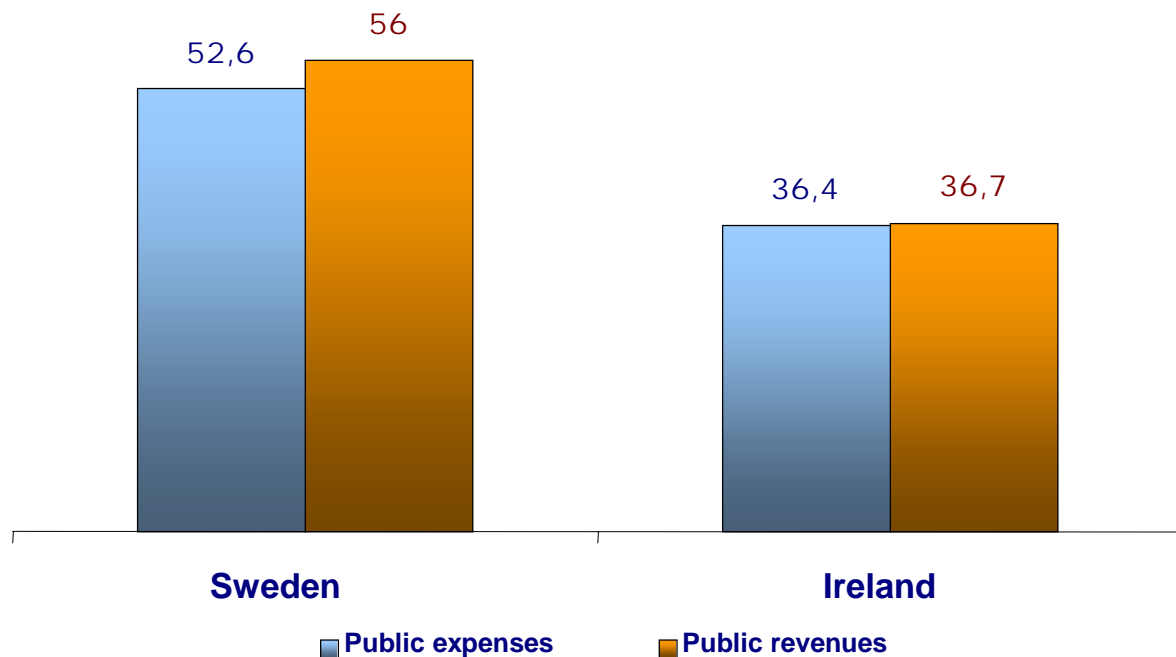
This social and cultural heritage was followed by the four decades of Communism, restricting and prohibiting free business activities. It is obviously associated with these precedents that the negative attitude about private investments and business activities has remained even after the systemic change and even became an individual political character forming factor in the policy of some parties, including primarily the rhetorics and anti-private capital actions of Fidesz.

There is no single European competitiveness model. After the Second World War, three relatively clear formulae emerged: the Anglo-Saxon, the Scandinavian and the so-called Rhine model in the middle of the continent, in where German and French were spoken. The Anglo-Saxon and Scandinavian models managed to reform themselves and successfully respond to the crises accompanying the extensive transformation and restructuring of the world economy in the 80s and 90s, and the countries using this model are still included among the most competitive countries. The Rhine model slowly lost its model nature parallel with the significant weakening of the tripartite system forming its basis, as Germany, Austria and France follow their own respective paths involving more and more national characteristics.

Instead of comparing the two still successful models in detail, I would only like to refer to their basic characteristics. The Anglo-Saxon model has still preserved the heritage of liberalism from the end of the 19th century. The strong citizen, civilian and market autonomies are accompanied with a high degree of individual responsibility. The state intervenes in the economy moderately, low taxes allow for public services of limited scope and quality. Basic economic and social coordination constitutes competition.

The Scandinavian model is based on the historical tradition of communal land and forest property, as well as long-term cooperation culture. The modern Scandinavian state has remained an active economy and society organising force, and citizens accept and require extensive public service organisation and supply by the state, and are willing to pay high taxes in order to maintain this system. In addition to competition, bureaucratic coordination and solidarity based on mutuality are typical economic-social coordination forms.

Public expenses and revenues as a percentage of GDP in 2007

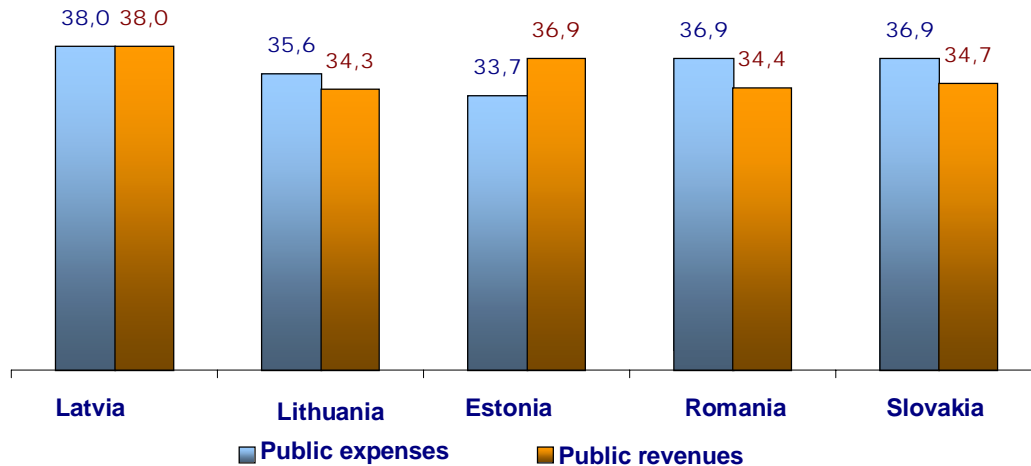


These models are very similar to each other as they tackled the challenges of globalisation operating in countries with an open economy and a developed market, yet somewhat differently, but the dominant economic policy is liberal. It is also true that both models assume strong citizen awareness and civilian participation, as well as a strong, and well-performing public institution system adjusted to their respective characteristic features.

Naturally, we cannot say at all that, for example, the Anglo-Saxon model is conservative, and the Scandinavian model is social-democratic on its own. As it was stressed earlier, the individual social and economic models are institutional reflections of the dominant social culture. Consequently, the right and left tones may and can be distinguished only within the individual models.

The European countries, not relating to the two models described above, have been struggling with competitiveness problems for years, and finally some of them adopted a few components of the Anglo-Saxon model. These countries introduced a single-rate tax system and cuts in their public services at least with respect to the previous structure thereof. Consequently, economic growth began, yet social tensions also increased dramatically.

**Public expenses and revenues as a percentage of GDP
in some countries joining the EU in 2007**



Perhaps it is not accidental that first those countries managed to implement this continental version of the Anglo-Saxon model, which regained their independence or were established as new states after the 1990s. In these countries, which regained their status as a state or were established as a completely new state obviously did not have any strong social interest protection, or a social solidarity net deeply integrated into the society and protecting the weakest people, therefore, the majority was able to transfer the burden of the reducing welfare services to the minority that could not protect itself effectively.

On the other hand, it is not accidental either, that the single rate taxation has not been introduced in any of the social market economies with strong traditions yet, and social services and benefits have not been reduced at the expense of radical restrictions in welfare services. There is no question that in these countries it would not be possible to obtain the support of the social and political majority required for such decisions.

The Hungarian mule

Perhaps it is important to stress that this issue is not a simple dispute on taxation. The dispute on taxation, which is on the surface, in fact is associated with the issue of the choice of a social model. More specifically, the choice of what we think of the responsibilities and obligations and the rights of the people in the framework of parliamentary democracy and social market economy, i.e. what should the states, families and people do.

Obviously, the majority of people do not spend their everyday life by studying the budget. It is natural that they cannot understand the details of the operation of the state, or the budget, they cannot see the correlation between the taxes paid by them and the services provided to them by the state. Those who can, try to optimise the situation as customers and consumers following a learned recipe, paying the least amount of tax and claiming as much as possible from the state. There is some sort of an illusion, too, suggesting that the state has got money and it is only the question of decisions on what and how much that money is spent.

The rights and obligations are connected in the conduct of a democratic citizen. The state can only act and protect, safeguard and serve its citizens, if they are willing to cooperate as citizens and maintain the state. Obviously, part of this latter concept is the performance of the tax-paying obligation. Although it is a trivial issue, it should still be stressed: a state cannot do more for its citizens than its citizens do for the nation. This principle has almost been forgotten in the young democracies, and also in Hungary. As a result, the performance of citizen's rights and exercising citizen's rights are detached from each other, which breaks the internal performance, social and responsibility balance of the national community.

The picture would not be complete without adding that us, politicians also contribute to the maintenance of this thinking and conduct. It is a well-known political gesture to promise more social support without specifying the respective source of funding either in the form of additional tax payments, or the loss of a previous support.

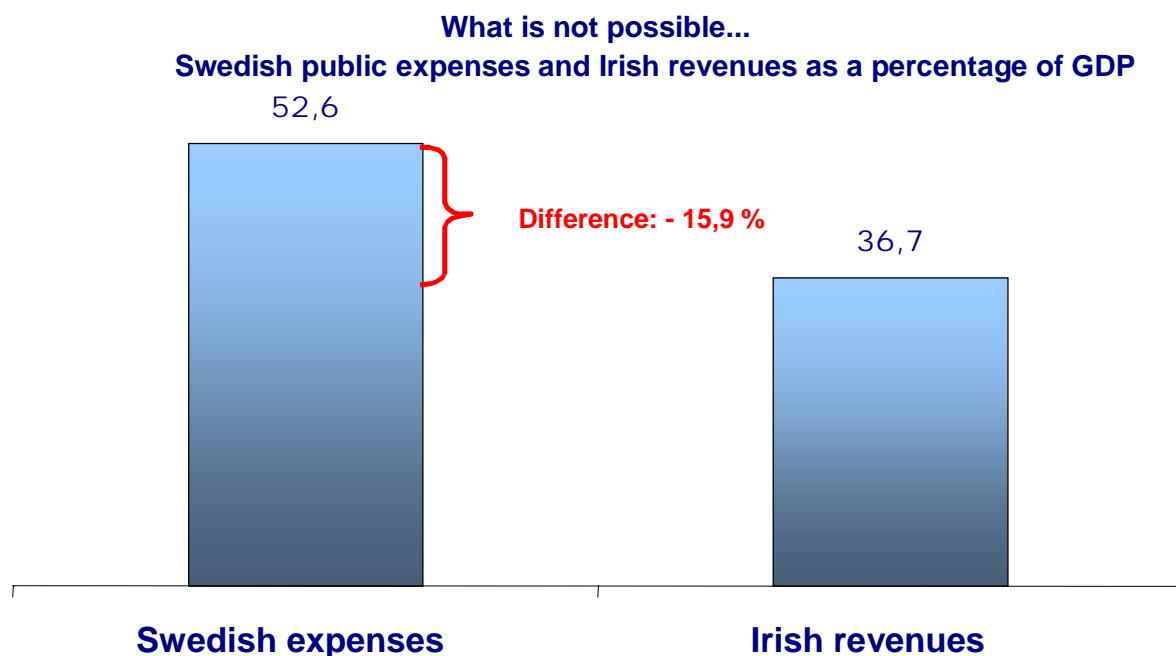
The same illusion is mirrored in the promised tax and contribution deduction without saying who, consequently, will get less of the pie, and who will miss the lost revenues. The governing parties have made such mistakes on several occasions in the last six years. It is a qualified case of a political deceit when someone promises even more from less, as Fidesz did in 2006, when it simultaneously intended to reduce the social security contribution and increase pensions.

