

NECESSITY AND POSSIBILITIES OF AN ECO-SOCIAL BUDGET REFORM

Proposals for the 2004 State Budget of Hungary

**Clean Air Action Group
Budapest, 2003**

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Contents

Recommendation	6
Foreword	7
I. Economic and financial policy foundations for our proposals	9
Introduction	9
1. Maintaining the long-term equilibrium through financial instruments	10
1.1. Employment	10
1.2. Protecting the Hungarian economy in conformity with WTO guidelines	17
1.3. Exchange rate and customs policy, and other protective policies	17
1.4. Changes in the balance of trade; providing support to foreign working capital on a basis of mutual advantages	24
1.5. Unfavourable changes of some elements of the Hungarian taxation and price system	38
1.6. Why is it inevitable to implement a human-ecological-oriented reform to the state budget?	40
1.7. Eco-social budget reform — increased state responsibility in a world of intensifying globalization	40
1.8. What is the optimal rate of state redistribution?	41
1.9. How can we fight inflation?	46
2. Chief aim of our proposals:	
environmentally- friendly and solidarity-based development of the Hungarian society	50
2.1. Reducing the costs of live labour	50
2.2. Increasing the share of live labour	51
2.3. Abolishing subsidies to environment-polluting and other harmful activities; incorporating external costs into the prices	51
2.4. Curbing the black economy	52
2.5. Preparation for the EU membership	52
2.6. Complex utilization of the possibilities related to environmental protection	53
2.7. Global rearrangement of economic incentives to the detriment of environmental criteria	53
3. Balance of the Hungarian state budget	54
II. Specific proposals to reform the Hungarian taxation and subsidization system	60
Introduction	60
A.) Reduction of wage costs and increase of subsidies granted for social tasks that cannot be placed on a market basis	61
1. Reduction of labour costs	61
1.1. Reduction of social security contribution	62
1.2. Reduction of personal income tax	62
2. Increasing state contribution to activities indispensable for the Hungarian society and its development but practically unfeasible under pure market conditions	64
2.1. Increasing state contribution to cultural activities, education, healthcare and scientific research	64
2.1.1. Education and culture	64
2.1.2. Healthcare	67
2.1.3. Scientific research and development	69
2.1.4. Modification of tax laws to favour education, healthcare and R&D activities	71
2.2. Restoration of the real value of family allowance to its 1994 level	73
2.3. Improvement of pensions and other social welfare services	74
2.3.1. Raising the real value of pensions and reviewing the system of private pension institutions	74
2.3.2. Improving social opportunities for disabled Hungarian citizens	74
2.4. Improvement of public safety	77
2.5. Support to underdeveloped and disadvantaged regions in Hungary	77
2.6. Transformation of the Hungarian housing policy	78
2.7. Higher state contribution to environmental protection and healthcare	79
2.7.1. Environmental and health protection awareness raising, information, education and culture	79
2.7.2. Offsetting energy price rises; improving energy efficiency	80
2.7.3. Support to environmentally friendly means of transport	86
2.7.3.1. Improved public transport services	86
2.7.3.2. Improved railway transport services	88
2.7.3.3. Aiding the depressed north-eastern region of Hungary through support to railway transportation	92
2.7.3.4. Significantly improved system of logistics	93
2.7.3.5. Promoting the general use of traffic calming measures	93
2.7.3.6. Abolishing financial discrimination against bicycle use	93
2.7.3.8. Giving preferences to the use of taxis	94
2.7.3.9. Abolition of motorway tolls	94

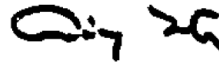
2.7.4. Protection of air quality	95
2.7.5. Protection against noise and vibration	95
2.7.6. Organizing integrated waste management	95
2.7.7. Water and soil protection	96
2.7.8. Support of the National Agrarian Environmental Protection Programme	96
2.7.9. Nature conservation; protection, improvement and extension of Hungary's forest-lands and the green areas of its settlements	96
2.7.10. Removal of long-term environmental damage and rehabilitation of contaminated areas	97
2.8. Increased support to small and medium-sized enterprises	97
2.9. Promotion of environmentally sound tourism	99
B.) Elimination of subsidies granted to activities damaging the environment and human health	99
3. Transport	101
3.1. Valorization of excise duties on petrol	104
3.2. Increased excise duties on diesel fuel	108
3.3. Imposing excise duties and VAT on fuels entering Hungary in fuel tanks of motor vehicles	110
3.4. Valorization, increase and better collection of motor vehicle taxes	113
3.5. Imposing infrastructure charges on heavy trucks in compliance with the principle of competition under equal terms	117
3.6. Imposing highly progressive road charges on motor vehicles with axle loads above 10 tons	119
3.7. Uniform rates of daily travel allowances	120
3.8. Stricter rules for accounting expenses of motorcar use	121
3.9. Increased taxes on company cars	121
3.10. Increase of consumption tax (registration fee) on motorcars	124
3.11. Increase and effective collection of consumption tax (registration fee) on used motorcars	127
3.12. Raising funds for handling motor vehicle wrecks	128
3.13. Elimination of motorcar credits granted by withholding VAT unlawfully	128
3.14. Substantial reduction of subsidies to construct further high-speed roads	129
3.15. Abandonment of direct and indirect subsidies granted to the Formula-1 Hungarian Grand Prix	129
3.16. Collecting VAT on foreign buses	131
3.17. Introduction of urban road charges	132
3.18. Compulsory introduction of parking fees	133
3.19. Postponement of the construction of Metro line 4 in Budapest	133
3.20. Increased taxes and duties on air transport	133
3.20.1. Increased air tolls	135
3.20.2. Introduction of airport utilization fees	135
3.20.3. Abolition of duty-free shops	136
3.20.4. Other measures	136
3.20.5. Abandoning direct subsidization by the state and by local governments	136
3.20.6. Landing fee of non-public-service flights	136
4. Energy	137
4.1. Harmonization of taxes on electricity, natural gas and coal	146
4.2. Current situation of natural gas and electricity prices for household use in Hungary and proposals for a solution	147
4.2.1. Environmentally harmful impacts of increasing the price of natural gas	147
4.2.2. Past development, current situation and expected changes in factors influencing the price of natural gas	148
4.2.3. Main data of the 2002 Flash Report of MOL Co.	150
4.2.4. Further data on the standing of some domestic companies of the energy sector	151
4.2.5. Joint application of mining taxes and administrative prices	153
4.2.6. Proposal for the methodology of a solution	153
4.2.7. On electricity prices	154
4.2.8. Opening up the market and market competition	156
4.2.9. Expected impacts of introducing a uniform European energy tax	156
4.3. Extension of the energy efficiency programme	157
4.4. Proportionate refilling of the Central Nuclear Fund	157
4.5. Investment policy changes in the energy sector	158
4.6. Purchase of natural gas through barter transactions	158
4.7. Raising to 25 per cent the VAT rate applicable to artificial fertilizers and some other products	159
5. Environmental load fees, environmental product charges and mining taxes	161
5.1. Introduction of air load fee	162
5.2. Introduction of water load fee	163
5.3. Introduction of soil load fee	163
5.4. Increase and extended scope of environmental product charges	164
5.5. Increased mining taxes	167
5.6. Stricter rules for the treatment of hazardous wastes	171
5.7. General and mandatory use of deposit refund	172

6. Protection of green areas and arable land; taxes promoting environmentally friendly agriculture	173
6.1. Increased land protection fees	173
6.2. Extended scope of land protection fees	173
6.3. Introducing up-to-date appraisal methods for the evaluation of trees and shrubs	174
6.4. Environment-oriented taxes on agricultural production	174
6.5. Transformation of the agrarian subsidization system	174
6.6. Introduction of a charge on covering large areas	175
6.7. Lowering the rate of local trade taxes	175
6.8. Increasing the locally used portion of environment protection fines	176
7. Increased taxes on luxury goods and higher cultural contributions	
7.1. Increase of excise duties on tobacco products at a rate exceeding the consumer price index	177
7.2. Increase and efficient collection of cultural contribution charged on products and services involving pornography, sex and violence	179
7.3. Increase of cultural contribution charged on advertisements	180
7.4. Stricter prohibition of tobacco advertisements	182
8. Modifications of the value-added tax	185
8.1. Keeping the 25 % VAT rate	185
8.2. Reducing the 12 % VAT rate	185
10. Other proposals related to environmentally and economically detrimental preferences	188
10.1. Review and publication of preferences	188
10.2. Review and enhanced transparency of separated state funds and ministry budgets	188
10.3. Stricter conditions for state guarantees and borrowings	189
10.4. Enhanced economic discipline in banking activities	190
10.5. Enhanced economic discipline and improved social efficiency of insurance companies	190
10.6. Reduction of state debt	191
C.) FURTHER MODIFICATIONS OF LAWS	192
11. Legislation to improve the state of the environment, enrich available human resources, streamline the economy and curb black economy	192
11.1. Enhanced interestedness of the National Board of Customs and Finance Guard, the Tax and Financial Audit Office, police, foreign trade licensing institutions, environment and nature protection inspectorates, healthcare authorities and consumer protection agencies	192
11.2. Other measures to prevent corruption in state administration	193
11.3. Introducing the obligation to provide environment and nature protection securities and to form environment protection provisions	194
11.4. Increased rates of penalties	195
D.) RESEARCH ACTIVITIES	196
12. Research activities necessary to provide better foundations for the measures described in Chapters 1 to 11	196
12.1. Detailed preliminary impact assessment of specific measures	198
12.2. Determination of external costs	198
12.3. Applying the so-called Genuine Progress Indicator to Hungarian conditions	198
E.) PUBLIC PARTICIPATION	199
III. Summing-up	202
References	205

Recommendation

The National Environment Protection Council of Hungary has recently decided that in addition to its statutory responsibilities, it will also perform some other activities on its own initiative. Economic regulation connected to environment and nature protection is one of these new tasks. Clean Air Action Group has been doing pioneering work in this field; every year since 1992 they have elaborated their proposals for an environmentally-friendly transformation of the State Budget and the taxation system of Hungary. The National Environment Protection Council has discussed these proposals on several occasions, appreciating the importance of this work and granting moral support for the continuation. And now, it has become possible for the Council, as part of its newly initiated work programme, to grant also financial support for that mission. The National Environment Protection Council, however, has not analysed in detail each specific proposal of the Clean Air Action Group, and has not formulated its standpoint in connection with them. Nevertheless, it can be ascertained that regarding their fundamental principles, the proposals are in conformity with the concepts set forth in the Programme of the Hungarian Government and with the requirements of the European Union.

I recommend this study for everyone who is interested in how we could improve the environment in Hungary.



István Láng

*Member of the Hungarian Academy of Sciences
President of the National Environment Protection Council*

Foreword

“The current development model is outdated and has led to an impasse. ...On the one hand, industrial societies are squandering natural resources (which either do not have a price at all, or the price does not express how scarce they are), and on the other, they are using less and less live labour. ...The low utilization rate of labour and its ever-growing replacement by capital and energy stem from the distorted prices of production factors.”

*Quote from the speech of Jacques Delors,
President of the European Union,
delivered on the 1995 Summit Meeting in Essen*

Our proposals for the following year's state budget have been published each year since 1992. This year, taking into consideration the materials of former years, as well as the connected discussions and comments, our study evaluates some major tendencies in the Hungarian society and economy, and formulates our proposals for the annual state budget bill and for other related statutes.

In this year's study we have placed even greater emphasis on the environmentally focussed protection of human life and health. To achieve this goal, it is necessary to regroup means and instruments in a manner to eliminate or at least reduce the subsidization of environment-polluting activities and the cross-financing which distorts economic competition. Besides these features, we have preserved all elements from the studies of previous years, which we thought worth taking over – with modifications in line with changing conditions. We have paid special attention to bringing our proposals into harmony with the principles, expectations and future objectives of the European Union. We were glad to note a strengthening trend within the European Union of giving priority to the protection of human life and the environment when elaborating plans for the future.

Of course, we are well aware that our proposals cannot be implemented from one day to the other, because sometimes, in connection with some specific modifications, it is not easy to recognize that the long-term interests of the economy, the society and the environment in fact coincide with one another; and proposed changes may conflict with the interests of certain groups of great influence and strong interest enforcement power. At the moment we accept the fact that the ma-

jority of those preparing and making decisions do not fully share our standpoint, although, despite all conceptual disagreements and practical objections, more and more of them have started to pay attention to our approach and stand by our principles to achieve sustainable development. A proof of that is that the Government and the Parliament of Hungary have adopted a series of our specific proposals over the past few years, and incorporated them into the Hungarian system of statutes in force.

An increasing number of civil movements, interest groups and even government agencies represent the principles upon which our proposals have been based. The European Commission in Brussels, the European Parliament, the OECD and other institutions also stand by those principles and reinforce them in their statements, standpoints and documents published day after day. Opinion polls in Western Europe also reveal that people understand and support the ideas to restructure the state budget in a way that gives priority to people, culture and environmental protection. Our experience shows that the representatives of virtually all industries recognize that the proposals are reasonable. Although, not surprisingly, the industries which are the most adversely affected momentarily but are still extremely powerful, do their utmost in practice to delay the already inevitable changes as much as they can.