What was said earlier also applies to the process, which is currently described in Hungary as a discussion on taxation, i.e. that according to the underlying, hidden contents of this discussion, it is about economic and social model and not taxes. It is true, even if almost no one has talked/talks about it clearly. In most cases, suggestions are made and good or bad intentions illusions are created instead of discussing models.

All in all, I think that at present Hungary is in a non-productive state of an economic, social and political disequilibrium. Without any party or power political references, I think that the ultimate cause of the lack of social and

economic equilibrium is the almost two decades of uncertainty of model selection, which has become an acute problem by now.

The only difference between the political cycles following each other in the almost twenty years since the systemic change is that they either wished to move towards the Anglo-Saxon model, or intended to unsustainably combine the advantages of the Anglo-Saxon and Scandinavian models avoiding conflicts and creating illusions. These days a false consensus seems to be developing again, suggesting that a specific distorted model may be created, in which the wide range of social solidarity and extensive and high quality public services of the Scandinavian model are combined with the low tax rates and public re-distribution of the Anglo-Saxon model. No such mule exists.



The real issue is, therefore, which complex social and economic model Hungary will choose to react to the current lack of social, economic and political equilibrium.

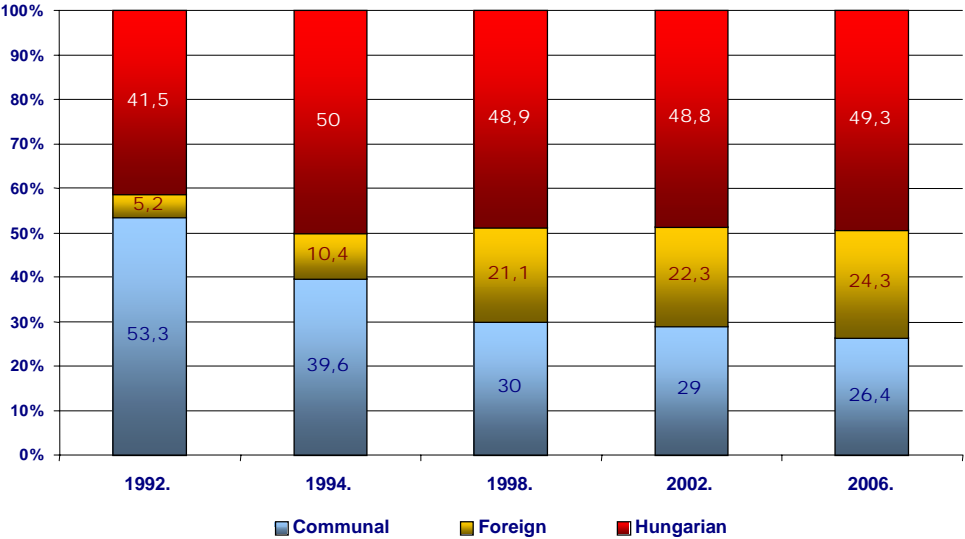
Social and economic snapshot

Before moving on, let us take a look at some important factors reflecting the state of our economy and society.

Like during the “happy and peaceful times” following the Compromise, the Hungarian economy was primarily modernised with foreign investments also after the 1990s. Apart from the well-known, and in certain aspect, historical reasons, valid for our entire region, there is also another explanation for it,

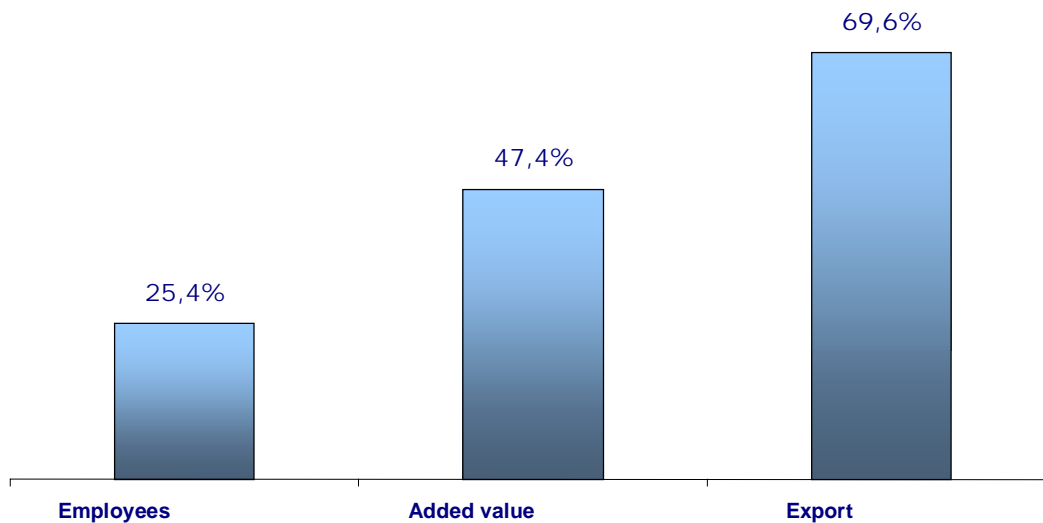
which relates only to Hungary. Apart from Poland, there was no other country, which reached the systemic change with an almost unbearable amount of debt. Thus, after the beginning of the 1980s, the Hungarian almost went financially bankrupt for the second time in 1994–1995, but we avoided it owing to Lajos Bokros’ successful adjustment programme. One of the important components of the programme was the complex market-based privatisation programme. As a result, the considerable portion of the Hungarian economy, including also the majority of the companies of the strategic sectors, were acquired by foreigners and the state managed to consolidate its financial position from the revenues.

Breakdown of the added value by ownership sector



The foreign investments modernised the majority of the economy. Investors brought new knowledge, technology and business culture as well. Considering the corporate sector, every fourth employee work in a company owned by foreigners, and such companies produce fifty percent of the added value created in this sector, and generate approximately two-thirds of the export.

Ratio of foreign-own companies in the corporate sector
all companies=100%)

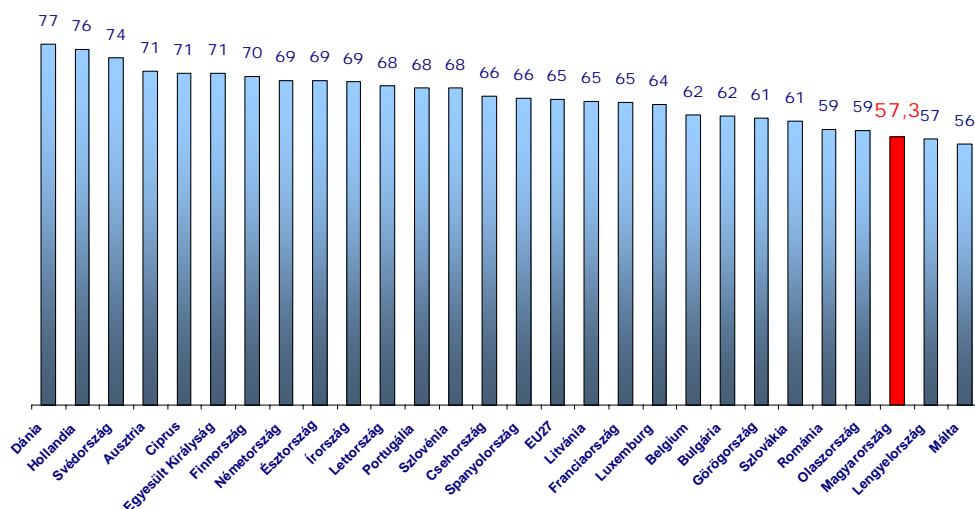


On the other hand, the Hungarian economy seems to consist of two parts, which are hardly related to each other. The companies controlled by foreigners have high quality production and technology, they are well-capitalised and are integrated into the international distribution of work and are also actively involved in the world market. Apart from a few hundreds, or perhaps thousands of strong and successful companies, the companies owned by Hungarians constantly face product, technology development and financing problems, and their market growth and expansion are hindered by barriers that are very difficult to overcome.

By now, both large groups of the Hungarian economy have almost reached their development limits. Foreigners find increasingly difficult to recruit qualified workforce at an acceptable cost, or work with Hungarian suppliers that satisfy their own quality requirements. Because of the difficulties listed above, Hungarian companies find it increasingly difficult to develop or grow and have to take extremely large efforts to retain their markets and find new ones.

The traditionally low employment is another chronic problem of the Hungarian economy.

A 15-64 évesek foglalkoztatottsági rátája 2007-ben

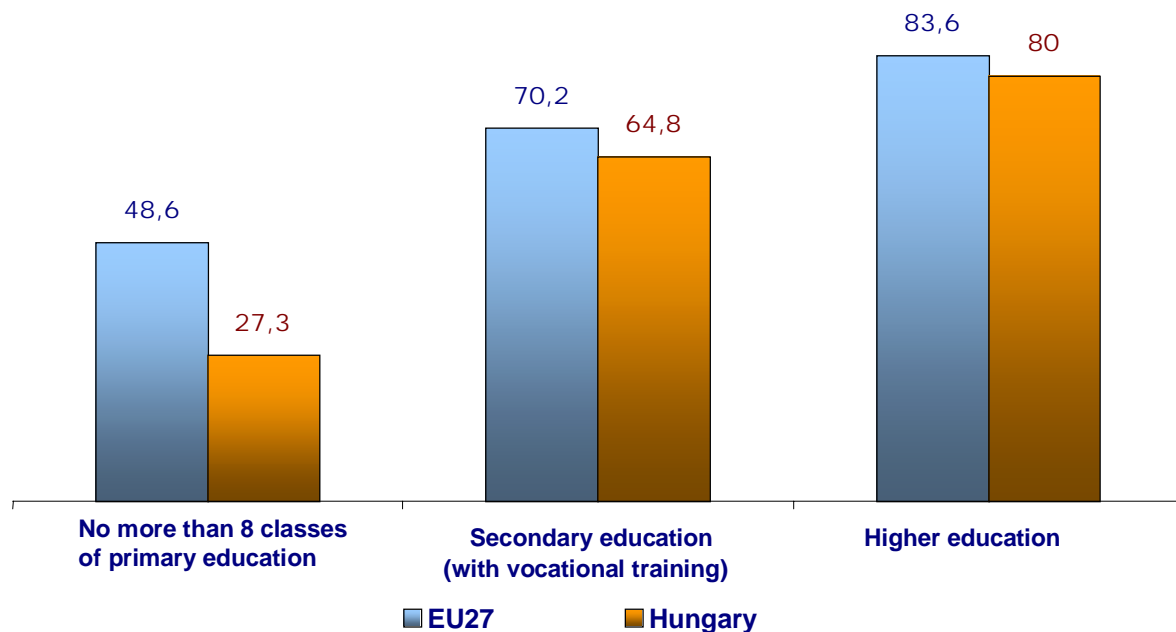


Employment rate of people aged 15-64 in 2007

Denmark, Holland, Sweden, Austria, Cyprus, United Kingdom, Finland, Germany, Estonia, Ireland, Latvia, Portugal, Slovenia, Czech Republic, Spain, EU27, Lithuania, France, Luxemburg, Belgium, Bulgaria, Greece, Slovakia, Romania, Italy, Hungary, Poland, Malta

However, this general statement is deceiving. The employment rate of people holding a diploma or possessing secondary vocational qualifications complies with the European average. However, only approximately one-third of the large population of active age, not possessing vocational qualifications, are employed, which is much below the European average. The situation is similar in the employment of people with reduced working capacity. To complete the picture, it must also be added that there is a permanent shortage of workforce in certain industries and certain regions, for example, there are not enough turners, qualified welders, mechanical engineers or anaesthesiologists or X-ray physicians in certain regions.