“Three quarters of the EU population thinks that politicians fail to pay proper attention to environmental aspects in taking decisions which have an influence on the economy, labour market, etc.” (See *Eurobarometer*, 5th June 2002.) Among the 7000 European citizens questioned, more think that the state of the environment (73 per cent) is a stronger determin-

ing factor for their quality of life than the economic situation (64 per cent) or social equality (64 per cent). Nearly 86 per cent of those filling in the questionnaire claimed that politicians and decision-makers should regard environment protection just as important as the economy or the social justice. It is important to note that in 1999, the same type of survey still found that environment protection was only the fifth most important factor.

We do not think that our proposals are extremist; rather the decisions, only delaying the necessary actions, which further aggravate the destruction of the environment – already today seriously jeopardizing social and economic development in Hungary. These delays will result in accumulating the contradictions and expenses, and further increasing the immeasurable damage caused to human life and health. The proposed restructuring would favourably affect the overwhelming majority of citizens and enterprises already in the short run, and it would contribute to the long-term development of the whole society.

The restructuring of the financial resources, quantified in our proposals, could have been implemented both economically and technically already in 2003. In this year's study the numerical data of our proposals are based on the estimates of the Act on the 2003 State Budget of Hungary, but may also provide direction for elaborating the guidelines of the 2004 budget and then for preparing the budget bill.

It is up to the politicians to decide – in case they agree with our proposals – about the schedule of the implementation: how gradual the implementation should be, and how many years it may take, considering the political aspects. In order to promote this, people should be supplied with adequate information on the reforms, and the general public should be involved in a comprehensive discussion of the issue – we have pre-

pared our proposals for the methodology of this public relation work as well.

In our study we have used the latest available data. The sources of the data are the relevant Hungarian official statistics or the base institutions supplying these data, as well as some international institutions and organizations (primarily the European Commission and its agencies, and the OECD). Our proposals are being updated on a continuous basis; therefore the present volume should be regarded as a “snapshot” of the process of our work. The updated versions and supplements may be read on our homepage.

Our proposals are meant to help Hungary be at the forefront of progress and take action to promote sustainable development. We are convinced that the implementation of our proposals would contribute to the **preservation of human life and health**, and would help:

- improve the state of the environment,
- expand employment,
- enhance the competitiveness of Hungarian labour force,
- raise the income levels of workers,
- reinforce social market economy,
- establish better conditions for education, culture, health and scientific research,
- accelerate economic restructuring,
- improve the balance of trade,
- utilize raw materials and energy more efficiently,
- relieve social tensions,
- improve social welfare services, and
- make more efficient preparations for the accession of Hungary to the European Union.

On behalf of the Clean Air Action Group, national association of 126 Hungarian environmental NGOs, I am kindly requesting the support of the Reader to accomplish the above goals



András Lukács
President

* Between 1993 and 2000, our budget proposals have been published jointly with the Trade Union of Workers in Public Collections and Public Education /Trade Union of Culture/ (KKDSZ). Clean Air Action Group continues its cooperation with the KKDSZ and with other trade unions and numerous non-government organizations.

Economic and financial policy foundations for our proposals

“The Earth is the property of each generation, entirely and on their own right, during the whole of their lifetime. The second generation shall receive this property free from all debts or encumbrances from the first generation, just like the third generation shall receive it from the second, and so on. It is because, if the first generation encumbered this property with debts, then the Earth would belong to the dead, and not to the living generations. Therefore no generation shall undertake more debts than they are capable of paying back during their own lifetime...”

Thomas Jefferson (Letter to James Madison, 1789)

Introduction

One of the documents that we have used as a starting point to elaborate the economic and financial grounds of our proposals was “Hungary’s medium-term economic programme to lay the foundations for the EU accession, 2002” (hereinafter in short: Economic Policy Programme) published by the Ministry of Finance in August 2002. Among other factors, this will ensure that our eco-social budget proposals fit in with Hungary’s economic and financial policies. The Economic Policy Programme’s Chapter on Environment Protection contains a half-sentence which, if consistently implemented, may prove to be of crucial importance for the development of the Hungarian economy and society: “The Government of Hungary intends to enforce the «polluter pays» principle even more relentlessly in the future...” Much less needs to be spent on environmental and health tasks if direct and

indirect state subsidies which contribute to damaging the environment are eliminated. This will also enhance considerably the efficiency of the Hungarian economy.

In our opinion there are four key topics which are advisable to be treated as the principal focal points of a human-values-oriented economy, and other issues need to be subordinated to these. The four topics are:

- environment protection,
- healthcare,
- education and culture,
- employment.

First we will present an overview of the issue of employment, as well as of some other economic factors, which are indispensable to be taken into account for laying the foundations for our proposals. We will discuss the other three key topics later on in detail.

1. Maintaining the long-term equilibrium through financial instruments

We have based our alternative budget proposals on realistic economic principles, which, in addition to enhancing the quality of life of Hungarian citizens, may also improve the performance of Hungary's economy as a whole. Unlike short-term crisis management, our policies focus on measures promoting long-term structural changes in a manner that they meet the requirements of Hungary's membership in the EU.

Since Hungary is an open economy, the internal balance can only be improved lastingly on condition that the external balance is improved at the same time. (In 2001 the total value of exports equalled 59.2 per cent of the GDP, while that of imports amounted to 65.4 per cent of the GDP. Without the trade turnover of customs-free zones, the same indexes are 33.2 per cent for exports and 45.6 per cent for imports.)

Therefore, **long-lasting improvement of the external balance** is the key element of the policy. The point of this statement will become evident if we look at the long-term (i.e. longer than one year) trends. The current practice and approach of elaborating annual (short term) state budgets is not capable of managing the long-lasting, primarily external, deficit. (Recent years have brought some changes to include projections for another three years in the annual budget proposals. However, this is only a formal technical solution, because the state budget is not based on a consistent three-year economic programme.) The state budgets for 2001 and 2002 already coupled two years as a basis, but it is still a short-term approach. Unfortunately, this approach is even more characteristic of the Hungarian banks and banking activities.

1.1. Employment

“In the Republic of Hungary, all people have the right to work, and to freely choose their work and vocation.”

*Paragraph (1) of Art. 70/B
of the Constitution of the Republic of Hungary*

It is well known that Hungary's most important resource is its workforce, in which the country possesses abundant reserves, having lost 1.5 million jobs since 1989. The external economic balance can also be best improved through increasing the employment, because this has the highest net foreign exchange yield. What is more, goods of high specific labour content – especially

when coupled with knowledge-intensive activities – are in general also environmentally friendly. In spite of that, some government concepts only wish to encourage investments of high specific capital intensity and mostly of foreign origin. Given that these investments are also highly material and transport-intensive, they put an increased load on the environment in Hungary. After a period of provisional profusion of capital, international capital has shrunk to just one-third of its former volume by now, which makes it highly probable that the funds spent on encouraging foreign working capital will not bring about the expected result.

In the present situation we think that the Government is right to stress already in the introductory section of its Economic Policy Programme that “the Government of Hungary considers it one of its most important tasks to attain a general rise of the employment rate, in line with the EU objective to increase the overall employment rate to 70 per cent in the member states by 2010. The Government intends to promote this primarily by reducing the financial burdens on live labour, by making the labour market more flexible, by stimulating the creation of new jobs and by implementing measures to maintain the existing jobs.”

As regards employment, Hungary has accumulated an enormous backlog. (See Tables I.1.1.a – e. showing the level of employment.) Even the Economic Policy Programme states that the activity rate in Hungary is still under 60 per cent at present (calculated in relation to the population in working age), which includes the unemployed, too – without them the employment index is not more than 56 per cent. According to the calculations of the Central Statistical Office of Hungary, which projects the number of individuals on the payroll upon the population in working age (15–74 years), the employment rate reached only 50 per cent in 2001.

The tendency of losing jobs in mass proportions began at the time of the change of political regime in Hungary. Between 1989 and 1994, the number of employees went down by nearly 1.5 million. The so-called Bokros package (austerity measures named after the Minister of Finance at that time) resulted in a further major fall in the employment rate. (At that time the standard of living was worsening not only because of the decline of wages and pensions in real terms, but also due to the deteriorating employment figures.) Official statistics reveal that 155 thousand jobs were lost in 1995, then another 100 thousand in 1996, and a further nearly 100 thousand in 1997.

Table I.1.1.a.: Employment rate of the workforce in percentage of the working population

Table I.1.1.b.: Change in the employment rate compared to the previous year (%)

Table I.1.1.c.: Impact of reduced employment on the state budget between 1995 and 1998 (million HUF)

	1995	1996	1997	1998	1995–98 total
Number of effectively employed workforce, thousand persons	4055.9	3957	3917	3933.1	
Drop in the number of employees compared to the previous year, thousand persons	186.6	285.5	325.5	309.4	
Net wage of employees losing their jobs	107446	164393	187426	178155	637419
Lost revenues of the state budget	116810	178720	203760	193681	692973
Additional unemployment relief	49195	75269	85814	81570	291849
Lost revenues plus additional expenditures of the state budget in total	166005	253989	289575	275252	984822
*Decrease of purchasing power (difference between net wage and unemployment relief)	11650	17824	20322	19316	69113
Aggregate impacts as quantified above	177655	271814	309897	294569	1053937

*Impact of the decreasing purchasing power: lost state budget revenues can be calculated by taking 20 per cent of the amount remaining after deducting unemployment relief from wages.

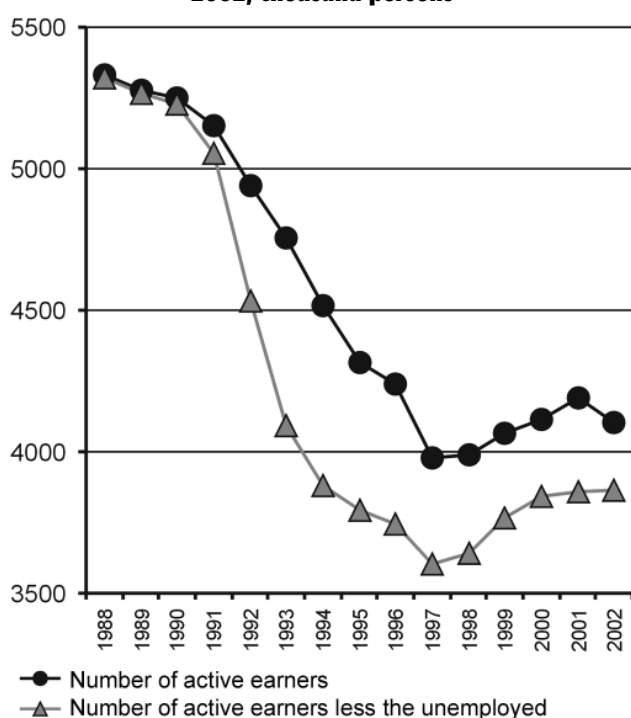
Source: Monthly Statistical Bulletins of the Central Statistical Office of Hungary, No. 1999/12

In 1998, the Central Statistical Office (KSH) already reported a slight improvement: some tens of thousands of new jobs were created, mainly in the entrepreneurial sector. Data of the Tax and Financial Auditing Office of Hungary (APEH), however, show real weighted average figures; these figures are derived from the actual payment of taxes and social security contributions on the wages, which makes them more trustworthy in many respects than the “purely statistical” employment data of the Statistical Office. According to the labour surveying methodology of the Statistical Office, “individuals are regarded employed, if they, as employees ... during the week observed, perform at least 1 hour work which ensures earnings ...” (Statistical Yearbook of Hungary 1998, p.75).

Statistical registration of employees is further complicated owing to calculating with the so-called Hungarian method (see the periodical titled “A KSH jelenti” /“The Central Statistical Office reports”/), which is not compatible with the internationally accepted practice. Data of the OECD, however, ensure international comparability, and demonstrate in a comparable way the level of employment and the changes thereof between 1983 and 2001 (see Tables I.1.1.a – b.). It is to be highlighted that in smaller countries the number of employees is increasing at a higher rate. In this respect, Hungary is in an exceptionally bad position, because in international comparison its employment level was already extremely low, and this has further diminished now. The mentioned OECD statistical statement shows that in Hungary the number of employees decreased by 309 thousand between 1994 and 1998. Only a slight improvement was recorded in the period between 1998 and 2001. In 2002, once again, the entrepreneurial sector saw a drop in the employment level, which was more or less offset by increasing employee numbers in the public administration sector. As a result, employee number remained the same on the whole as compared to 2001, despite the slackening international boom.

Another reason why official statistics fail to reflect the reality is that they only contain data on registered unemployment, and leave out the number of jobless people unregistered. For example, the nearly 300,000 disability pensioners in Hungary are not registered as unemployed, although at least a part of them could do without their pensions and find jobs for themselves after rehabilitation.

Shrinking employment, as a primary impact, added HUF 985 billion to the state budget deficit between 1995 and 1998, calculated at 2000 prices and compared to the base value of 1994. We define as secondary impact 20 per cent of the income difference between net wages and unemployment benefits, which is made up of the non-payment of the value-added tax, excise duties, etc., as a

Figure I.1.1.: Changes in employment between 1988 and 2002, thousand persons

consequence of the declining purchasing power. This item amounted to an additional HUF 69 billion for the mentioned 4 years. **Therefore, all in all, state budget revenues worth HUF 1054 billion were not collected owing to the falling employment level** (see Table I.1.1.c.).