Employment rate of people aged 25-64 by school qualifications in 2007



The specifically launched re-training programmes or voluntarily agreed moves of families for employment purposes could not effectively reduce the structural tensions between labour demand and supply in the last few years. We should also add that employment problems are increasingly coupled with employability problems, i.e. it turns out of even a relatively high ratio of employees of active age that they are unable to accept or perform the job offered to them due to lack of qualifications or other reasons.

There is no doubt that at the same time our social system also keeps other people away from employment those who could work if they wanted to, but they decide not to. Instead, many claim benefits, to which access is assumingly easy, and accept occasional grey or black jobs at the same time. This conduct increasingly insults people who work and pay taxes regularly, and the number of local conflicts arising from such causes has increased rapidly in the recent past.

Both Hungarian and international analyses of the Hungarian public education indicate that our educational system cannot effectively reduce the differences in the family background of students, and that the Hungarian school system continues to reproduce, and sometimes even increase, social disadvantages instead of reducing them. Approximately one-fifth of the students leave public education without having any vocational qualifications, while an important objective of secondary technical education is to subsequently provide general knowledge that was not obtained in primary education. A large number of teachers are not properly trained for the integrated education of children with studying difficulties and behavioural problems. There is much room for

improvement in the financial and moral appreciation of teachers, and this career is much less attractive than it should be.

At the same time, the state can perform certain tasks only in average or even lower quality. The surveys indicate that there is extensive dissatisfaction with the various authority proceedings. Apart from a few exceptions, such as the majority of the official document bureau services, citizens complain of slow and bureaucratic services and proceedings in administration, and refer to a lot of cases of the insolence of officials, heartlessness and corruption.

The unacceptably large grey and black economy is one of the most important factors of the Hungarian economy and society. The measures adopted in the last few years have led to quantifiable effects, but have not managed to achieve a fundamental cultural or behavioural breakthrough.

Approximately one-fifth of the Hungarian economy is partly or completely outside the framework of fair norms and lawful operation, which is clearly unacceptable because, apart from a continuously disrupting the morale of the society, this also causes indirect damages by allowing unfair participants to gain from their practices at the expense of the law-abiding citizens.

What should be the Hungarian model?

I shall not go on describing the outlined picture as I hope I have managed to support the statement that the problem is a lot more complex than a problem, which could be managed with one or several tax measures. Simultaneous and coordinated actions would be required in several areas, so that all interventions could change the interests and behaviour of people, companies, institutions and the state, as a result of which their overall performance could increase and the lack of economic, social and political disequilibrium could decrease at the same time.

Following the scenario dictated by the history of the systemic change, the state gradually weakened in the last almost twenty years. This process started with the assumption that the intensive reduction and restriction of the rule of the state is a prerequisite for the strengthening of the freedom of citizens, the civilian world and the market. But it is only partial truth. Partial truth, as it is only one but not the only prerequisite of the establishment of non-state autonomies that the state does not control everything. The appearance of strong non-public actors requires many things, including for example, advanced civilian courage, a lot of financial and other resources, and a norm-abiding and norm-respecting mentality. The complete or partial lack of those, and on several occasions the excessive retreat

by the state has resulted in a situation, which was opposite to the originally desired combination of strong citizens, strong economy and a strong state.

These days, most social actors, families, towns and villages, companies and the state have less power and ability to act than it would be necessary and required in view of the tasks and responsibilities required from them.

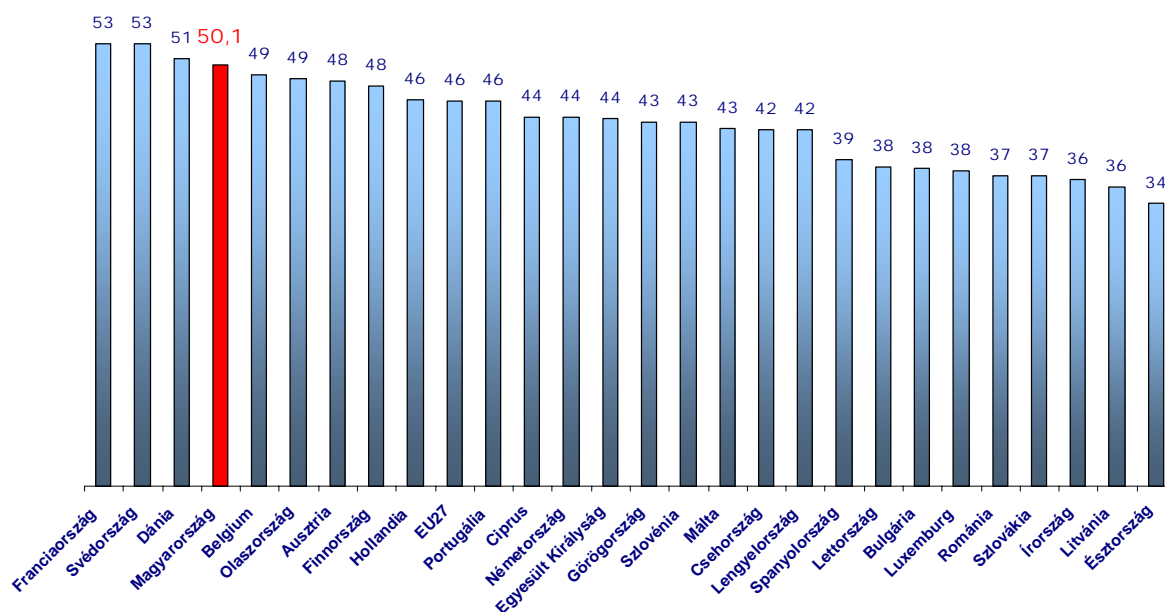
Which way to proceed? What should be the Hungarian model?

Let us conclude first: there is and there cannot be a specific Hungarian way or Hungarian model in a sense that the generally accepted and proved elemental truths do not apply to it. We cannot overwrite scientific facts or conclusions or those stated in textbooks, and we cannot think that the world processes do not apply to us. The Hungarian model – *yes, with a small “m”* – is nothing else but a specific social and economic balance typical of Hungary, the internal proportions of which can be decided by ourselves, within certain limits.

Hungary is not Ireland and it is not Sweden, either. What people do there can only be an example, a lesson, a point of reference for us, but under no circumstances should it be a solution to copy. The main issue of a social and economic model is who undertakes what in it. What is the responsibility of the state, what are the responsibilities and what is the freedom of citizens, institutions and market actors.

An indicator showing how much of the total income of the country is paid into the budget for so-called state re-distribution indicates the degree of the involvement of the state very well. In countries where the state assumes few tasks, such as Ireland, this indicator is close to thirty-five percent. In another state, like for example, Sweden, where the state has assumed a lot of tasks, the state income re-distribution ratio is close to fifty-five. In Hungary, this indicator was closer to the latter figure in the last few years.

Állami kiadások a GDP %-ában 2007-ben



Public expenses as a percentage of GDP in 2007

France, Sweden, Denmark, Hungary, Belgium, Italy, Austria, Finland, Holland, EU27, Portugal, Cyprus, Germany, United Kingdom, Greece, Slovenia, Malta, Czech Republic, Poland, Spain, Latvia, Bulgaria, Luxemburg, Romania, Slovakia, Ireland, Lithuania, Estonia

Taking into account our own national and social culture, and seeing the clear demand of people for direct assistance from the state in many things, providing various services to them, I think it would be unreasonable and irresponsible to say that we must reach the low state re-distribution ratio of the Anglo-Saxon model. This would require radical cuts in pensions, family support, health and educational expenses, and HUF billions in the budgets, which I think would be absolutely impossible.

We must also add that the acceptance of the state, the true support of community values and the level of public services does now allow the state to collect as much money from its citizens as the Scandinavian countries. The not too strong members of the Hungarian economy cannot bear such a burden without it undermining their competitiveness.

An agreement must be reached!

In view of our often state-centred social culture and to be improved competitiveness, I propose moving towards a social economic model as a mid-term solution, which still involves an active role for the state, but also allows for the reduction of the current tax burden and re-distribution ratio.

In order to make sure that this middle course of action should not be turned into a middle instrument, all parties must assume more than before. The state must

operate better, in more active cooperation with civilians and the market sector, but the same also applies the other way round.

Concerning the level of state re-distribution: considering all former aspects, I consider it reasonable and feasible to set the mid-term re-distribution target at approximately 43-45%, lower than at present, with approximately 35-37% average tax centralisation, which is 3-4 percentages lower than at present.

We have learned from the Anglo-Saxon model that the excessive power of the state must be limited, giving space to social autonomies and the strengthening of “the small circles of freedom”. Now, it is time to learn something also from the Scandinavian model. I mean the role of the state as a partner, its active and responsible actions towards the economy and society, and high level cooperation of all members of the society. Instead of abandoned society, a cooperative society could give new impulses and create new resources in Hungary.

And let me add one thing to this: there is no doubt that the issue of social and economic competitiveness is integrated into the requirements of long-term sustainability. There is no longer a successful social-economic model in the heart of Europe that would not require an environment conscious conduct from the state, companies, civilians and people.

However, irrespective of the model we envisage, we can be certain that an introverted Hungary cannot be successful. Basically, it is the world that decides what is good Hungarian performance and not us. We must compare ourselves to the world standards in science and culture, or the world market in business. Those who wish to be good only in Hungary will sooner or later be not good enough in Hungary either, because the foreign competitors will beat him even at home. If we do not go out to the world market, then its actors will come to Hungary and beat us in our own country.

The second component of success is the acceptance that freedom and respect for law go together. The laws and regulations of the democratic Hungary set out a framework and conditions of our common social and economic life, binding for everyone, i.e. neither the state, nor the citizen can decide whether to comply with them or not. At last, we should leave behind the world of everyday and official disorder of the “sloppy” Hungary; and we have no reason to explain who and why is exempted from the law abiding behaviour.

Once we have accepted these prerequisites, we can set the exact limits of public and community, as well as private responsibility, and obligation. I would like to highlight only two aspects before it is described in more detail in the special policy.

Liberalism and an active role of the state exists side-by-side in economic policy, if the state strengthens market processes with regulations, development and the enforcement of fair competition instead of weakening them. If numerous, weak

participants fight a few giants on the market, then it is not a problem that the state assists the small ones, and does not give in to the pressure of the giants in order to maintain long-term sustainable competition. If there are no strong companies controlled by Hungarians, if there are no strong sectors giving a character and direction for the economy, then the state may apply development instruments assisting their development. Of course, these actions can only be done transparently and controllably, based on public regulations and considerations.

On the other hand, we must also accept the following: if people prefer important social functions financed from taxes to the application of the “customer pays” principle, then the institutions performing these functions must be owned by the state. However, in this case, people must also understand that in order to finance the public functions with public funds, people must also pay taxes diligently, institutions and companies must be managed efficiently, because public property cannot be a synonym for low efficiency.

Consequently, the development of our special Hungarian model requires the understanding that we shall not improve our situation and shall not strengthen Hungary by continuing what we did before, i.e. trying to make progress at the expense of others. Citizens and civilians demand more from the state, and the state demands more from them. This way, we do not do anything else but redistribute our problems and weaknesses.

The model that I propose does not aim at the reduction of communal and individual responsibilities or obligations, on the contrary, it moves on towards their extension.

In other words: the new Hungarian social and economic model should be built on active and not passive, communal and not individual, competitive, yet cooperative, social and economic cooperation.

Strong state – partner state

In order to make progress, we should concentrate on our tasks instead of the real or assumed rights.

Let us start with the state. If a state is kept by its citizens with their tax payments, and its power originates from the people, then the state must serve and protect its people. These days, the state is heavily criticised in both functions, many think that the state acts as a superior where it should be a more

of a partner, and appears to be weak in many cases where it should act as a strong leader and controller. The direction is clear, citizens and institutions require better quality service and higher degree of security.

The state provides numerous services. For example, it organises the majority of education and health sector, as well as public transport, issues personal ID cards, and gives justice to parties involved in litigation. The citizens pay for these services in different ways, such as taxes, contribution, duties and procedural fees. The state as a service provider very rarely states the quality guarantees, it assumes for its services all the consequences of its defaults in performing a promise. These days, there is such a rule in some cases, for example, in the proceedings of company court, but it does not apply to the entire public administration at all. Consequently, I propose going through the various fields of public services, establishing the service guarantees of the state, and then introducing them gradually.

The state applies various regulations on how citizens and institutions can exercise their rights. Within the framework of these rules, it sets the requirements for a license with regard to various activities. For example, a licence is required for construction, opening a business, drilling a well, etc. According to our traditional practices, the state is mistrustful, and therefore, requires compliance with complicated requirements, controlled in advance, for the start and performance of various activities. Although all proceeding authorities represent the state, they operate with lengthy and cumbersome proceedings, independently from and occasionally arguing with, each other. Many people think that the authorities represent and protect themselves instead of the citizens.

Let us change this logic! Let us trust the citizens and institutions. Let us change the licensing procedures by radically reducing the number of licenses required in advance for commencing an activity. Let us use simple statements wherever it is possible, the authenticity of which can be checked later in subsequent regular reviews. Let us introduce integrated administration widely, whereby applicants do not have to apply separately to the individual authorities, as it is a task of one of the authorities appointed for this task on behalf of the state.

Later on, I shall also write separately on the need for a tax reform in Hungary, but allow me to bring one component of the tax reform here in advance and integrate it into this paper. Let us simplify the tax proceedings and tax administration, let us provide more assistance to people, helping them fulfil their tax obligations. For example, upon the citizens' request, the tax authority should be able to complete their annual personal income tax returns, which the citizens only need to approve, or supplement with any tax credits claimed by them. This

would relieve hundreds of thousands or even more than a million people from the annual burden of completing the forms that are difficult to understand for laymen and bearing the consequences of any faults in the completion of the documents.

Let me bring another example in how our own state could be more helpful for us. These days, certificates are requested in numerous proceedings (for example, public procurement or EU tenders, etc.) stating that a specific person does not have any tax debts. In such cases, citizens must attend office after office obtaining the necessary certificates. Instead, we should assign the tax authority to create and regularly keep a so-called “positive” list of taxpayers containing all taxpayers, who request their additions this database and authorise the tax office to obtain all data concerning the balance of their tax debts kept elsewhere each month. This way, the taxpayers listed in this database could be exempted from the obligation of separately applying for each certificate.

In the recent years, more and more fierce disputes and conflicts developed around the constitutional fundamental rights, including especially the freedom of speech and right of assembly. These conflicts, and sometimes open street fights sufficiently harmed public calm and public safety. The state and its agencies were occasionally uncertain and acted contradictorily trying to manage these conflicts, which did not satisfy the expectations of citizens and hurt their sense of justice. Citizens cannot trust enough a state that appears to be uncertain and weak. Consequently, the public order protecting functions of the state must be strengthened immediately so that they should not hinder the citizens in the lawful exercise of their fundamental constitutional rights.

The latest decisions of the Constitutional Court made it clear that while no new punitive instruments may be used against the so-called hate speech, the Constitutional Court has defined the constitutional framework of civil law actions. The government will urgently prepare its proposal for more effective regulations with respect to this framework.

The professional and social disputes following the violent street actions of the recent months, people are increasingly convinced that more effective actions are permitted also within the framework of the effective Act on Assembly against people gathering for non-peaceful purposes. Accordingly, on the basis of the existing authorisation by law, the police should reject the acknowledgement of announcements of any event, which is expected to violate the right or freedom of others, or if a carefully prepared study or analysis suggests that it will most probably not be implemented peacefully. Following due legal remedy, the police must act against any unannounced events by complying with the effective laws and regulations most consistently and strictly.

In addition, the legal regulations on punitive actions and offences also need to be supplemented and modified in order to pursue new types of conducts which

have not been regulated before, but are harmful to the society. In this context, we should take into account expert proposals, which would allow for stronger actions against certain riotous act or disturbance of any public operation. I agree with the opinion that, contrary to the present practice, even preparations for criminal actions involving bodily harm should be pursued and punished, thus we would have a significantly better chance to prevent the increasing number of incidents and atrocities violating and threatening the physical safety of people.

In order to strengthen the calm of small villages, I support the idea of immediate reinforcement of the police forces serving them with improved conditions of operation.

In total, I think that the state must guarantee the calm and safety of its citizens, in which respect all its agencies must act clearly and lawfully instead of performing sheepish and uncertain actions.

Number One place to knowledge

The states of the countries following the Scandinavian model have an active, sustaining and developing role in all aspects of education, as well as in cultural and scientific activities. The future orientation of the state and its role in preserving the national traditions and strengthening national identity is concentrated primarily in the public initiatives made in these areas.

If we cannot increase the re-distribution role of the state, and our objective is to reduce it, then we can endeavour to spend more on no more than one or two areas compared to our total income in the near future. I shall make it clear: I propose spending more, on the medium term, in proportion to our national income only on the area stated above, i.e. education, culture and support of scientific activity. However, we must make relevant progress in these areas. Our objective in the next five-ten years is to catch up with the practice of the Scandinavian countries and allocate 6-7 % of the national income to education. This is approximately 150 % of the amount spent in Hungary on education at present.

I need not even say that it is not just the issue of money but also content. It depends on the structure of the educational system, the values it conveys, the dominant pedagogical approach and practice, and the recognition of teachers socially and financially, etc. I am convinced that the 'New knowledge, new culture programme', which is widely supported by the educational sector, is an initiative in the right direction; the actions contained in the programme must be completed and a further mid-term development programme must be developed.

Just as a reminder and example: in the next few years, we shall employ three hundred new district nurses, our aim is to provide a place in kindergartens for

each children in need from the age of three by 2010, and to introduce mandatory quality development in secondary institutions with higher than average dropout ratios. We shall launch the Hungarian Genius Programme to assist and monitor the development of the most talented children and will create the National Talent Fund to concentrate resources. We shall increase the role of colleges and refurbish 30,000 student hostel places parallel with the development of professional and pedagogical work.

From 2010, the English language may be studied in all secondary schools based on a subjective right, and everyone will have access to preparatory language courses. Almost every second classroom will be equipped with the digital equipment of interactive education. Students will be equipped with laptops gradually in several years, starting in 2009. Similarly, in 2009 we shall introduce wage supplements for career starters and teachers working with children with multiple disadvantages, we shall treble the funds available in performance boosting applications and raise the supplement of institution managers. In addition, in the framework of the most comprehensive infrastructure modernisation programme of the last fifty years, approximately 700 kindergartens and schools will be reconstructed in the next few years.

The reform will be extended to higher education in the next two years, focusing on the implementation of decisions made earlier, and encouragement and assistance of gradual adjustment. It is becoming increasingly difficult for young people with fresh diplomas to find their job. Certain employers hesitate to employ career starters without any working experience but this does not even give a chance to them to gain working experience. In order to ease this tension, we shall elaborate a national trainee programme, within the framework of which employers can provide scholarship to students studying in higher education and young people with fresh diplomas for one year, free of tax or contributions.

The Hungarian vocational training system has been significantly transformed in the last few years. The main objective of this transformation was to bring vocational education closer to the labour market, enabling it to satisfy better the rapidly changing and higher-quality technical requirements. The Regional Integrated Vocational Training Centres were established and equipped with the most advanced technologies and the Regional Development and Training Committees, dominated by the participants of the market sector were given decision-making rights with regard to the structure of education in the same spirit. Simultaneously with the refining of the system, the most important task is to increase the attraction and prestige of skilled work and vocational training. Having recognised this need, in some shortage trades we shall introduce scholarship for vocational students in the amount of HUF 10,000-30,000 a month, depending also on their study results.

Work instead of benefits

While in certain trades it is impossible to find qualified workforce, hundreds of thousands of unskilled workers cannot find jobs. Some of the unemployed seek employment, but a significant number of them have escaped into the benefit system, trying to cope with the everyday tensions accepting temporary work or sometimes jobs in the grey and black markets. It is becoming clearer and clearer that the automated forces of the market will not solve this increasing problem.

The situation is aggravated by the fact that local conflicts whereby a lot of people think that the current benefit system also encourages those not to choose legal jobs who could work if they could find a job in the smaller village and small town communities. These local conflicts made numerous municipalities to set the requirement of work as a prerequisite for granting social aid, occasionally even violating the law. We strongly reject all initiatives that consider work as a kind of punishment. It is also unacceptable to create even the appearance that poor people need to be punished or treated as scapegoats in any social conflict.

In this situation, the government assumes direct responsibility for job creation for the most exposed groups, which significantly overwrites the social economic model, dominating since the systemic change, in which job creation was left mainly to market forces. In 2009, we shall launch a National Public Employment Programme, which is expected to create useful and valuable work for at least fifty thousand people in 6–8 hours a day as early as in 2010. We shall set a requirement of at least ten per cent of the employees working in large public investment projects to be employees in disadvantaged situations.

Parallel with the launch of this programme, the rules of regular social aid will also be transformed. Consequently, those citizens of active working age may be eligible to benefit only who are unable to work and keep themselves or their families due to the state of their health or other equitable reasons.

The criticism of the benefit system has also extended to family allowance in the recent months. Having studied the views of several mayors, NGOs and professional organisations, we still think that a universal family allowance available on a subjective right has an indispensable role in the mitigation of child poverty, therefore we do not wish to change this concept. At the same time, we must make parents more responsible for providing the conditions required for the healthy and balanced physical and intellectual development of their children in each family. In this context, we shall rely primarily on family assistance and child welfare services and create a so-called signalling system reporting any threat against children by strengthening co-operation between other agencies and organisations involved in child protection. If a child is exposed to threats, then, according to the current expert proposals, the family

may temporarily lose its right to decide on the allocation and spending of the total amount of the family allowance itself and other measures will also be applied. In such cases, two thirds of the family allowance would be transferred to the competent child welfare service to ensure that the funds are used for the child, terminating the established threats.

The unacceptable practice of usury loans and their often violent recovery creates a final social trap for many families living in difficult positions in villages of most disadvantaged regions. Apart from the increased role of the state in criminal investigation, we must also propose solutions to families facing payment problems. Such a solution could be an advance charged to the regular social benefit, or the reopening of the 'bank of the poor' based on known and recognised international experiences.