So the loss of 309 thousand jobs causes massive financial losses for the Hungarian economy, in addition to the human agony of the unemployed.

We estimate that the total “value” of manpower in Hungary is roughly 10 times higher than the annual gross wages. Therefore, one person is “worth” HUF 7 million; i.e. the accumulated skills and experience of the 309 thousand Hungarian citizens “sacked” are worth approximately HUF 2200 billion. Using an analogue based on accelerated depreciation we may presume that in the first year of unemployment 30 per cent of that value is lost, in the second year 20 per cent, and in the third a further 10 per cent.

It is well-known that approximately 1.4 million jobs were lost in the period between 1989 and the end of 1996 in Hungary (see Figure I.1.1.). This means an increase of over 30 per cent in the amount of social expenses per one employed individual. Letting this process going on is more than irresponsibility, because Hungary’s most important treasure and value is its rela-

tively well-trained, hard-working and well-performing labour force, which is also the country’s most competitive resource due to its comparative cheapness in the international market.

As a consequence of the international economic boom, in the period from 1998 to 2001, some 100 thousand new jobs were created in Hungary. In 2002 a recession followed, which stopped the increase of job opportunities; there are signs that indicate a provisional tendency of job losses (see the case of IBM in Székesfehérvár in Western Hungary). The Government’s medium-term development plan stresses the need to expand employment in Hungary, which is an important and positive intent, but unfortunately, the system of financial instruments to promote the achievement has not been set up and is not yet functioning. The objective of the “labour department” to attain EU employment level also in Hungary within ten years, in line with the EU employment policy, would roughly mean creating 500 thousand to 1 million new jobs. Providing vocational training to 1 million individuals – a goal set in the medium-term development plan – would be a great contribution towards increasing the employment level in Hungary.

Besides employment level, it is also very important to look at the structure of employment, and to compare

**Table I.1.1.d.: Employment structure in selected countries of the world
(per cent)**

Country	Employment rate*	Agriculture	Industry, building and construction	Services
Austria	74.7	5.7	29.9	64.4
Belgium (1990)	60.9	3.1	30.6	66.3
Denmark (1998)	79.7	3.6	26.6	69.8
Finland	72.6	5.7	27.2	67.1
France	68.0	3.7	24.1	72.2
Greece (2000)	64.0	17.0	22.5	60.5
Netherlands (2000)	66.2	3.2	21.1	75.7
Ireland	67.2	7.1	28.9	64.0
Luxembourg (1990)	61.7	3.2	30.4	66.4
Great Britain	75.3	1.4	24.8	73.6
Germany	73.8	2.6	32.7	64.7
Italy	58.8	5.3	32.1	62.6
Portugal	73.3	12.7	34.6	52.7
Spain	63.3	6.4	31.5	62.1
Sweden	75.2	2.3	23.8	73.7
USA	67.1	2.4	22.4	75.2
Japan	78.2	4.9	30.5	64.6
Hungary	58.7	6.3	34.7	59.0
Poland (1999)	65.1	19.1	30.5	50.4
Slovak Republic (1999)	69.0	6.1	37.6	56.3

* Data of the column “Employment rate” have been taken from Table 19 in the publication OECD Economic Outlook No. 70

Source: Yearbook of the Central Statistical Office of Hungary, 2001, p. 557

Hungary with the advanced industrial countries in this respect (see Table I.1.1.d.). The table reveals that Hungary has a much lower portion of labour force employed in the tertiary sector than the advanced industrial countries. As a consequence of that, by expanding the sector of services (including environmental-protection-type services) it is possible to ensure employment for a large number of workers in a manner that will also contribute to the modernization of the country's economic structure. Hungary has a considerable comparative advantage in this field: its relatively cheap and well-trained labour force. It would be necessary to formulate or modify several statutes and technical specifications in order to encourage enterprises to perform or to utilize various services.

All the other candidate countries which have a chance to achieve EU membership in the first stage of enlargement have significantly better employment indicators than Hungary.

According to official statistical data, the unemployment rate is lower in Hungary than in the EU, but the rate of employment, which is a crucial indicator of the real situation of the country, suggests a much less favourable overall position. (In some instances jobless people are not registered at all because they stand no chance to find a job.) This can be explained by the high number and rate of the so-called latent unemployed in Hungary, who are not included in the statistics. It is to be noted that some government agencies have been boasting that regarding unemployment, Hungarian rates and ratios are better than those of EU countries!

EU countries have launched a well-prepared, unified programme to increase the number of available jobs and to combat unemployment. Since Hungary has an open economy, which is becoming even more open as a consequence of reduced customs duties, this may have the effect that the expanding EU jobs exert additional pressure to close down even more Hungarian job opportunities. Or, owing to the low wages, Hungary will not have any choice but to perform primitive job work, which would further reduce the earning capacity, too. These adverse tendencies can only be avoided if a scheme (even more effective than in the EU) is introduced to increase the rate of employment. Research and development should be given priority within the employment scheme, for R&D is the engine that should pull the economy ahead by its positive multiplier effect and usefulness for the entire society.

The issue of employment has become a pivotal part of economic policies even in countries where the economic activity level is higher than in Hungary. The latest EU programme sets the goal to catch up with the United States of America in 10 years. The main indicator to measure that, the rate of employment, is to be raised from the current 61 per cent to 70 per cent, which means es-

tablishing 30 million new job opportunities. Even then, regarding the rate of employment, the European Union will remain behind its two archrivals, the USA and Japan, both having a rate around 74 per cent at present.

Higher rate of employment will bring about enhanced productivity at the level of the society as a whole, which is more efficient than the traditional way to increase productivity. It is so because for the latter, gross production value is the basis of the calculation, containing also the value of goods supplied for production. Consequently, the more is the value of the goods supplied and the less is the live labour input, the higher is the productivity that may be shown, which is a distorted data due to the ever-increasing accumulation at international level.

Expanding employment and protecting the environment are closely connected. In Hungary live labour costs only a fragment of its EU price. Therefore the most efficient means of development here is to employ live labour, whereas giving preference to capital and raw material-intensive development projects has most unfavourable consequences (especially considering the country's high debt burden). Protection of the environment and modernization of the economic structure can both be implemented through expanding activities which have a higher specific live labour content – and as a result are more efficient at the level of the society as a whole.

A good example to illustrate the above is the replacement of the now almost universally used disposable packaging by state-of-the-art multi-way containers. Disposable packaging is incorporated into the price of goods, increasing it by 20 to 30 per cent, or in some cases even by 60 per cent. It causes considerable waste-disposal costs already today, which is expected to grow exponentially in the future. All this destroys the local economy and also the local environment. In contrast, state-of-the-art multi-way packaging adds only very slightly to the purchase price of goods, causing hardly any pollution to the environment. Such activities may give a new chance for local industries and for small and medium-sized enterprises as well. Some methods, also applied in the USA, may further strengthen these favourable effects: social benefits should be put at the beneficiaries' disposal in the form of in-kind grants. In Hungary, for example, it would be advisable to arrange the "milk in schools" programme by distributing milk from cans, using the children's own cup. Thereby the cost-increasing and environment-polluting activity of the milk monopolies, which have gone into foreign ownership, can be avoided; what is more, milk producers would immediately receive the price of their product, without the need to grant credit to the monopolies for several months.

Low rates of employment in Hungary entail several problems to be solved:

Table I.1.1.e.: Employment growth of employees with high and with low qualification levels (annual average rate of increase, per cent)

Country	Period	High qualification*	Low qualification
		employees	
Canada	1981-1991	3.10	0.65
Japan	1980-1990	2.90	0.60
USA	1983-1993	2.60	1.40
Germany**	1980-1990	2.55	-0.01
France	1982-1990	2.20	-0.55
Italy	1981-1991	2.05	1.17

Notes:

* The high qualification category includes:

ISCO-88 Group I – legislators, senior associates and managers;

ISCO-88 Group II – qualified employees;

ISCO-88 Group III – technicians and teachers.

** In Germany ISCO-88 Group I does not include managers, and ISCO-88 Group III does not include teachers; therefore the number and proportion of highly qualified employees are underestimated.

Source: OECD (STI/EAS Division). Quoted by National Technical Development Commission (OMFB) – Hungarian Academy of Sciences (MTA), Research Institute of World Economy

- Low rates of employment, together with average earnings that are only about the eighth of those of the developed countries, result in exceptionally low income levels in an average family in Hungary.
- Hungary's comparative advantage due to the low costs of labour is less utilized.
- Long-term unemployment destroys a part of the available human resources (skills and knowledge become obsolete, adverse psychological impacts, etc.).
- Part of the labour force leaves the labour market, which is good for statistics because it looks as if the rate of unemployment was below the rate in EU countries, but it is nothing but distorting the real picture.

Links between employment and education are becoming ever stronger, because the need of the information society for highly-qualified workforce is immense already today, and it is getting even more so in the future. The employment of well-qualified professionals, for example, increases each year by 3.1, 2 and 2.5 per cent in Canada, Japan and Germany respectively. Detailed surveys conclude that industries which invest more into scientific research and are among the first ones to apply new methods, acquire more human resources as a rule and improve their performance and competitive position by using the expertise and the results of innovations. Products with high "intellectual content" are in demand in the international market and are able to attain increasing prices, while material-intensive goods are losing their value. Those trends in the advanced industrial countries could serve as a lesson to learn from for the less developed countries as well when forming their education and employment policies (see Table I.1.1.e.).

Key deficiencies of the employment policy in Hungary over the past few years have been its predominantly financial focus and the lack of selectivity; this has led to radical cutbacks in the number of jobs even in key sectors, for instance in education. In 1994, the number of staff employed in education in Hungary totalled 336,800, whereas in September 1998 it was only 225,200, representing a drop of over 113,000, i.e. one third. Austerity measures of the so-called Bokros package have hit education the hardest: real wages went down dramatically, which necessarily affected the quality of education. In the meantime, other countries, thinking in the long run, are improving education to make it one of their leading and most competitive sectors, which is to be the most profitable business of the next decade. In Canada, for example, education is given priority and 21 thousand new jobs were opened in 1995 alone. Education and training is being developed and expanded in Great Britain and France as well. The US exported education and training services worth USD 7 billion in 1995. (Source: Hungarian economic daily "Világgazdaság", 18th February 1999)

The current Hungarian Government deserves credit for raising the base wage of employees in the education sector by 50 per cent in 2002. Nevertheless, further progress should be made in this direction, because this single step is far from being enough even to offset the serious setback experienced in this sector recently.

We were glad to see that the previous Government started the elaboration and implementation of a complex employment stimulating programme in 2001 – in keeping with the proposals that Clean Air Action Group has been advocating for many years – and the current Hungarian Government is intending to continue and step up the programme.

1.2. Protecting the Hungarian economy in conformity with WTO guidelines

Hungary is an economically open country: the value of the Hungarian product export equals some 60 per cent of the GDP. In the last few years, protective customs duties have been reduced, the supplementary duty has been abolished, and the rate of devaluating the Hungarian currency, announced in advance, has been lowered; then in 2001 the devaluation system was terminated altogether, which resulted in the appreciation of the forint. The tendency of forint revaluation has gained strength during 2002. As a consequence, imports have become relatively cheaper. These measures increase the competitiveness of imports as against Hungarian products. In order to offset at least a portion of the adverse impacts, it is necessary to provide protection for the Hungarian environment and economy in a manner which would restrict imports through safeguarding human life and the environment and in so doing would put Hungarian producers into a more favourable position. The measures proposed in the present study principally contribute to achieving this goal.

The current level of foreign trade relations between Hungary and the European Union anticipate Hungary's EU membership, because, already today, the country's economic relations are predominantly tied to the Union. This is demonstrated by Table I.1.2.a. and b.

International competitiveness of the Hungarian economy should not be attained through classic short-term implements, but through a system of instruments which have more long-lasting effects. It is a well-known fact that the competitiveness of the qualified Hungarian labour force is essentially comparable to that of the EU countries. (Under identical conditions, its productivity is approximately of the same level, while wage costs are only a fraction of those in the EU – although this advantage is somewhat deteriorated by lower organizational and management standards.) Hungary has to make sure that no more job losses are provoked by imports, therefore, among others, increased support should be granted in order to strengthen sectors and enterprises which create competitive jobs and which can produce goods that find their markets abroad and reconquer the domestic markets. This would have a simultaneous effect of squeezing out imports, too. Such economic policy would generate higher returns in foreign exchange even with a very low growth rate of exports, and would bring about greater improvement to the balance and higher increase in the added value. Products of high specific live labour content (i.e. of lower specific material and

energy content) would initiate methods and means of production which are less harmful to the environment.