I wish to cover one more component of the social system. I would like to repeatedly confirm that it is unacceptable for us to change the practice of annual pension and wage increase adjusted to inflation. We reject the fact that behind the misleading slogan of 'value preservation', pensioners are deprived from having a share of the benefits of economic growth. This is a pension system of hopelessness which must not be supported. We intend to follow the path marked with the introduction pension for the thirteenth month, the equity-based pension and travel allowances. The next item in this line will be the so-called jubilee support of pensioners to people who have reached ninety, ninety five and one hundred years of age.

Active, patriotic economic policy

The Hungarian economy struggles with internal structural problems which cannot be solved by the actors of the moderately developed Hungarian market who are not strong enough and are left alone, using their own strength only. Naturally, it may be concluded that the state should help in such a situation. While this assumption is widely popular, no public consensus has developed about the desirable extent, method or instruments of the involvement of the state in the economy.

The fact that there was a lot of space for improvement in relation to such attempts in the last twenty years only adds to the doubts concerning the intervention of the state in the market. With regard to the most frequently referred economic development programme, the Széchenyi Plan, the State Audit Office concluded in the recent weeks that the completed follow-up audits suggests that the efficiency of the projects supported by the programme was far below the expectations. And it has not been mentioned yet that public investments are continuously surrounded by political relations or, in worse

cases, by the spirit of corruption. This is why prudent actions are required if we intend to assign specific economic development tasks to the state, ensuring transparency, controllability and accountability. Bearing all these in mind, I think that without violating the independence of markets, the state should use its own instruments and assist more actively in the attempts to ease the tensions indicated above.

It would be a mistake and an error to think that we, the representatives of the state, should identify the sectors that have a future. This is not our responsibility. However, relying on the analysis of the market trends, we intend to support the success of sectors that already have proved themselves and have good perspectives with state development policy instruments too. These sectors include information technology, the vehicle industry, the pharmaceutical industry and biotechnology. We still provide outstanding support to logistics and special tourism projects. Complex development programmes are developed in co-operation with the representatives of these sectors.

We shall review and simplify the legal regulations developing an educational system that is better adjusted to the requirements of the labour market and provide targeted, individual investment promotion support for launching more and more job creating projects in these sectors. The troubles experienced by the Indian tyre factory in the last few weeks clearly indicate the need for a partnership-based industry creation policy. The government has already paid outstanding attention to the support of job creating projects, which was perhaps also involved in the latest success of our country in bringing the Mercedes factory to Kecskemét. At the same time, we also need the support of municipalities, as job creating options cannot be sacrifices in political games. For this reason, we shall form a community of investment-friendly municipalities, which will have access to training, consultation and support to attract job-creating investment projects.

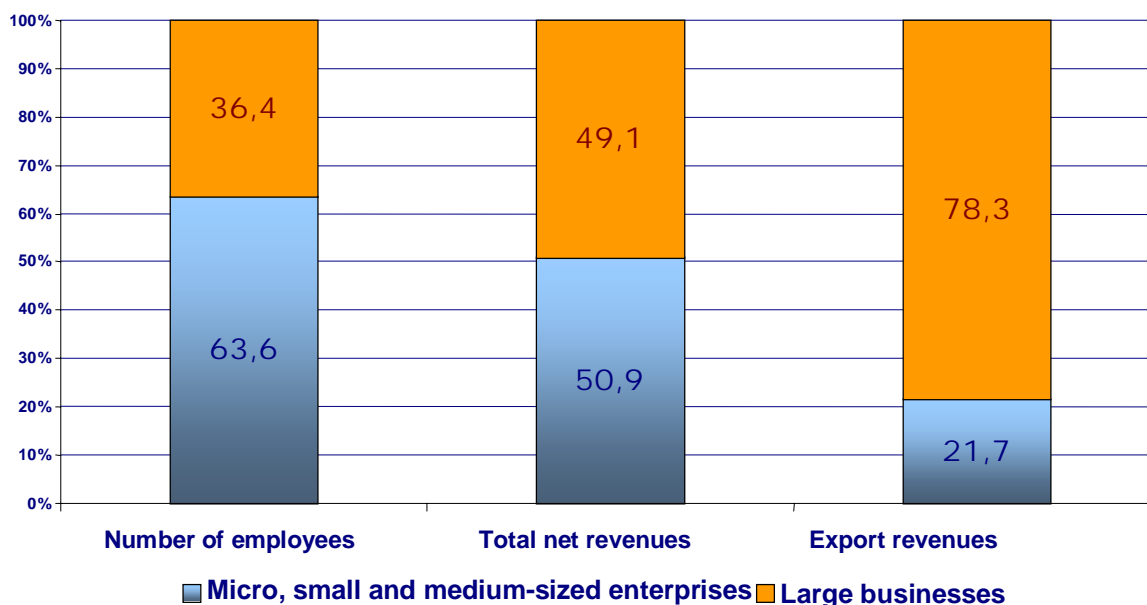
It is a huge potential for rural Hungary that it has excellent-quality arable land, abundant rivers and a lot of thermal water. Apart from the largest lake in Central Europe, Lake Balaton, we also have three other lakes representing significant biological, tourist and economic values. Healthy, efficiently protected and used water and arable land could be among the most valuable resources of the Hungarian future. Naturally, considerable investments are needed to utilise them. The conditions for that are laid down in the New Hungary Rural Development Programme, which allows for thousands of farmers to modernise their farms and involves complete regions again into irrigated cultivation.

Naturally, these resources can only be preserved on a long term if sacrifices are made according to the principles of sustainable development and resources are

protected. Consequently, the environment must continue to remain in the focus of the government's attention.

A strong Hungarian economy cannot be imagined without developed small and medium-sized enterprises, SMEs. The micro, small and medium-sized enterprises employ two thirds of the employees, they produce 50% of the added value and made 25% of the export sales in the recent years.

**Performance of businesses subject to corporate income tax
by the size of the business**



To date more than three thousand businesses have received support in the framework of the New Hungary Enterprise Programme. With the help of the micro credit programme, even those businesses can have access to loans under conditions more favourable than those offered by banks that were not creditworthy for banks. We help those who do not have collateral to secure their loans and also those who need a capital instead of loans. We shall launch a new venture capital programme for the latter ones. We know that in many cases the problem is not financing, but limited sales opportunities.

Last year approximately four thousand small and medium-sized enterprises exported for at least HUF 30 million. 1,500 of those have requested state assistance in their activities on external markets. During the next 12 months, all such businesses will be visited personally by the experts of the State Trade Development Agency offering personalised assistance and support to them.

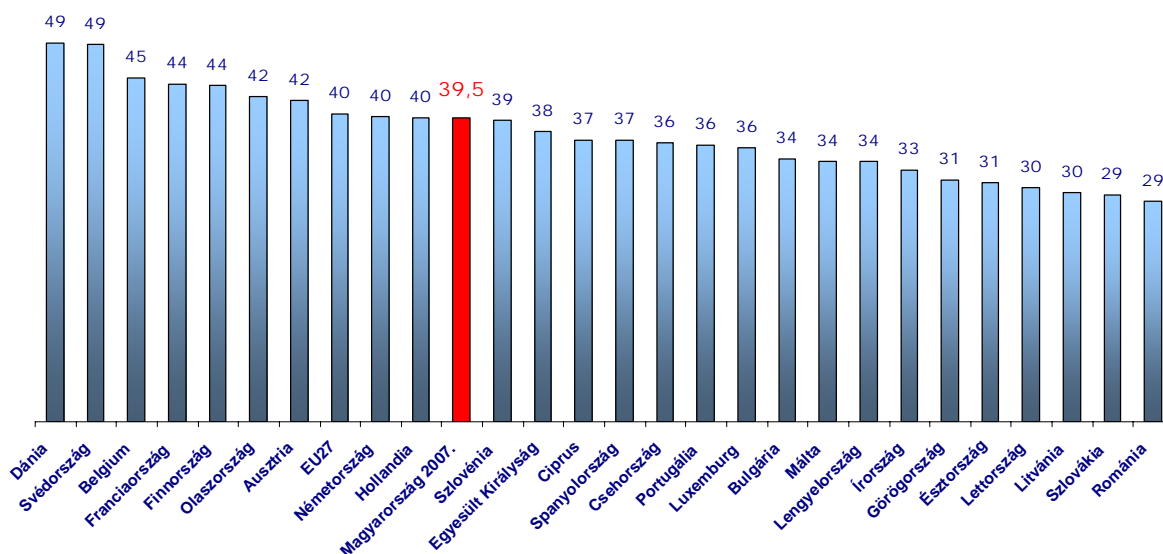
In the part dedicated to the partner state, I have already partially referred to the need to transform the role of public authorities, reduce bureaucracy and improve the business environment. In comparison with the national income, the administrative burden of Hungarian companies is twice as high as the burden of

their competitors in the European Union and four times as high as the burden of Swedish businesses. Our objective is to reduce the administrative burden by at least 25 per cent by 2012. Within the framework of these efforts, we shall make all forms used in the official and public administrative proceedings available for downloading from the government's portal and they can also be filled electronically.

How taxes cannot be reduced

It is slowly becoming an economic commonplace that taxes are high in Hungary. Although the share of all taxes and contributions in the national income is not outstandingly high, but as relatively few people pay tax, each taxpayer carries a relatively large burden.

**Adóbevételek a GDP %-ában 2006-ban az EU országokban
(Magyarország 2007-ben)**



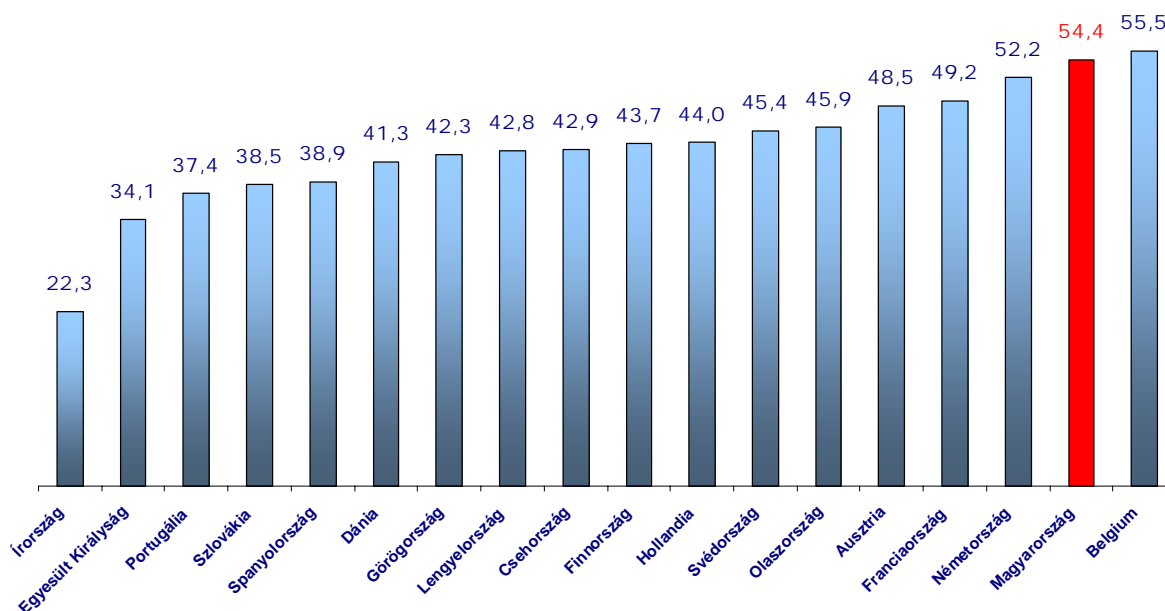
**Tax revenues as a percentage of GDP in 2006 in the EU countries
(Hungary in 2007)**

Denmark, Sweden, Belgium, France Finland, Italy, Austria, EU27, Germany, Holland, Hungary 2007, Slovenia, United Kingdom, Cyprus, Spain, Czech Republic, Portugal, Luxemburg, Bulgaria, Malta, Poland, Ireland, Greece, Estonia, Latvia, Lithuania, Slovakia, Romania

The wage-related taxes and contributions are especially high, therefore, it is not worth to be employed and some of those who work manage to avoid paying taxes one way or another. In addition, the Hungarian tax system is rather complicated, not transparent and it creates difficulties for taxpayers with many mandatory detailed rules. It seems obvious that we can no longer postpone the

simplification of the tax and tax administration system, the extension of the number of taxpayers and reduction of tax burden.