Reducing gross labour costs is a major implement to enhance the rate of employment and to slow down the rate of inflation. Increasing the employment is a key programme in the EU as well. The Amsterdam Treaty of the European Union says: *"The Community is to promote a high rate of employment and high standards of social safety, to ensure equal treatment for male and female employees, to improve the living standard and the quality of life, to promote economic and social cohesion, and to strengthen solidarity among the member countries."* Akin measures to increase employment are necessary in Hungary to avoid importing "live labour" from the EU. At present, Hungary has to face the problems of under-employment; therefore even more efficient measures are needed to **open up new job opportunities in the required numbers.**

With a view to maintaining the equilibrium of state finances, reduced revenues from lower taxes and social security contributions imposed on live labour must be compensated by other sources of income for the state. Taxes on material- and energy-intensive products that pose serious threats to human health and the environment should be increased and directly transferred to the social security funds. This is also required by the "polluter pays" principle. In this way the financial burdens on the Hungarian society would not grow in the aggregate, but would start to diminish gradually. Another favourable impact is that inflation would go down because wage costs would be lower and taxes would only be imposed on end-users.

The measures we propose would promote employment and boost the entire economy, which would reduce the per capita social costs.

Protection of the Hungarian economy needs to be organized in compliance with the World Trade Organization's guidelines; and based on that, an export-oriented economic policy should be followed. Special care should be taken to protect the existing domestic environmental-protection-type activities as well as the Hungarian environmental protection activities to be developed, which, even by WTO standards, definitely comply with international practice.

1.3. Exchange rate and customs policy, and other protective policies

Official reports and evaluations handle the foreign trade data of the area within the customs borders of Hungary and the industrial duty-free zones in a consolidated manner. By doing so, however, we will obtain average data without any reasonable meaning, because

Table I.1.2.a.: Share of the European Union and of the industrial customs-free zones within Hungary's foreign trade turnover (million USD)

	1995*	1996	1997	1998	1999	2000	2001
EXPORTS							
Total	14391.8	15703.6	19069.1	23005.3	25012.5	28091.9	30497.8
of which EU 15:	9449.6	10949.4	13582.9	16781.6	19067.8	21116.6	22651.2
Hungarian customs area	12867.0	12858.5	14043.6	14733.1	14260.3	15522.4	17109.1
of which EU 15:	8079.6	8247.3	8790.9	9586.9	9818.4	10413.3	11262.9
Industrial customs-free zones	1524.8	2845.1	5025.5	8272.2	10752.2	12569.5	13388.7
of which EU 15:	1370.0	2702.1	4792.0	7194.7	9249.4	10703.3	11388.3
IMPORTS							
Total	16730.7	18143.7	21106.3	25706.4	28008.2	32079.5	33681.9
of which EU 15:	10559.4	11301.3	13203.2	16479.1	18048.6	18760.2	19464.4
Hungarian customs area	15466.3	15617.0	17077.3	19235.8	19447.7	22021.5	23474.5
of which EU 15:	9514.7	9260.3	10057.4	11804.9	11975.0	12827.3	13872.8
Industrial customs-free zones	1264.4	2526.7	4029.0	6470.6	8560.5	10058.0	10207.4
of which EU 15:	1044.7	2041.0	3145.8	4674.2	6073.6	5932.9	5591.6
BALANCE							
Total	-2338.9	-2440.1	-2037.2	-2701.1	-2995.7	-3987.6	-3184.1
of which EU 15:	-1109.8	-351.9	379.7	302.5	1019.2	2356.4	3186.8
Hungarian customs area	-2599.3	-2758.5	-3033.7	-4502.7	-5187.4	-6499.1	-6365.4
of which EU 15:	-1435.1	-1013.0	-1266.5	-2218.0	-2156.6	-2414.0	-2609.9
Industrial customs-free zones	260.4	318.4	996.5	1801.6	2191.7	2511.5	3181.3
of which EU 15:	325.3	661.1	1646.2	2520.5	3175.8	4770.4	5796.7

Note:

*The 1995 base of industrial customs-free zones is incomplete.

Source: Foreign trade statistics

Table I.1.2.b.: Share of the European Union and of the industrial customs-free zones within Hungary's foreign trade turnover (per cent)

	1995*	1996	1997	1998	1999	2000	2001
EXPORTS							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which EU 15:	65.7	69.7	71.2	72.9	76.2	75.2	74.3
Hungarian customs area	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which EU 15:	62.8	64.1	62.6	65.1	68.9	67.1	65.8
Industrial customs-free zones	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which EU 15:	89.8	95.0	95.4	87.0	86.0	85.2	85.1
IMPORTS							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which EU 15:	63.1	62.3	62.6	64.1	64.4	58.5	57.8
Hungarian customs area	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which EU 15:	61.5	59.3	58.9	61.4	61.6	58.2	59.1
Industrial customs-free zones	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which EU 15:	82.6	80.8	78.1	72.2	70.9	59.0	54.8
BALANCE							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which EU 15:	47.4	14.4	-18.6	-11.2	-34.0	-59.1	-100.1
Hungarian customs area	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which EU 15:	55.2	36.7	41.7	49.3	41.6	37.1	41.0
Industrial customs-free zones	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which EU 15:	124.9	207.6	165.2	139.9	144.9	189.9	182.2

Note:

*The 1995 base of industrial customs-free zones is incomplete.

Source: Foreign trade statistics

the content of the two mentioned areas are different and the processes in them are of opposite direction. In order to achieve a real economic analysis, we will treat the two areas separately.

According to the 2001 customs statistics (not including free zones), the balance of foreign trade shows an annual deficit of USD 6.4 billion, which is a slight improvement compared with the previous year's deficit of USD 6.5 billion. In 1999, the deficit as per the customs statistics was USD 5.2 billion, that is it increased by a further USD 1.2 billion by 2001. The preliminary actual data for January through November 2002 show that the trade deficit of the area within the customs borders increased significantly, compared with the same period of the previous year, and surpassed USD 7.9 billion (see Table I.1.3.a.). By the end of 2002 the deficit is expected to rise above USD 8 billion.

The balance of foreign trade of the **area within the customs borders of Hungary** in the first six months of 2002 – after an improvement of USD 143 million in 2001 – deteriorated by USD 928 million compared with the same period of the previous year, despite the fact that Hungary had to pay USD 90 million less for energy sources. All in all, over a period of six months, the trade deficit of the area within the customs borders of Hungary went up by USD 1018 million, which indicates an annual trade balance deterioration of some USD 2 billion. The system of interests of the Hungarian customs area, employing 98.3 per cent of all employees in 2000, has become seriously disadvantaged as against imports, due to the following factors:

- As of 2001 the imports of industrial products from the EU and the CEFTA are free from any customs duties.
- Continuous appreciation of the Hungarian currency makes imports cheaper, whereas it reduces sales revenues from exports.
- Foreign commercial chains give preference to products from their home countries or to products from the Far East, ensuring maximum profits.
- Foreign industrial products have more favourable credit facilities (there is a discrimination against Hungarian industrial products, which is the opposite of the former system of import deposits).
- When inviting tenders, it is not an essential condition to employ Hungarian labour and thereby to ensure revenues for the state budget; as a consequence, tenders are usually won by foreign companies, and so the import comes out on top.

Actual data of the first six months clearly demonstrate the financial impacts of the above tendencies (see Table I.1.3.a-d.):

Exports of the Hungarian customs area expressed in USD are only by 0.1 per cent lower than the base fig-

ure, and yet, their value in HUF has come down by 6.3 per cent; this means that over a period of only six months these exports have to bear a loss of **HUF 155.4 billion** as a consequence of the revaluation policy of the National Bank of Hungary.

In contrast, imports of the Hungarian customs area expressed in USD grew by 7.9 per cent, while in HUF they only paid by 1 per cent more; therefore the “import exchange rate” gain amounts to **HUF 233.6 billion**.

The two effects add up, so over a period of only six months, the National Bank of Hungary promotes the deterioration of the foreign trade balance of the Hungarian customs area by HUF 389 billion. Projected for a whole year, this means HUF 800 billion, which equals 4.8 per cent of the GDP. Expressed in number of jobs in manufacturing industries, this is tantamount to **losing some 70 thousand jobs**.

The consolidated trade balance of the Hungarian customs area and the industrial customs-free zones, however, shows an improvement of USD 456 million.

In the trade balance of **industrial customs-free zones** in the first half of 2002, an important feature was the diminishing import-intensity (a fall of about 20 per cent), which may indicate an economic withdrawal, with stocks being cut down without new imports arriving in.

In recent years, customs duties have been reduced continuously, and sometimes without proper prior consideration, but at the same time responsible state agencies **failed to develop a protective system based on instruments other than customs duties**. In this manner, government measures have artificially reduced the competitiveness of the Hungarian economy against foreign economies. Up until now, not a single manufactured industrial product has been given protection. Reductions of customs duties, including the panic-stricken abolition of the supplementary duties, have alleviated the burdens of imports by HUF 2157 billion between 1995 and 2001 (calculated at prices of 2000), compared with a situation assuming unchanged 1995 level for customs duties (see Figure I.1.3.). At the same time, the growth rate of imports has accelerated recently, partly as a consequence of lower customs duties. The state budget compensated for lost revenues by imposing further taxes on the domestic industry and by increasing the financial burdens placed on the Hungarian society, either directly or indirectly. This made it necessary to raise the taxes levied on domestic tax-payers, and to cut the expenditures of the state budget. As a result, **the competitiveness of the Hungarian economy against imports deteriorated by nearly HUF 810 billion in 2000 alone**.

Government agencies were wrong when they only signed international agreements (and had them ratified by the Parliament of Hungary) on reducing customs

Table I.1.3.a.: Foreign trade turnover broken down by customs-free zones and customs statistics (million USD)

Turnover type	1994	1995	1996	1997	1998	1999	2000	2001	Jan-Nov 2001	Jan-Nov 2002
EXPORTS										
Customs statistics	10701	12867	12859	14066	14733	14260	15522	17109	15792	16615
Industrial customs-free zones	0	1613	2845	5034	8272	10752	12570	13389	12486	14648
Total	10701	14480	15704	19100	23005	25013	28092	30498	28278	31263
Total (billion HUF)	1129	1825	2392	3567	4935	5939	7943	8748	8123	8141
of which: customs statistics	1129	1623	1959	2621	3157	3380	4375	4909	4538	4323
<i>Customs-free zones</i>	0	203	433	946	1778	2559	3568	3840	3585	3818
IMPORTS										
Customs statistics	14554	15466	15617	17032	19236	19448	22022	23475	21607	24527
Industrial customs-free zones	0	1287	2527	4202	6471	8561	10058	10207	9487	9493
Total	14554	16753	18144	21234	25706	28008	32080	33682	31094	34020
Total (billion HUF)	1537	2112	2764	3961	5512	6646	9064	9665	8937	8850
of which: customs statistics	1537	1950	2379	3170	4121	4611	6211	6736	6211	6382
<i>Customs-free zones</i>	0	162	385	791	1390	2034	2854	2929	2726	2469
BALANCE										
Customs statistics	-3853	-2599	-2758	-2966	-4503	-5187	-6499	-6365	-5815	-7912
Industrial customs-free zones	0	326	318	832	1802	2192	2512	3181	2999	5155
Total	-3853	-2273	-2440	-2134	-2701	-2996	-3988	-3184	-2816	-2757
Total (billion HUF)	-408	-287	-372	-394	-577	-707	-1121	-917	-814	-710
of which: customs statistics	-408	-328	-420	-549	-965	-1232	-1836	-1828	-1674	-2059
<i>Customs-free zones</i>	0	41	48	155	388	525	715	911	859	1349

Note: The 2002 data are preliminary estimates.

Source: Foreign trade statistics

duties, and **at the same time failed to develop and implement up-to-date measures, conforming to WTO regulations, in order to protect the national economy.** Currently used protective measures act against the true economic interests of the Hungarian economy, because:

It is unprecedented that no policies or measures have been elaborated to protect any manufactured industrial goods with high labour content (no protection is given even if health or environmental considerations required it).

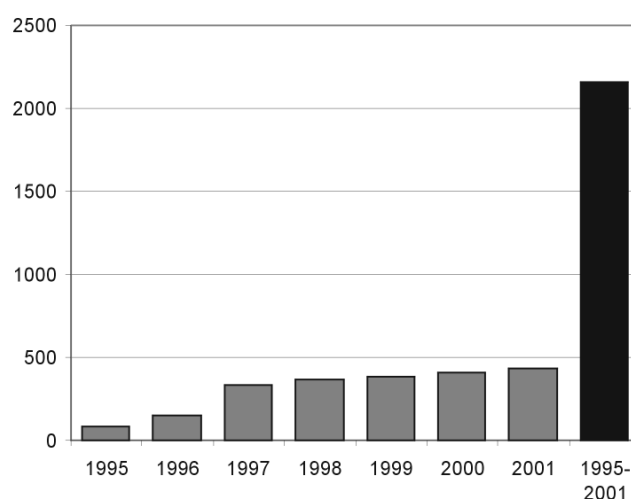
Among primary materials, these measures only cover some selected goods directly imported from Eastern Europe in exchange for exports of manufactured goods from Hungary (such as nitrogen fertilisers for Hungarian foodstuff).

They do not give protection to products imported through Western intermediaries from Eastern European countries, whose origin is usually uncertain due to inadequate control (such as large volume of steel products from the Ukraine and Russia).

Hungary's commitments made for the EU require the elimination of different import quotas, which, along with the stimulus caused by abolished customs duties, may give further impetus to imports.

It is vital that the Hungarian Parliament devote extra time to deal with this issue separately.

Excessive import volumes can only be prevented by a state-of-the-art protection of the Hungarian industry, and by increasing domestic production which creates new jobs in significant numbers (see the example of France!). Higher supply of goods from within Hun-

Figure I.1.3.: Customs and related VAT revenues lost by the state budget owing to the abolition of customs duties (billion HUF, at prices of 2000, compared to 1994)

Source: Actual facts and estimates of state budgets for 1995, 1996, 1997, 1998, 1999 and 2000; as well as Act CXLVI of 1997

Table I.1.3.b.: EXPORTS by economic sectors, and within that broken down by industrial customs-free zones

No.	Economic sector	Jan - June 2000			Jan - June 2001			Jan - June 2002		
		Hungarian customs area	Customs-free zones	Total	Hungarian customs area	Customs-free zones	Total	Hungarian customs area	Customs-free zones	Total
01	Agriculture and game farming	318.2	0.0	318.2	280.0		280.0	385.3	0.8	386.1
02	Forest management	38.6		38.6	38.9		38.9	37.6		37.6
05	Fishing	2.4		2.4	2.2		2.2	1.7		1.7
	Total agriculture	359.2	0.0	359.2	321.1	0.0	321.1	424.6	0.8	425.4
10	Coal and peat mining	0.3		0.3	0.3		0.3	0.5		0.5
11	Crude oil and natural gas mining	1.2		1.2	0.3		0.3	0.0		0.0
12	Uranium ore mining	0.0		0.0	0.0		0.0	0.0		0.0
13	Metallic ore mining	0.2		0.2	0.2		0.2	0.1		0.1
14	Other mining	5.2		5.2	5.4		5.4	5.0		5.0
	Total mining	6.9	0.0	6.9	6.2	0.0	6.2	5.6	0.0	5.6
15	Food and beverages production	748.5	4.7	753.2	787.0	11.1	798.1	736.9	7.3	744.2
16	Tobacco product manufacturing	6.8		6.8	7.4		7.4	0.5		0.5
	Total	755.3	4.7	760.0	794.4	11.1	805.5	737.4	7.3	744.7
17	Textiles manufacturing	240.1	37.9	278.0	252.2	78.6	330.8	248.9	77.4	326.3
18	Clothes manufacturing	467.6	80.5	548.1	472.6	92.3	564.9	441.9	86.5	528.4
19	Leather and footwear manufacturing	188.0	29.1	217.1	197.7	33.4	231.1	193.7	23.3	217.0
20	Wood processing	160.3	1.2	161.5	158.2	1.7	159.9	155.6	5.2	160.8
21	Paper and paper products manufacturing	165.0	4.0	169.0	191.1	7.4	198.5	199.3	2.6	201.9
22	Publishing and printing	29.0	1.5	30.5	28.7	1.1	29.8	29.4	2.9	32.3
36	Furniture manufacturing and n.e.c.*	231.0	123.3	354.3	242.6	133.4	376.0	224.2	786.3	1010.5
	Total light industry	1481.0	277.5	1758.5	1543.1	347.9	1891.0	1493.0	984.2	2477.2
23	Petroleum processing and coke production	180.9		180.9	246.2		246.2	233.8		233.8
24	Chemical materials and products	852.8	21.1	873.9	941.1	15.2	956.3	968.9	8.1	977.0
25	Rubber and plastic products manufacturing	316.1	29.0	345.1	358.2	32.7	390.9	374.5	31.2	405.7
	Total chemical industry	1349.8	50.1	1399.9	1545.5	47.9	1593.4	1577.2	39.3	1616.5
26	Non-metallic mineral products	169.7	16.8	186.5	186.2	13.3	199.5	182.9	13.3	196.2
27	Metallurgy	492.1	3.1	495.2	530.2	4.9	535.1	484.9	4.2	489.1
28	Manufactured metal products	268.6	46.7	315.3	302.3	52.0	354.3	310.5	45.1	355.6
29	Machinery and equipment	667.8	109.1	776.9	787.5	207.8	995.3	850.7	214.9	1065.6
30	Office equipment and computers	28.1	1722.8	1750.9	43.1	1363.7	1406.8	50.4	1136.0	1186.4
31	Electric machinery and equipment	871.3	447.5	1318.8	933.8	500.5	1434.3	879.8	502.2	1382.0
32	Telecommunications products	452.1	961.0	1413.1	515.3	1788.8	2304.1	507.4	2296.1	2803.5
33	Instruments manufacturing	122.4	51.6	174.0	148.5	107.5	256.0	162.9	133.1	296.0
34	Road motor vehicle manufacturing	475.0	2058.9	2533.9	598.9	2196.7	2795.6	610.7	2299.8	2910.5
35	Other vehicle manufacturing	60.1	0.0	60.1	67.5	0.0	67.5	68.1	0.0	68.1
	Total engineering industry	2945.4	5397.6	8343.0	3396.9	6217.0	9613.9	3440.5	6627.2	10067.7
40	Electricity, gas, heat	40.5		40.5	41.2		41.2	17.1		17.1
72	Information technology activities	0.0	0.0		0.0	0.0		0.0	0.0	
74	Services assisting economic activities	0.3		0.3	1.3	0.0	1.3	0.2	0.1	0.3
92	Entertainment, culture, sports	12.0		12.0	10.0	0.1	10.1	8.7	0.1	8.8
	Return goods	0.0			37.1	94.8	131.9	36.1	95.0	131.1
	Grand total	7612.2	5749.8	13362.0	8413.2	6737.0	15150.2	8408.2	7771.5	16179.7
	of which: Manufacturing industry	6438	5745	12183	7201.9	6631	13833	7178.5	7668	14847
	Food industry	1114.5	4.7	1119.2	1115.5	11.1	1126.6	1162.0	8.1	1170.1

Note: The 2002 data are preliminary estimates.

*n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

Table I.1.3.c.: IMPORTS by economic sectors, and within that broken down by industrial customs-free zones

No.	Economic sector	Jan - June 2000			Jan - June 2001			Jan - June 2002		
		Hungarian customs area	Customs-free zones	Total	Hungarian customs area	Customs-free zones	Total	Hungarian customs area	Customs-free zones	Total
01	Agriculture and game farming	169.8	0.0	169.8	182.6		182.6	179.8	0.6	180.4
02	Forest management	11.4	0.0	11.4	11.7		11.7	11.5		11.5
05	Fishing	0.8		0.8	1.2		1.2	1.3		1.3
	Total agriculture	182.0	0.0	182.0	195.5	0.0	195.5	192.6	0.6	193.2
10	Coal and peat mining	42.7		42.7	41.1		41.1	27.9		27.9
11	Crude oil and natural gas mining	833.5		833.5	1062.8		1062.8	914.6		914.6
12	Uranium ore mining	0.0		0.0	0.0		0.0	0.0		0.0
13	Metallic ore mining	38.8		38.8	29.7		29.7	32.0		32.0
14	Other mining	24.0	0.1	24.1	23.8	0.1	23.9	24.2	0.1	24.3
	Total mining	939.0	0.1	939.1	1157.4	0.1	1157.5	998.7	0.1	998.8
15	Food and beverages production	344.7	4.8	349.5	390.4	10.9	401.3	449.2	5.9	455.1
16	Tobacco product manufacturing	4.3		4.3	5.0		5.0	5.5		5.5
	Total	349.0	4.8	353.8	395.4	10.9	406.3	454.7	5.9	460.6
17	Textiles manufacturing	526.5	59.9	586.4	511.8	97.9	609.7	493.1	103.6	596.7
18	Clothes manufacturing	166.5	49.6	216.1	166.6	66.8	233.4	167.6	56.7	224.3
19	Leather and footwear manufacturing	210.1	31.0	241.1	234.5	31.5	266.0	249.7	24.7	274.4
20	Wood processing	120.2	4.7	124.9	126.1	5.9	132.0	149.6	5.9	155.5
21	Paper and paper products manufacturing	367.8	11.3	379.1	379.4	10.0	389.4	373.7	10.7	384.4
22	Publishing and printing	83.7	6.5	90.2	75.7	14.5	90.2	82.3	13.3	95.6
36	Furniture manufacturing and n.e.c.*	212.7	18.0	230.7	208.7	13.1	221.8	239.7	23.5	263.2
	Total light industry	1687.5	181.0	1868.5	1702.8	239.7	1942.5	1755.7	238.4	1994.1
23	Petroleum processing and coke production	216.7	0.6	217.3	177.2	1.3	178.5	255.0	1.3	256.3
24	Chemical materials and products	1342.5	165.9	1508.4	1440.2	120.2	1560.4	1546.7	115.9	1662.6
25	Rubber and plastic products manufacturing	462.6	176.9	639.5	502.2	184.6	686.8	539.3	156.1	695.4
	Total chemical industry	2021.8	343.4	2365.2	2119.6	306.1	2425.7	2341.0	273.3	2614.3
26	Non-metallic mineral products	221.4	14.8	236.2	241.9	13.0	254.9	256.3	20.1	276.4
27	Metallurgy	654.0	55.6	709.6	719.1	61.0	780.1	683.5	65.4	748.9
28	Manufactured metal products	369.0	145.4	514.4	391.5	152.8	544.3	429.4	152.9	582.3
29	Machinery and equipment	1076.7	458.8	1535.5	1266.7	450.4	1717.1	1326.4	540.5	1866.9
30	Office equipment and computers	240.3	679.0	919.3	239.2	773.4	1012.6	448.4	610.9	1059.3
31	Electric machinery and equipment	606.5	457.5	1064.0	624.8	590.8	1215.6	689.8	486.3	1176.1
32	Telecommunications products	859.3	1197.4	2056.7	1067.8	1691.1	2758.9	1364.2	1536.5	2900.7
33	Instruments manufacturing	225.7	113.2	338.9	238.2	100.6	338.8	251.8	100.4	352.2
34	Road motor vehicle manufacturing	957.6	849.1	1806.7	1101.6	795.3	1896.9	1164.9	825.9	1990.8
35	Other vehicle manufacturing	81.0	0.2	81.2	73.0	0.3	73.3	90.1	0.1	90.2
	Total engineering industry	4416.1	3900.6	8316.7	5002.8	4554.7	9557.5	5765.0	4253.5	10018.5
40	Electricity, gas, heat	66.9		66.9	72.7		72.7	75.0		75.0
72	Information technology activities	0.0		0.0	0.0		0.0	0.0		0.0
74	Services assisting economic activities	0.5	0.7	1.2	0.4	1.5	1.9	1.4	1.3	2.7
92	Entertainment, culture, sports	18.4	0.4	18.8	20.0	2.2	22.2	20.6	1.6	22.2
	Return goods	0.0			27.3	52.6	79.9	33.6	31.5	65.1
	Grand total	10556.6	4501.4	15058.0	11654.9	5241.8	16896.7	12578.1	4891.7	17469.8
	of which: Manufacturing industry	9000.8	4495.4	13496.2	9786.2	5174.5	14960.7	10801.5	4850.7	15652.2
	Food industry	531.0	4.8	535.8	590.9	10.9	601.8	647.3	6.5	653.8

Note: The 2002 data are preliminary estimates.