Adók az átlagkereset szintjén 2007-ben
(személyi jövedelemadó és járulékok a bérköltség %-ában)



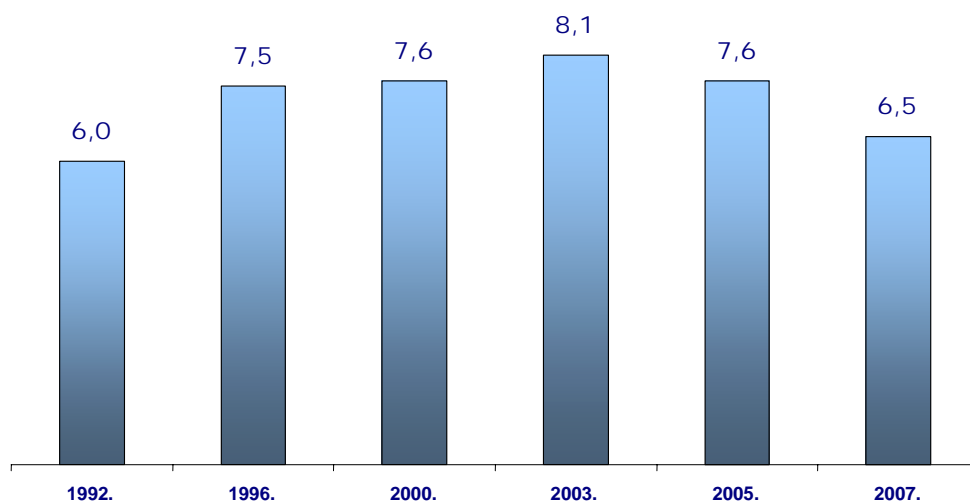
Taxes on average income in 2007
(personal income tax and contributions as a percentage of wage costs)

Ireland, United Kingdom, Portugal, Slovakia, Spain, Denmark, Greece, Poland, Czech Republic, Finland, Holland, Sweden, Italy, Austria, France, Germany, Hungary, Belgium

Let us state something before we go into details. We, Socialists, believe that we can reduce taxes and contributions only if they do not put a threat on the deficit target set in the convergence programme for the next few years and do not reduce the average quality of the present welfare and social security system.

If we managed to protect the interests of the groups with the lowest income in the period of budgetary restrictions and if social differences decreased and not increased as a consequence, which is exceptional internationally too, then we would have no reason to make a decision on tax reduction now by giving up the previous principles. Consequently, the tax issues must be managed together with the balance and social aspects. To satisfy only two of three criteria at the expense of the third one is not difficult. Anyone can give such a programme at any time, although let me add that I am not certain that he would also be able to manage its consequences.

Per capita income of the tenth of households with the highest income as a the tenth with the lowest income

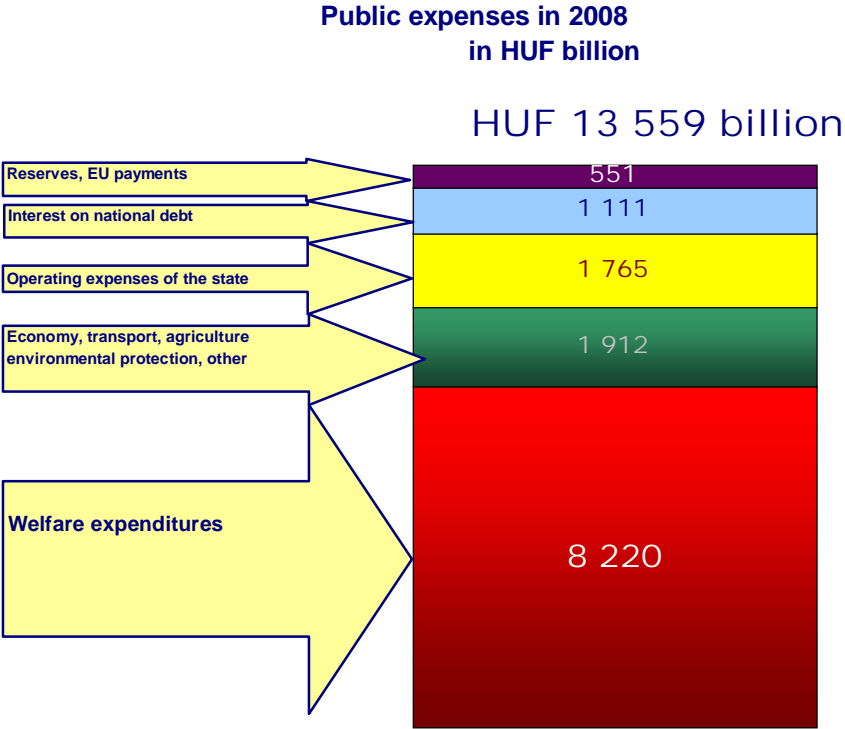


We are well aware of the critical aspects of the tax system. We know that we should abolish the solidarity tax and the special tax of companies, introduced as a temporary measure in 2006. There is no doubt that the total amount of social security contribution and personal income tax and their share in the total wage costs is extremely high both generally and especially in certain income categories. The local business tax is criticised extremely intensively, many people would like to get rid of the so-called small taxes paid by companies in one way or another. The tax system could be simplified and more transparent by reducing the number of various exceptions and exemptions and items increasing and decreasing the tax base.

Earlier we said that the success and competitiveness of countries are based on a supportive social culture, therefore the ultimate goal of reform measures is to change the behaviour of the actors of the society. In the area of taxation, this means changing the taxation morale and willingness to pay tax. It is not enough to make small corrections in this direction. Unless conditions change significantly and if one or two per cents are increased at one place yet decreased elsewhere, the people and companies will not change their behaviour. Consequently, we must agree with those who demand significant tax reduction, arguing that tax liabilities should be cut by approximately HUF one thousand billion in order to have any impact on the behaviour of taxpayers.

HUF one thousand billion is a lot of money. This huge amount is enough to cover the pension of three million pensioners for four months, pharmaceutical support for three years and the annual budget of twenty county boroughs. We must act very carefully, therefore, not to impose any risk on our welfare system or operation of the state. How and from what can such a huge tax reduction programme be financed? This will be reviewed below.

In the simplest scenario, the taxes can be reduced from the budget because it is closed with a surplus, or at least a better position than the acceptable deficit. In this case, the revenues, not missed by the budget, can be returned to the taxpayers in the form of tax reduction. Assuming no changes in the conditions, the budget will not contain additional resources required for a complex significant tax reduction in the next few years. At the beginning of 2008 it seemed that we could waive approximately HUF 200 billion revenues. The events since the end of winter, especially the increased interest expenses triggered by the international credit crisis, have reduced our possibilities by approximately fifty per cent. It is clear that it is very far from the HUF 1,000 billion.



Naturally, it may be suggested that if we reduce taxes and contributions and have lower revenues, then we should also spend less, therefore the balance will not be broken. Theoretically this is feasible. There are three large expense categories. The interest expenses, the operating expenses of the state and welfare expenses. We have no influence on interest expenses. More than two thirds of the operating expenses of the state represent wages of public employees, teachers, police officers, physicians and judges. As a result of the public administration reform, the number of public employees was reduced in the last two years, and they did not receive any wage increase for a while, with which we achieved considerable savings.

I cannot see any further opportunities to make cuts in this field, as we are looking for options to strengthen public services in the area of public security or education. The largest item among the welfare expenses of the state is pension

and family support. The budgetary ‘benefit’ of any expense cuts in these areas and its social consequence, or price, are simply not proportionate to one another. While the correction of the welfare and social system cannot be avoided at several points, we should not expect any funds from it to be used for tax reduction.

If there are no funds outside the tax system, there is still one option. We should consider restructuring the tax system. In order to reduce any tax or contribution, we can increase another tax or contribution without changing the total tax burden.

In order to understand the consequences of such a decision, first let us clarify that there are only two groups of taxpayers, individuals and companies. If our intention is not to change the total tax burden but reduce the burden of one group, let’s say, the individuals, then we must increase the burden of the other group, the companies, and naturally the same also applies the other way. In our current situation, we should reduce the burden of the companies in order to enable them to be more efficient, to make investments, recruit new employees and grow. On a long-term basis, it is good for everyone, but in this option families should pay higher taxes. It is not an easy decision.

We have looked at several options recently which could bring a solution in this direction. We analysed most intensively the option in which the social security contribution payable by the employers would have been reduced and the revenues lost this way would be compensated with higher value added tax (with a simultaneous tax reduction in a limited group of products and services).

The completed impact study showed an alarming picture. As a result of the measure, inflation would have increased significantly in the next eighteen months and the higher VAT would have hit most the people with lower than average income. Today we do not think that the increase of inflation or the burden of people with lower income would be acceptable as a price of otherwise desirable tax reduction.

This seems that with this option we have completed the circle. Earlier we set a requirement that tax reduction should not involve a higher deficit or lower social security. The cases discussed above could not satisfy this requirement. We are left with two alternatives. We either give up the idea of tax reduction, or involve a new option, not yet analysed, into our studies. I propose that we do so.

And how can it be done...

Earlier we stated that the currently existing social and economic practice needs to be reformed and replaced with active co-operation and more responsible actions from all members of the society. The successful model of the active social market economy is based on civilian conduct and law abiding mentality as well as consistent compliance with norms and regulations instead of non-transparent bargains and avoidance of regulations. Let us take seriously what we said.

In the cases analysed above, we could not find enough money which could be used for tax reduction anywhere. I strongly argue that there is no such money where we looked for it at an acceptable social price. Yet there is money in front of us, in fact, quite a lot of money, but we cannot notice it because we have too much accustomed to something that should be changed.

In Hungary, the grey and black economies represent approximately twenty per cent. It is very high, more or less twice the percentage observed in the countries of Western Europe. Looking at the amount of our national income, approximately HUF six thousand billion turns around in the economy without being part of taxation. The tax and contribution content of this huge amount is approximately HUF 2,400 billion. If we also consider the average European size of the grey and black economies considered 'natural', then the country and the honest taxpayers both lose at least HUF 1,000–1,200 billion.

During the meetings with various economic interest representation groups, our partners described relevant tax and contribution reduction as the only condition of whitening the economy. They argued that if the burden were lower, businesses would be willing to pay the tax. However, if it is true like this, then we can also state the contrary. If tax reduction leads to the whitening of the economy, then whitening of the economy may lead to tax reduction. Of course, in such a situation the question is which should take place first. In order to avoid the classical problem of the 'hen or the egg', let us take a look whether or not we can rapidly whiten the economy and considerably reduce taxes and contributions financed from this process simultaneously.