*n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

**Table I.1.3.d.: FOREIGN TRADE BALANCE by economic sectors,
and within that broken down by industrial customs-free zones**

No.	Economic sector	Jan - June 2000			Jan - June 2001			Jan - June 2002		
		Hungarian customs area	Customs- free zones	Total	Hungarian customs area	Customs- free zones	Total	Hungarian customs area	Customs- free zones	Total
01	Agriculture and game farming	148.4	0.0	148.4	97.4	0.0	97.4	205.5	0.2	205.7
02	Forest management	27.2	0.0	27.2	27.2	0.0	27.2	26.1	0.0	26.1
05	Fishing	1.6	0.0	1.6	1.0	0.0	1.0	0.4	0.0	0.4
	Total agriculture	177.2	0.0	177.2	125.6	0.0	125.6	232.0	0.2	232.2
10	Coal and peat mining	-42.4	0.0	-42.4	-40.8	0.0	-40.8	-27.4	0.0	-27.4
11	Crude oil and natural gas mining	-832.3	0.0	-832.3	-1062.5	0.0	-1062.5	-914.6	0.0	-914.6
12	Uranium ore mining	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
13	Metallic ore mining	-38.6	0.0	-38.6	-29.5	0.0	-29.5	-31.9	0.0	-31.9
14	Other mining	-18.8	-0.1	-18.9	-18.4	-0.1	-18.5	-19.2	-0.1	-19.3
	Total mining	-932.1	-0.1	-932.2	-1151.2	-0.1	-1151.3	-993.1	-0.1	-993.2
15	Food and beverages production	403.8	-0.1	403.7	396.6	0.2	396.8	287.7	1.4	289.1
16	Tobacco product manufacturing	2.5	0.0	2.5	2.4	0.0	2.4	-5.0	0.0	-5.0
	Total	406.3	-0.1	406.2	399.0	0.2	399.2	282.7	1.4	284.1
17	Textiles manufacturing	-286.4	-22.0	-308.4	-259.6	-19.3	-278.9	-244.2	-26.2	-270.4
18	Clothes manufacturing	301.1	30.9	332.0	306.0	25.5	331.5	274.3	29.8	304.1
19	Leather and footwear manufacturing	-22.1	-1.9	-24.0	-36.8	1.9	-34.9	-56.0	-1.4	-57.4
20	Wood processing	40.1	-3.5	36.6	32.1	-4.2	27.9	6.0	-0.7	5.3
21	Paper and paper products manufacturing	-202.8	-7.3	-210.1	-188.3	-2.6	-190.9	-174.4	-8.1	-182.5
22	Publishing and printing	-54.7	-5.0	-59.7	-47.0	-13.4	-60.4	-52.9	-10.4	-63.3
36	Furniture manufacturing and n.e.c.*	18.3	105.3	123.6	33.9	120.3	154.2	-15.5	762.8	747.3
	Total light industry	-206.5	96.5	-110.0	-159.7	108.2	-51.5	-262.7	745.8	483.1
23	Petroleum processing and coke production	-35.8	-0.6	-36.4	69.0	-1.3	67.7	-21.2	-1.3	-22.5
24	Chemical materials and products	-489.7	-144.8	-634.5	-499.1	-105.0	-604.1	-577.8	-107.8	-685.6
25	Rubber and plastic products manufacturing	-146.5	-147.9	-294.4	-144.0	-151.9	-295.9	-164.8	-124.9	-289.7
	Total chemical industry	-672.0	-293.3	-965.3	-574.1	-258.2	-832.3	-763.8	-234.0	-997.8
26	Non-metallic mineral products	-51.7	2.0	-49.7	-55.7	0.3	-55.4	-73.4	-6.8	-80.2
27	Metallurgy	-161.9	-52.5	-214.4	-188.9	-56.1	-245.0	-198.6	-61.2	-259.8
28	Manufactured metal products	-100.4	-98.7	-199.1	-89.2	-100.8	-190.0	-118.9	-107.8	-226.7
29	Machinery and equipment	-408.9	-349.7	-758.6	-479.2	-242.6	-721.8	-475.7	-325.6	-801.3
30	Office equipment and computers	-212.2	1043.8	831.6	-196.1	590.3	394.2	-398.0	525.1	127.1
31	Electric machinery and equipment	264.8	-10.0	254.8	309.0	-90.3	218.7	190.0	15.9	205.9
32	Telecommunications products	-407.2	-236.4	-643.6	-552.5	97.7	-454.8	-856.8	759.6	-97.2
33	Instruments manufacturing	-103.3	-61.6	-164.9	-89.7	6.9	-82.8	-88.9	32.7	-56.2
34	Road motor vehicle manufacturing	-482.6	1209.8	727.2	-502.7	1401.4	898.7	-554.2	1473.9	919.7
35	Other vehicle manufacturing	-20.9	-0.2	-21.1	-5.5	-0.3	-5.8	-22.0	-0.1	-22.1
	Total engineering industry	-1470.7	1497.0	26.3	-1605.9	1662.3	56.4	-2324.5	2373.7	49.2
40	Electricity, gas, heat	-26.4	0.0	-26.4	-31.5	0.0	-31.5	-57.9	0.0	-57.9
72	Information technology activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
74	Services assisting economic activities	-0.2	-0.7	-0.9	0.9	-1.5	-0.6	-1.2	-1.2	-2.4
92	Entertainment, culture, sports	-6.4	-0.4	-6.8	-10.0	-2.1	-12.1	-11.9	-1.5	-13.4
	Return goods	0.0	0.0	0.0	9.8	42.2	52.0	2.5	63.5	66.0
	Grand total	-2944.4	1248.4	-1696.0	-3241.7	1495.2	-1746.5	-4169.9	2879.8	-1290.1
	of which: Manufacturing industry	-2562.8	1249.7	-1313.1	-2584.3	1456.5	-1127.8	-3623.0	2817.5	-805.5
	Food industry	583.5	-0.1	583.4	524.6	0.2	524.8	514.7	1.6	516.3

Note: The 2002 data are preliminary estimates.

*n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

gary is the only effective way to curb imports; and it is advisable to attain that through increasing the volume of live labour and improving its competitiveness. It is not meant to say that domestic industries should be granted additional preferences; the point is that equal chances need to be given to both the Hungarian production and import, by eliminating a situation where imports receive unilateral preferential treatment, forcing back domestic production.

The Public Procurement Act needs to be modified to give more protection to Hungarian industries and facilitate the development of underdeveloped regions of the country.

Within the protection of domestic industry and jobs, special attention needs to be paid to protecting activities that meet state-of-the-art environmental requirements, as well as to safeguarding the existing Hungarian industrial production. It is untenable that even the public transport companies, which operate with a high rate of state and local government subsidies, acquire their buses and tramway cars from imports (in Budapest MAN buses, in Pécs, South-West Hungary, Mercedes buses were purchased, etc.). Practice in the USA should be an example to follow: local governments there are only entitled to obtain budgetary subsidies for their public transport acquisitions, if the share of domestic suppliers is at least 60 per cent.

Protection of domestic production and the environment in conformity with WTO requirements can only be achieved through properly elaborated measures. Hungarian refrigerator manufacturing is a model to be followed. The government may assist in the product modernization of domestic refrigerator manufacturing by implementing a standard modification (protecting Hungarian consumers) that would only allow the sales of refrigerators in Hungary on condition they meet specific environmental and energy efficiency norms. It is to be noted that no foreign refrigerator manufacturers will be discriminated against, unless they fail to meet the state-of-the-art requirements.

1.4. Changes in the balance of trade; providing support to foreign working capital on a basis of mutual advantages

We have used the traditional customs statistics (not including industrial customs-free zones) for calculating the balance of trade, for the following reasons:

This method is in conformity with EU standards. Following Hungary's accession to the European Union,

most of the industrial free zones will have to be abolished, or the conditions of their operation will have to be modified. (It is important to note that in Hungary there are 110 industrial customs-free zones, while in Germany there are only 3 such zones.)

Base data of 1994 come from customs statistics; trade figures including industrial free zones are not comparable with that, because in 1994 such statistical documentation and comparative data processing were not yet carried out.

The latest foreign trade turnover data of the Hungarian customs area from January to November 2002 show a trade deficit which is about double the deficit of 1994, i.e. of the period before the so-called Bokros package was introduced (*see Table I.1.3.a.*). And yet, this does not pose any financing problems today, which proves that the Bokros package had a very much biased professional approach. In our opinion, Hungary's key problem on the eve of the EU accession is not the external economic balance, but the need to expand employment as much as possible.

Foreign trade reflected by customs statistics is an intrinsic part of the Hungarian economy (its exports pay for imports of energy supplies and pharmaceutical products; it produces the surplus of food industry, etc.). Practically all the imports of the industrial free zones will be exported, what is more, they use up a part of the energy import in the customs statistical trade as well.

We have analyzed figures of trade in various economic branches (exports, imports and balances) within the customs boundaries and in industrial free zones (*see Tables I.1.4.a-l.*).

The tables illustrate that the industrial free zones have a high specific import value, and their operations are concentrated on a few areas only. They have weak and occasional links with the Hungarian economy. Their indicators are predominantly gross figures, i.e. they have high import content, and therefore also their production value is of a large volume; but this is mostly just superficial, lacking any real significance for the Hungarian economy.

Companies operating in industrial free zones show extremely unfavourable national economic characteristics in many respects (actual data of 1997, based on processing by ECOSTAT):

- The rate of paid corporate tax amounts to only 0.5 per cent as compared to the added value generated by companies operating in industrial free zones (most of which will finally leave the country in the form of profits, so it is only a temporary and formal factor in increasing the GDP in Hungary), whereas other companies in Hungary have a ratio of 2.6 per cent.
- Tax allowances expressed by using the same ratio go up to 10.1 per cent for companies operating in in-

dustrial free zones, while they are only 3.4 per cent for other companies in Hungary.

- In addition to that, these foreign companies have received considerable, and partly unpublished, state subsidies.
- Wages and related expenses represent 5.2 per cent in the expenditures of companies operating in customs-free zones, while this portion is 17.1 per cent for other Hungarian companies. Most of the state revenues, however, do not come from corporate taxes, but from taxes and contributions charged on wages, and also from consumption-type taxes that are levied upon spending those wages. As a consequence of the joint impact of the former two factors, the relative contribution of companies operating in industrial free zones towards revenues of the Hungarian state budget is fifteen times less than that of the other companies (operating within the customs borders of Hungary).

Support granted to the above type of capital investments does not substantially expand the employment or increase the GNI, while it does mean enormous burdens for the Hungarian economy. The profits are high, but they leave the country soon. At the same time, the gross national income (GNI) only covers what shows the income surplus which a country has effectively at its disposal. The essential point that makes the difference between the GDP and GNI is that in order to obtain the GNI, the income on investments in Hungary by foreign companies is to be subtracted from the GDP and the income on Hungarian investments abroad is to be added to it. According to preliminary data, in 1998 the GNI was by about 10 per cent lower than the GDP. In addition to the benefits of getting a true picture of the situation, elaborating and applying the GNI has an effective advantage for Hungary: following the accession to the European Union, all payments due into EU budgets are calculated on the basis of the GNI (and not the GDP), which would save Hungary around 100 million Euros a year. **Therefore we recommend that the GNI should be accurately calculated and made public as soon as possible, and that the EU should be notified about its value.**

There are two major items representing the outflow of income in the accounts of the National Bank of Hungary: one of them is debt service, and the other one is repatriated income. The latter one saw a twofold increase in 1998 compared to the previous year, and it was nearly USD 1 billion, while in 1999 it amounted to USD 0.8 billion. It is vital, therefore, to restructure the system of subsidies to foreign capital investments, and only grant subsidies to the ones that provide long term jobs in labour-intensive production.

(A more detailed analysis of the above can be found in the information bulletin No. 1997/7 of the Economic

Analysis and Information Institute of the Hungarian Central Statistical Office. The present study contains further discussion of the subject in Chapter 3.1.)

In the state budget sector cutbacks worth HUF 8,000 billion were effected between 1995 and 1999 (using 1994 as the base year, and calculated at 1999 prices). In 1999, for example, this sum was nearly HUF 1,600 billion, which equals USD 6.7 billion, calculated at the exchange rate of that time. Supposing all the favourable impacts of these cutbacks had been moved into the balance of trade to improve it, it would have shown a surplus of USD 1.5 billion in 1999 (not including customs-free zones) instead of the actual deficit of USD 5.2 billion. Additionally, wages worth HUF 1,535 billion were “saved” as a result of the austerity measures affecting the entrepreneurial sector in the period between 1995 and 1998 (also using 1994 as the base year and at 1999 prices). This amount would have further improved the above-stated “surplus” of the balance of trade (if it had appeared there) by about USD 6.5 billion up until 1998.

Although for the reasons just being discussed, we should only take into account the customs statistics (not including free zones), it is to be noted that the balance of trade showed an uncorrected deficit of USD 3 billion for 1999 even after including the customs-free zones into the calculation. The deficit in real terms must have been higher than that due to the drop in energy prices at that time and the changes in the cross currency rates.

It is important to devote a few words here to trade statistics and to their conformity with EU standards. Hungary has adjusted its statistical system and methods as a whole to meet EU requirements, with the exception of foreign trade where industrial free zones were included among data files as of 1st January 1997. It is a known fact that the previous Hungarian Government requested derogation from the EU to sustain the system of industrial free zones even after joining the EU, for at least another year.

From the above figures we can draw the conclusion that the austerity measures hardly had any effect (not even in the initial period right after their introduction) on the balance of trade – apart from “advanced imports”. Supplementary customs duties, introduced at the same time, had a substantially greater impact.

The austerity measures have not affected the operations in the industrial free zones, which is another reason to exclude them from the trade balance calculations. In order to make propaganda for the so-called Bokros package, some wanted to present these facts as if the turnover data and the trade surplus of the industrial customs-free zones had resulted from the favourable impact of the austerity measures.