If we do not do anything else but believe that tax reduction will lead to the whitening of the economy, then entrepreneurs and the other taxpayers do not assume risks equally because the tax of businesses is reduced, yet whether the economy will actually be whitened and whether the required revenues will be collected as a result of the process, will only turn out later. If we make a mistake in the calculations and the expected revenues are not collected, then the consequences must be paid by the other taxpayers. Obviously, it is not acceptable like this.

We need incentives and guarantees that the business and economic sector will actually start moving and the long-rooted culture of rule avoidance and tricks will actually change. What can be such incentives and guarantees? Zero tolerance towards the grey and black economy. Because if it is true that lower taxation whitens the economy, then nobody should be afraid of anything and no strict sanctions can be harmful for anyone.

Consequently, I offer partnership and a deal to the Hungarian small, medium-sized and large companies. We request a change of behaviour in exchange for considerable tax reduction. They should support our strictest actions against those who achieve gains at the expense of the other taxpayers by avoiding the legal regulations.

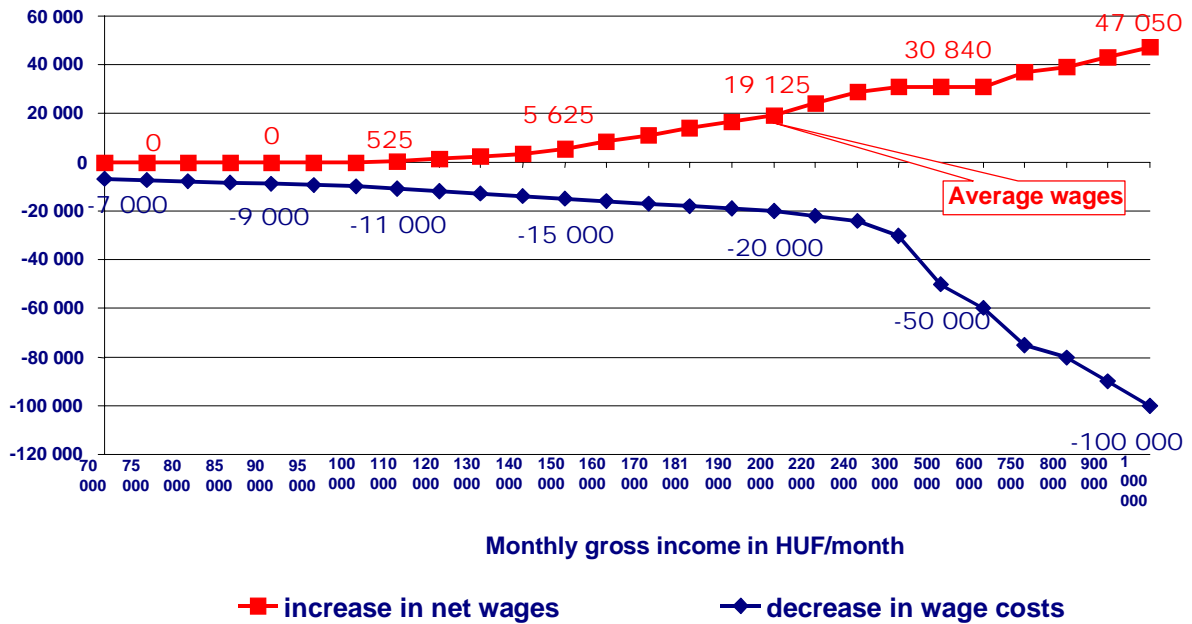
However, not only restrictions are needed. The tax office must enter into partnership agreements with reliable and good taxpayers and the occasional unreasonable threats of punishment and frequent audits, often experienced as harassment must be replaced by consultation and assistance.

On the basis of all this, I propose complex tax reduction and zero tolerance, complemented with simplified tax administration and proceedings.

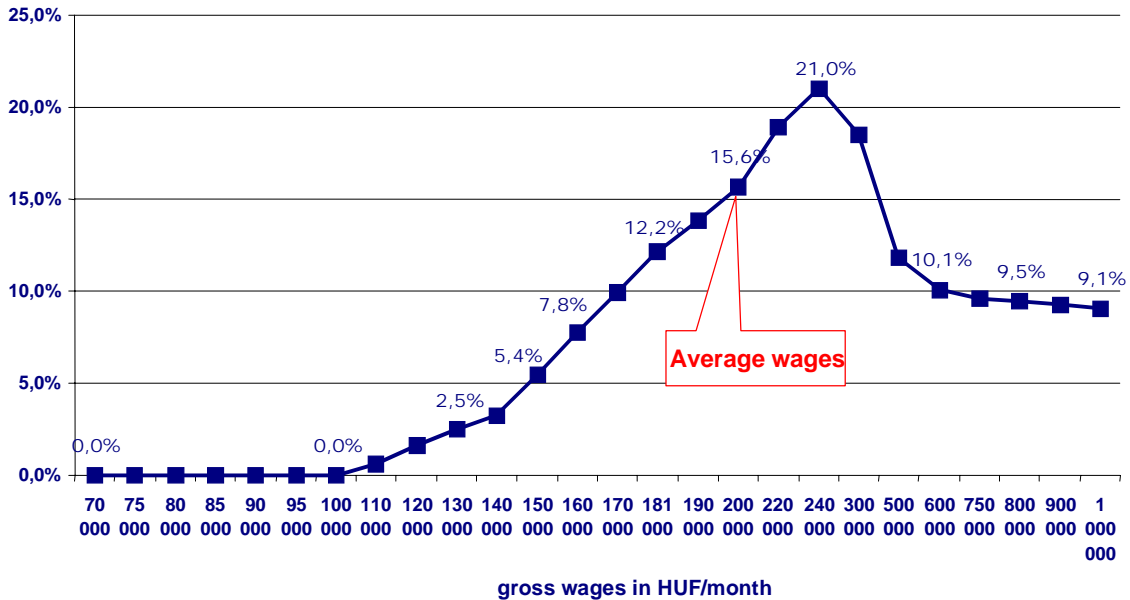
The whitening of the economy may ease the tax burden of law-abiding taxpayers by HUF 1,000–1,200 billion in the next 3-4 years. Such tax reduction and the sanctions associated with zero tolerance together can in fact have an impact on the behaviour of taxpayers, influencing the social culture of taxation. Two thirds of this significant tax reduction could be returned to the businesses and one third to the population.

What can be covered with this money? The tax burden of companies may be reduced by ten percentage points, approximately by one third. Secondly, the personal income tax system could also be simplified. There could be a flat rate 18 per cent personal income tax, complemented with zero tax rate up to HUF 750,000 and 36 per cent tax rate over HUF 3 million. This will in fact increase the net income of people earning around the average wages or above by 10-20 per cent, respectively. Thirdly, we can abolish the special tax of companies and apply 18 per cent corporate tax rate. This could result in approximately 18-20 per cent taxation in the Hungarian economy, which is already compatible with the flat rate tax system applied by one or two of the neighbouring countries.

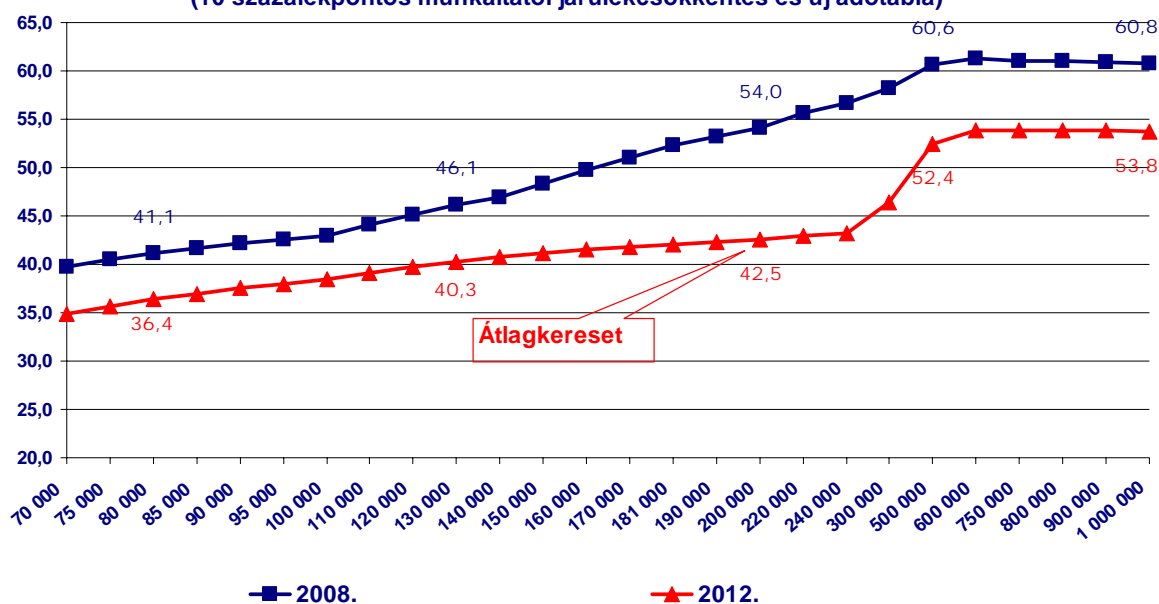
Variation of net wages and wage costs in 2012 compared to 2008
without any changes in gross wages (HUF/month)
 (With a new personal income tax table and 10% employer contribution reduction)



Variation of the net income in % in 2012 compared to 2008
without any changes in wages
 (New tax table, without the special tax)



Adóék változása változatlan bruttó bérek mellett
A munkavállaló és a munkáltató által fizetett adó és járulék a bérköltség %-ában
(10 százalékpontos munkáltatói járulékcsökkentés és új adótábla)



Variation of taxes with no changes in gross wages
Tax and contribution paid by the employees and employers as a percentage of wage costs
(10 percentage point employer contribution reduction and a new tax table)
Average wages