Including industrial free zones into the statistics of trade within the Hungarian customs boundaries does

**Table I.1.4.a.: EXPORTS by economic sectors HUNGARIAN CUSTOMS AREA
(million USD)**

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					76.7
01	Agriculture and game farming	805.8	886.4	650.1	649.1	801.8
02	Forest management	72.4	72.0	74.6	71.3	70.3
05	Fishing	5.9	7.9	6.4	4.7	4.8
	Total agriculture	884.1	966.3	731.1	725.1	876.9
10	Coal and peat mining	1.6	0.5	0.6	0.5	0.7
11	Crude oil and natural gas mining	0.0	1.6	0.0	11.3	0.5
12	Uranium ore mining	2.9	2.5	0.0	0.0	0.0
13	Metallic ore mining	16.8	22.9	0.6	0.4	0.6
14	Other mining	10.6	10.2	11.5	11.1	10.1
	Total mining	31.9	37.7	12.7	23.3	11.9
15	Food and beverages production	1977.9	1822.8	1612.3	1591.6	1735.2
16	Tobacco product manufacturing	79.8	59.2	41.2	15.4	9.4
	Total	2057.7	1882.0	1653.5	1607.0	1744.6
17	Textiles manufacturing	434.7	533.1	455.0	476.9	489.4
18	Clothes manufacturing	991.0	1061.8	1010.0	912.9	937.5
19	Leather and footwear manufacturing	400.8	428.4	409.4	368.9	388.9
20	Wood processing	251.4	292.3	305.1	301.9	302.1
21	Paper and paper products manufacturing	207.3	227.4	326.6	333.6	392.2
22	Publishing and printing	51.2	60.4	43.4	58.1	62.4
36	Furniture manufacturing and n.e.c.*	343.8	383.4	459.4	443.6	462.6
	Total light industry	2680.2	2986.8	3008.9	2895.9	3035.2
23	Petroleum processing and coke production	403.6	319.9	295.8	397.9	501.3
24	Chemical materials and products	1518.8	1483.1	1409.8	1717.8	1828.5
25	Rubber and plastic products manufacturing	470.4	528.4	567.5	630.7	718.1
	Total chemical industry	2392.8	2331.4	2273.1	2746.4	3047.9
26	Non-metallic mineral products	315.3	359.6	359.0	355.8	370.6
27	Metallurgy	897.9	920.2	826.5	999.9	979.8
28	Manufactured metal products	452.7	542.8	540.9	562.3	611.5
29	Machinery and equipment	1065.3	1203.2	1258.6	1375.0	1559.6
30	Office equipment and computers	161.8	113.4	51.4	64.0	89.2
31	Electric machinery and equipment	1228.5	1396.0	1490.5	1710.3	1862.0
32	Telecommunications products	545.8	669.2	733.1	946.6	1070.5
33	Instruments manufacturing	192.1	208.6	215.6	249.2	298.8
34	Road motor vehicle manufacturing	994.9	914.5	856.2	1033.0	1211.3
35	Other vehicle manufacturing	69.9	89.9	104.7	131.2	162.5
	Total engineering industry	4711.0	5137.6	5251.0	6071.6	6865.3
40	Electricity, gas, heat	95.1	104.1	103.4	72.5	76.9
72	Information technology activities	0.0	0.0	22.1	0.0	0.0
74	Services assisting economic activities	0.0	0.0	1.2	0.9	1.8
92	Entertainment, culture, sports	0.0	7.6	17.9	23.8	21.6
	Grand total	14066.0	14733.3	14260.4	15522.2	17109.0
	of which: Manufacturing industry	10997.2	11735.6	11718.5	13069.6	14375.4
	Food industry	2941.8	2848.3	2384.6	2332.1	2621.5

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

Table I.1.4.b.: EXPORTS by economic sectors
CUSTOMS-FREE ZONES
(million USD)

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					220.7
01	Agriculture and game farming	0.1		0.0	0.0	0.0
02	Forest management			0.0	0.0	0.0
05	Fishing			0.0	0.0	0.0
	Total agriculture	0.1	0.0	0.0	0.0	0.0
10	Coal and peat mining			0.0	0.0	0.0
11	Crude oil and natural gas mining			0.0	0.0	0.0
12	Uranium ore mining			0.0	0.0	0.0
13	Metallic ore mining			0.0	0.0	0.0
14	Other mining		0.1	0.0	0.0	0.0
	Total mining	0.0	0.1	0.0	0.0	0.0
15	Food and beverages production	5.0	6.1	6.3	15.2	22.8
16	Tobacco product manufacturing			0.0	0.0	0.0
	Total	5.0	6.1	6.3	15.2	22.8
17	Textiles manufacturing	31.0	42.0	73.8	72.3	153.6
18	Clothes manufacturing	30.9	79.2	143.6	157.1	175.5
19	Leather and footwear manufacturing	20.5	33.2	47.2	50.9	59.2
20	Wood processing	7.7	8.2	8.3	3.9	4.8
21	Paper and paper products manufacturing	8.1	5.5	4.8	7.3	9.7
22	Publishing and printing	0.2	0.4	0.9	3.2	1.9
36	Furniture manufacturing and n.e.c.*	103.7	141.8	233.9	244.7	606.1
	Total light industry	202.1	310.3	512.5	539.4	1010.8
23	Petroleum processing and coke production					
24	Chemical materials and products	17.4	105.7	71.0	46.5	28.6
25	Rubber and plastic products manufacturing	44.8	55.4	55.0	63.4	60.7
	Total chemical industry	62.2	161.1	126.0	109.9	89.3
26	Non-metallic mineral products	21.4	23.0	23.7	31.9	25.0
27	Metallurgy	31.2	7.9	9.1	8.6	11.2
28	Manufactured metal products	68.8	99.0	112.5	87.0	102.6
29	Machinery and equipment	171.1	221.2	175.8	269.9	389.4
30	Office equipment and computers	1528.3	2316.0	3278.5	3822.9	2453.5
31	Electric machinery and equipment	575.6	687.2	751.1	900.4	970.8
32	Telecommunications products	926.0	1366.8	1657.8	2677.9	3582.6
33	Instruments manufacturing	11.5	12.0	31.0	119.5	191.9
34	Road motor vehicle manufacturing	1430.6	3060.2	4067.7	3986.6	4317.8
35	Other vehicle manufacturing	0.3	1.2	0.1		0.0
	Total engineering industry	4712.2	7763.6	10074.5	11864.2	12008.7
40	Electricity, gas, heat					
72	Information technology activities					
74	Services assisting economic activities				0.3	0.0
92	Entertainment, culture, sports				0.0	0.1
	Grand total	5034.2	8272.1	10752.1	12569.5	13388.7
	of which: Manufacturing industry	5029.1	8265.9	10745.8	12554	13365.8
	Food industry	5.1	6.1	6.3	15.2	22.8

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

**Table I.1.4.c.: EXPORTS by economic sectors
HUNGARIAN CUSTOMS AREA + CUSTOMS-FREE ZONES
(million USD)**

	Megnevezés	1997	1998	1999	2000	2001
0	Tértiáru					297,4
01.	Mező- és vadgazdálkodás	805,9	886,4	650,1	649,1	801,8
02.	Erdőgazdálkodás	72,4	72,0	74,6	71,3	70,3
05.	Halászat	5,9	7,9	6,4	4,7	4,8
	Mezőgazdaság összesen	884,2	966,3	731,1	725,1	876,9
10.	Szén- és tüzezbányászat	1,6	0,5	0,6	0,5	0,7
11.	Kőolaj- és földgázkitermelés		1,6		11,3	0,5
12.	Uránércbányászat	2,9	2,5			
13.	Fémtartalmú ércek bányászata	16,8	22,9	0,6	0,4	0,6
14.	Egyéb bányászat	10,6	10,3	11,5	11,1	10,1
	Bányászat összesen	31,9	37,8	12,7	23,3	11,9
15.	Élelmiszer- és italgyártás	1982,9	1828,9	1618,6	1606,8	1758,0
16.	Dohánytermék-gyártás	79,8	59,2	41,2	15,4	9,4
	Összesen	2062,7	1888,1	1659,8	1622,2	1767,4
17.	Textíliák gyártása	465,7	575,1	528,8	549,2	643,0
18.	Ruházati termékek	1021,9	1141,0	1153,6	1070,0	1113,0
19.	Bőr- és lábbeli gyártás	421,3	461,6	456,6	419,8	448,1
20.	Fafeldolgozás	259,1	300,5	313,4	305,8	306,9
21.	Papír és papíripari termékek gyártása	215,4	232,9	331,4	340,9	401,9
22.	Kiadói és nyomdaipar	51,4	60,8	44,3	61,3	64,3
36.	Bútorgyártás és MNS*	447,5	525,2	693,3	688,3	1068,7
	Könnyűipar összesen	2882,3	3297,1	3521,4	3435,3	4045,9
23.	Kőolaj-feldolgozás és kocsz	403,6	319,9	295,8	397,9	501,3
24.	Vegyí alapanyagok és termékek	1536,2	1588,8	1480,8	1764,3	1857,1
25.	Gumi- és műanyagtermék gyártása	515,2	583,8	622,5	694,1	778,8
	Vegyípar összesen	2455,0	2492,5	2399,1	2856,3	3137,2
26.	Nemfém ásványi termékek	336,7	382,6	382,7	387,7	395,6
27.	Kohászat	929,1	928,1	835,6	1008,5	991,0
28.	Fémfeldolgozási termékek	521,5	641,8	653,4	649,3	714,1
29.	Gépek és gépi berendezések	1236,4	1424,4	1434,4	1644,9	1949,0
30.	Irodagép és számítógép	1690,1	2429,4	3329,9	3886,9	2542,7
31.	Villamosipari gépek és készülékek	1804,1	2083,2	2241,6	2610,7	2832,8
32.	Híradástechnikai termékek	1471,8	2036,0	2390,9	3624,5	4653,1
33.	Műszergyártás	203,6	220,6	246,6	368,7	490,7
34.	Közúti gépjármű-gyártás	2425,5	3974,7	4923,9	5019,6	5529,1
35.	Egyéb járműgyártás	70,2	91,1	104,8	131,2	162,5
	Gépipar összesen	9423,2	12901,2	15325,5	17935,8	18873,9
40.	Villamos energia, gáz, hő	95,1	104,1	103,4	72,5	76,9
72.	Számítástechnikai tevékenység		0,0	22,1		
74.	Gazdasági tevékenységet segítő szolgáltatás		0,0	1,2	1,2	1,8
92.	Szórakoztatás, kultúra, sport		7,6	17,9	23,8	21,7
	Végösszesen	19100,2	23005,4	25012,5	28091,7	30497,7
	ebből: Feldolgozó ipar	16026	20002	22464,3	25623,6	27741,1
	Élelmiszergazdaság	2946,9	2854,4	2390,9	2347,3	2644,3

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

**Table I.1.4.d.: Share of foreign trade EXPORTS of economic sectors
compared to the sector's total exports
(per cent)**

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					74.2
01	Agriculture and game farming					
02	Forest management					
05	Fishing					
	Total agriculture					
10	Coal and peat mining					
11	Crude oil and natural gas mining					
12	Uranium ore mining					
13	Metallic ore mining					
14	Other mining		1.0			
	Total mining		0.3			
15	Food and beverages production	0.3	0.3	0.4	0.9	1.3
16	Tobacco product manufacturing					
	Total	0.2	0.3	0.4	0.9	1.3
17	Textiles manufacturing	6.7	7.3	14.0	13.2	23.9
18	Clothes manufacturing	3.0	6.9	12.4	14.7	15.8
19	Leather and footwear manufacturing	4.9	7.2	10.3	12.1	13.2
20	Wood processing	3.0	2.7	2.6	1.3	1.6
21	Paper and paper products manufacturing	3.8	2.4	1.4	2.1	2.4
22	Publishing and printing	0.4	0.7	2.0	5.2	3.0
36	Furniture manufacturing and n.e.c.*	23.2	27.0	33.7	35.6	56.7
	Total light industry	7.0	9.4	14.6	15.7	25.0
23	Petroleum processing and coke production					
24	Chemical materials and products	1.1	6.7	4.8	2.6	1.5
25	Rubber and plastic products manufacturing	8.7	9.5	8.8	9.1	7.8
	Total chemical industry	2.5	6.5	5.3	3.8	2.8
26	Non-metallic mineral products	6.4	6.0	6.2	8.2	6.3
27	Metallurgy	3.4	0.9	1.1	0.9	1.1
28	Manufactured metal products	13.2	15.4	17.2	13.4	14.4
29	Machinery and equipment	13.8	15.5	12.3	16.4	20.0
30	Office equipment and computers	90.4	95.3	98.5	98.4	96.5
31	Electric machinery and equipment	31.9	33.0	33.5	34.5	34.3
32	Telecommunications products	62.9	67.1	69.3	73.9	77.0
33	Instruments manufacturing	5.6	5.4	12.6	32.4	39.1
34	Road motor vehicle manufacturing	59.0	77.0	82.6	79.4	78.1
35	Other vehicle manufacturing	0.4	1.3	0.1		
	Total engineering industry	50.0	60.2	65.7	66.1	63.6
40	Electricity, gas, heat					
72	Information technology activities					
74	Services assisting economic activities				25.0	1.6
92	Entertainment, culture, sports				0.1	0.7
	Grand total	26.4	36.0	43.0	44.7	43.9
	of which: Manufacturing industry	31.4	41.3	47.8	49.0	48.2
	Food industry	0.2	0.2	0.3	0.6	0.9

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

Table I.1.4.e.: IMPORTS by economic sectors
HUNGARIAN CUSTOMS AREA
(million USD)