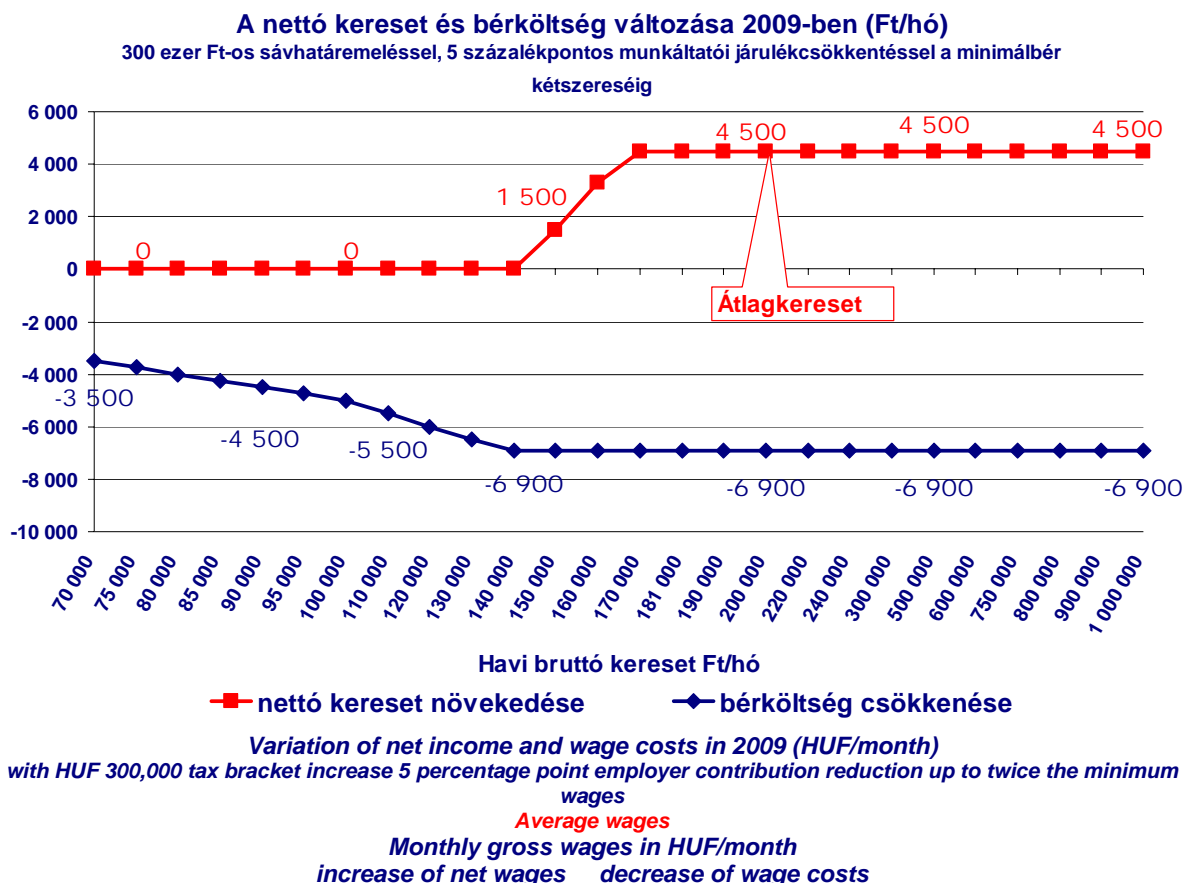
Naturally, this programme cannot be implemented in one year, because whitening the economy will be a longer process. However, the process can be completed in three-four years, with average HUF 300 billion tax reduction each year, providing that in exchange for tax reduction the economy in fact begins to whiten. The first step envisaged from 2009 may bring along approximately the same amount of tax reduction.

However, before talking about 2009, let us remind ourselves of what was said about the Hungarian labour market situation. The employment problems are concentrated in two areas. The employment rate is far below the average in certain regions, sub-regions and groups of society with a low degree of education and without vocational qualifications. In other words, beside the overall reduction of taxation on employment, specific targeted actions are also needed concentrating on these two areas. Taking these into account, I propose that, in view of also the adjustment period required for zero tolerance, we should introduce the following measures at the beginning of next April:

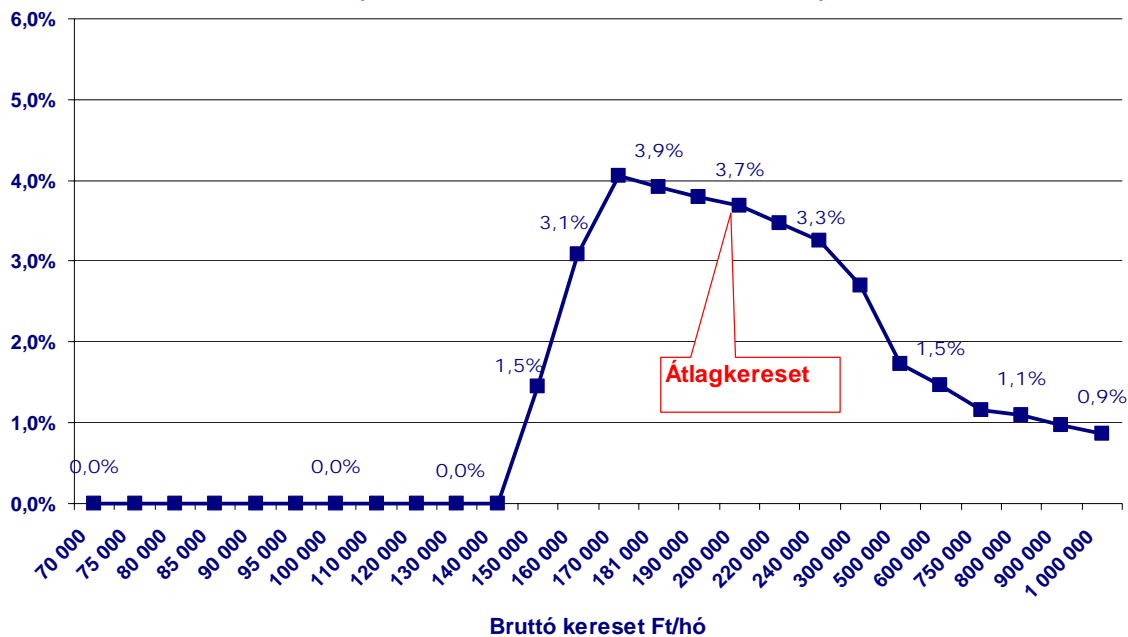
The employer's contribution should be reduced to zero in new jobs created in the most disadvantaged regions for the first three years of employment, which should only be gradually increased to a level, which will by then be already ten percentage points lower than at present in the next subsequent years (START Regional Programme). The average employer's contribution rate should be

reduced by 5 percentage points applicable only to the first HUF 140,000 of wages. This will reduce the tax burden of all income categories, but there is no doubt that it will mostly make it easier to employ people with low qualifications and lower income, i.e., its incentive impact may be felt in the areas where the employment problems are the largest.

In addition, we would increase the borderline of 18 per cent personal income tax rate to HUF 2 million and apply 18 per cent corporate profit tax as well while the special corporation tax would be abolished.



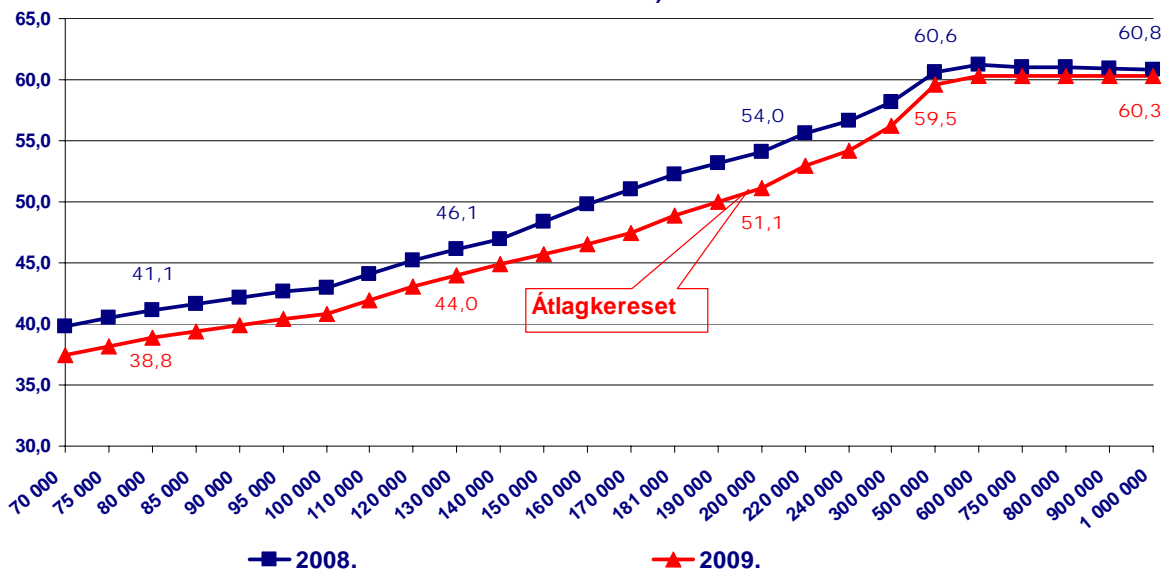
**A nettó kereset %-os változása 2009-ben
(300 ezer forintos sávhatáremeléssel)**



*Variation of net wages in % in 2009
(with HUF 300,000 tax bracket increase)
Average wages
Gross wages in HUF/month*

Adóék változása

**A munkavállaló és munkáltató által fizetett adó és járuléék a bérköltség %-ában
(5% munkáltatói járuléékcsökkentés a minimálbér 2-szereséig és 300 ezer Ft sávhatáremelés)**



*Variation of taxes
Tax and contribution payable by the employees and employers as a percentage of wage costs
(5% employer contribution reduction up to twice the minimum wages and HUF 2300,000 tax bracket increase)*

Average wages

In 2010, the five percentage point contribution decrease could be followed by two more percentage points and the 18 per cent PIT tax rate may be extended to HUF 2,500,000.

It is obligatory to pose a question: what guarantees that the whitening of the economy will generate money for the budget? Could it not happen that while taxes are reduced, the economic actors do not change their behaviour and the size of the grey and black economy remains. Naturally, this would mean that more and more money is missing from the budget. However, earlier we stated that the deficit target of the convergence programme is a taboo, it cannot be risked at all. However, in this case we must be able to manage the risk that the expected whitening process does not start.

In this context, we shall form a HUF 300 billion Tax Reduction Fund in next year's budget, identical with the amount of tax reduction. If the expected revenues are collected by the budget, then this Fund will be used as security for tax reduction in 2010. On the other hand, if the Fund or part of it has to be used, then the potential of future tax reduction will also be decreased proportionately.

Even stricter rules and related sanctions as well as incentives must be introduced in order to accelerate the whitening of the economy. E.g., for the purpose of reducing cash payments, wages and large purchases, trade deliveries should be paid by transfer as a mandatory requirement apart from certain exceptions. Based on sales without an invoice or black employment, the business operation would be temporarily or finally suspended or limited. Consideration should also be given to the idea to give exemption from sanctions applicable to the past under certain conditions to those who voluntarily register themselves and begin to whiten their operation and business activities or to make them gradually pay the total amount and lawful taxes within a transition period of several years.

Before conclusion

The special policy issues described above do not cover the entire range of the activities of the government. Perhaps I should not even mention that apart from these, as it is well known, we shall continue the New Ownership Programme, the first public companies will be listed on the stock exchange next year, and we hope that hundreds of thousands of people will purchase their shares under preferential conditions.

I did not give a lengthy description of health issues either because the new minister outlined his concepts recently, indicating that calm construction and growth, public health and development programmes formed in intensive dialogue with the health sector will be in the focus of attention. Sub-regional

outpatient centres will be constructed and hospitals and clinics will be reconstructed. At least four new ambulance stations will be opened later on this year. The scope of cancer screening will be extended and screening buses will visit small villages. Vascular Centres will be established in all regions in order to reduce the number of cardiac and vascular diseases and severity of their consequences. We shall offer and organise a complex free check-up for all sixteen-year-old teenagers enabling them to understand their own health characteristics on the verge of becoming adults. We shall extend the opportunities of, and support to, family doctors. We are aware that the current standard of medical services cannot be retained even on a medium term without a complex wage adjustment programme.

And finally...

Let me stop dealing with special policy issues. My intention was to present to Hungary that we can create a better, stronger and growing New Hungary if we want to and are willing to take action and make some changes for it. The Hungarian model proposed by us can combine the social and economic objectives of competitiveness. It depends on whether we can agree with the people and companies that we are creating clear and transparent conditions. The Hungarian Socialist Party and government intend to make the citizens, NGOs and institutions of the country accept this consensus and the New Hungary arising from it.

Ferenc Gyurcsány
Prime Minister,
President of the Hungarian Socialist Party