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					53.6
01	Agriculture and game farming	374.4	397.0	342.6	304.7	316.3
02	Forest management	15.2	20.5	23.5	20.8	20.1
05	Fishing	1.3	1.2	1.9	1.8	2.5
	Total agriculture	390.9	418.7	368.0	327.3	338.9
10	Coal and peat mining	122.1	97.0	96.0	96.0	79.5
11	Crude oil and natural gas mining	1510.3	1273.5	1263.8	2112.1	2146.9
12	Uranium ore mining	73.2	39.7	0.0	0.0	0.0
13	Metallic ore mining	55.8	77.3	51.5	74.9	63.8
14	Other mining	57.7	55.9	54.3	51.3	48.8
	Total mining	1819.1	1543.4	1465.6	2334.3	2339.0
15	Food and beverages production	780.5	848.8	677.7	743.0	839.2
16	Tobacco product manufacturing	11.5	8.4	10.6	9.7	10.9
	Total	792.0	857.2	688.3	752.7	850.1
17	Textiles manufacturing	1003.6	1153.7	1075.6	1016.3	990.2
18	Clothes manufacturing	324.2	342.6	340.0	326.9	336.8
19	Leather and footwear manufacturing	414.1	436.5	425.3	408.7	458.8
20	Wood processing	181.4	220.3	230.2	263.9	275.2
21	Paper and paper products manufacturing	588.3	657.9	674.5	742.9	752.7
22	Publishing and printing	109.3	196.1	110.7	168.3	174.0
36	Furniture manufacturing and n.e.c.*	344.8	394.9	451.3	458.1	465.2
	Total light industry	2965.7	3402.0	3307.6	3385.1	3452.9
23	Petroleum processing and coke production	309.5	225.2	289.2	427.4	409.4
24	Chemical materials and products	2258.3	2441.7	2452.3	2591.5	2749.8
25	Rubber and plastic products manufacturing	685.0	798.5	862.4	951.5	992.3
	Total chemical industry	3252.8	3465.4	3603.9	3970.4	4151.5
26	Non-metallic mineral products	342.3	424.0	447.8	467.6	504.0
27	Metallurgy	1144.4	1224.6	1116.4	1354.8	1342.7
28	Manufactured metal products	538.0	668.0	698.2	778.1	832.5
29	Machinery and equipment	1731.0	2231.7	2295.5	2252.6	2489.1
30	Office equipment and computers	591.6	564.5	488.8	523.5	556.4
31	Electric machinery and equipment	820.7	1015.4	1096.6	1237.4	1255.4
32	Telecommunications products	969.8	1258.0	1415.4	1894.6	2252.1
33	Instruments manufacturing	377.7	434.4	446.2	463.2	487.1
34	Road motor vehicle manufacturing	1090.3	1539.7	1708.0	1965.5	2223.5
35	Other vehicle manufacturing	101.9	93.6	91.6	140.9	152.1
	Total engineering industry	6221.0	7805.3	8240.3	9255.8	10248.2
40	Electricity, gas, heat	104.1	87.4	106.7	135.4	152.3
72	Information technology activities	0.0	0.0	75.7	0.0	0.0
74	Services assisting economic activities	0.0	0.0	1.7	1.3	0.8
92	Entertainment, culture, sports	0.0	8.2	25.7	36.9	40.5
	Grand total	17032.3	19236.2	19447.7	22021.6	23474.4
	of which: Manufacturing industry	13926.2	16321.3	16716.0	18433.7	19752.8
	Food industry	1182.9	1275.9	1056.3	1080.0	1189.0

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

Table I.1.4.f.: IMPORTS by economic sectors
CUSTOMS-FREE ZONES
(million USD)

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					107.7
01	Agriculture and game farming	0.3		0.0	0.0	0.0
02	Forest management	0.8			0.0	0.0
05	Fishing					0.0
	Total agriculture	1.1	0.0	0.0	0.0	0.0
10	Coal and peat mining					
11	Crude oil and natural gas mining					
12	Uranium ore mining					
13	Metallic ore mining					
14	Other mining	0.1	0.1	0.2	0.1	0.1
	Total mining	0.1	0.1	0.2	0.1	0.1
15	Food and beverages production	10.2	10.5	8.1	15.1	22.3
16	Tobacco product manufacturing					
	Total	10.2	10.5	8.1	15.1	22.3
17	Textiles manufacturing	79.2	90.9	117.5	115.3	181.8
18	Clothes manufacturing	6.0	26.4	81.6	97.3	123.3
19	Leather and footwear manufacturing	18.0	35.6	66.3	52.4	54.7
20	Wood processing	8.5	5.5	7.5	9.8	11.1
21	Paper and paper products manufacturing	19.5	20.8	20.6	25.4	19.9
22	Publishing and printing	4.7	6.2	6.5	19.2	31.8
36	Furniture manufacturing and n.e.c.*	29.1	15.8	24.7	36.9	31.1
	Total light industry	165.0	201.2	324.7	356.3	453.6
23	Petroleum processing and coke production	3.0	7.0	4.1	1.8	2.4
24	Chemical materials and products	128.9	382.6	490.5	337.8	250.8
25	Rubber and plastic products manufacturing	160.9	241.3	319.3	365.7	362.3
	Total chemical industry	292.8	630.9	813.9	705.3	615.5
26	Non-metallic mineral products	6.3	16.9	26.6	28.0	24.5
27	Metallurgy	65.6	87.8	88.5	115.8	125.2
28	Manufactured metal products	135.8	212.2	281.6	297.2	292.8
29	Machinery and equipment	453.8	780.1	963.6	942.1	989.4
30	Office equipment and computers	691.3	933.6	1382.5	1723.5	1442.5
31	Electric machinery and equipment	407.5	584.0	759.2	1097.1	1073.5
32	Telecommunications products	1005.3	1363.2	1780.2	2897.9	3259.0
33	Instruments manufacturing	52.2	69.7	148.4	238.6	212.4
34	Road motor vehicle manufacturing	913.5	1578.4	1979.7	1637.2	1582.2
35	Other vehicle manufacturing	1.3	1.7	0.3	0.3	0.9
	Total engineering industry	3660.7	5522.9	7295.5	8833.9	8852.6
40	Electricity, gas, heat					
72	Information technology activities			0.7		
74	Services assisting economic activities		0.0	1.8	1.2	2.2
92	Entertainment, culture, sports			0.5	2.0	3.7
	Grand total	4201.8	6470.3	8560.5	10057.7	10207.4
	of which: Manufacturing industry	4190.4	6459.7	8549.2	10039.3	10179.1
	Food industry	11.3	10.5	8.1	15.1	22.3

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

Table I.1.4.g.: IMPORTS by economic sectors
HUNGARIAN CUSTOMS AREA + CUSTOMS-FREE ZONES
(million USD)

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					161.3
01	Agriculture and game farming	374.7	397.0	342.6	304.7	316.3
02	Forest management	16.0	20.5	23.5	20.8	20.1
05	Fishing	1.3	1.2	1.9	1.8	2.5
	Total agriculture	392.0	418.7	368.0	327.3	338.9
10	Coal and peat mining	122.1	97.0	96.0	96.0	79.5
11	Crude oil and natural gas mining	1510.3	1273.5	1263.8	2112.1	2146.9
12	Uranium ore mining	73.2	39.7	0.0	0.0	0.0
13	Metallic ore mining	55.8	77.3	51.5	74.9	63.8
14	Other mining	57.8	56.0	54.5	51.4	49.0
	Total mining	1819.2	1543.5	1465.8	2334.4	2339.1
15	Food and beverages production	790.7	859.3	685.8	758.1	861.5
16	Tobacco product manufacturing	11.5	8.4	10.6	9.7	10.9
	Total	802.2	867.7	696.4	767.8	872.3
17	Textiles manufacturing	1082.8	1244.6	1193.1	1131.6	1172.0
18	Clothes manufacturing	330.2	369.0	421.6	424.2	460.1
19	Leather and footwear manufacturing	432.1	472.1	491.6	461.1	513.5
20	Wood processing	189.9	225.8	237.7	273.7	286.3
21	Paper and paper products manufacturing	607.8	678.7	695.1	768.3	772.6
22	Publishing and printing	114.0	202.3	117.2	187.5	205.8
36	Furniture manufacturing and n.e.c.*	373.9	410.7	476.0	495.0	496.2
	Total light industry	3130.7	3603.2	3632.3	3741.4	3906.5
23	Petroleum processing and coke production	312.5	232.2	293.3	429.2	411.8
24	Chemical materials and products	2387.2	2824.3	2942.8	2929.3	3000.6
25	Rubber and plastic products manufacturing	845.9	1039.8	1181.7	1317.2	1354.6
	Total chemical industry	3545.6	4096.3	4417.8	4675.7	4767.0
26	Non-metallic mineral products	348.6	440.9	474.4	495.6	528.5
27	Metallurgy	1210.0	1312.4	1204.9	1470.6	1467.9
28	Manufactured metal products	673.8	880.2	979.8	1075.3	1125.3
29	Machinery and equipment	2184.8	3011.8	3259.1	3194.7	3478.5
30	Office equipment and computers	1282.9	1498.1	1871.3	2247.0	1998.9
31	Electric machinery and equipment	1228.2	1599.4	1855.8	2334.5	2328.8
32	Telecommunications products	1975.1	2621.2	3195.6	4792.5	5511.1
33	Instruments manufacturing	429.9	504.1	594.6	701.8	699.5
34	Road motor vehicle manufacturing	2003.8	3118.1	3687.7	3602.7	3805.7
35	Other vehicle manufacturing	103.2	95.3	91.9	141.2	153.0
	Total engineering industry	9881.7	13328.2	15535.8	18089.7	19100.8
40	Electricity, gas, heat	104.1	87.4	106.7	135.4	152.3
72	Information technology activities		0.0	76.4		
74	Services assisting economic activities		0.0	3.5	2.5	3.0
92	Entertainment, culture, sports		8.2	26.2	38.9	44.2
	Grand total	21234.1	25706.5	28008.2	32079.3	33681.7
	of which: Manufacturing industry	18116.6	22781.0	25265.2	28473.0	29931.9
	Food industry	1194.2	1286.4	1064.4	1095.1	1211.2

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

**Table I.1.4.h.: Share of foreign trade IMPORTS of economic sectors
compared to the sector's total exports
(per cent)**

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					66.8
01	Agriculture and game farming	0.1				
02	Forest management	5.0			0.1	
05	Fishing					
	Total agriculture	0.3				
10	Coal and peat mining					
11	Crude oil and natural gas mining					
12	Uranium ore mining					
13	Metallic ore mining					
14	Other mining	0.2	0.2	0.4	0.2	0.3
	Total mining	0.0	0.0	0.0	0.0	0.0
15	Food and beverages production	1.3	1.2	1.2	2.0	2.6
16	Tobacco product manufacturing					
	Total	1.3	1.2	1.2	2.0	2.6
17	Textiles manufacturing	7.3	7.3	9.8	10.2	15.5
18	Clothes manufacturing	1.8	7.2	19.4	22.9	26.8
19	Leather and footwear manufacturing	4.2	7.5	13.5	11.4	10.7
20	Wood processing	4.5	2.4	3.2	3.6	3.9
21	Paper and paper products manufacturing	3.2	3.1	3.0	3.3	2.6
22	Publishing and printing	4.1	3.1	5.5	10.2	15.5
36	Furniture manufacturing and n.e.c.*	7.8	3.8	5.2	7.5	6.3
	Total light industry	5.3	5.6	8.9	9.5	11.6
23	Petroleum processing and coke production	1.0	3.0	1.4	0.4	0.6
24	Chemical materials and products	5.4	13.5	16.7	11.5	8.4
25	Rubber and plastic products manufacturing	19.0	23.2	27.0	27.8	26.7
	Total chemical industry	8.3	15.4	18.4	15.1	12.9
26	Non-metallic mineral products	1.8	3.8	5.6	5.6	4.6
27	Metallurgy	5.4	6.7	7.3	7.9	8.5
28	Manufactured metal products	20.2	24.1	28.7	27.6	26.0
29	Machinery and equipment	20.8	25.9	29.6	29.5	28.4
30	Office equipment and computers	53.9	62.3	73.9	76.7	72.2
31	Electric machinery and equipment	33.2	36.5	40.9	47.0	46.1
32	Telecommunications products	50.9	52.0	55.7	60.5	59.1
33	Instruments manufacturing	12.1	13.8	25.0	34.0	30.4
34	Road motor vehicle manufacturing	45.6	50.6	53.7	45.4	41.6
35	Other vehicle manufacturing	1.3	1.8	0.3	0.2	0.6
	Total engineering industry	37.0	41.4	47.0	48.8	46.3
40	Electricity, gas, heat					
72	Information technology activities			0.9		
74	Services assisting economic activities			51.4	48.0	74.6
92	Entertainment, culture, sports			1.9	5.1	8.4
	Grand total	19.8	25.2	30.6	31.4	30.3
	of which: Manufacturing industry	23.1	28.4	33.8	35.3	34.0
	Food industry	0.9	0.8	0.8	1.4	1.8

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

Table I.1.4.i.: Foreign trade BALANCE by economic sectors
HUNGARIAN CUSTOMS AREA
(million USD)

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					23.1
01	Agriculture and game farming	431.4	489.4	307.5	344.4	485.5
02	Forest management	57.2	51.5	51.1	50.5	50.2
05	Fishing	4.6	6.7	4.5	2.9	2.3
	Total agriculture	493.2	547.6	363.1	397.8	538.0
10	Coal and peat mining	-120.5	-96.5	-95.4	-95.5	-78.8
11	Crude oil and natural gas mining	-1510.3	-1271.9	-1263.8	-2100.8	-2146.4
12	Uranium ore mining	-70.3	-37.2	0.0	0.0	0.0
13	Metallic ore mining	-39.0	-54.4	-50.9	-74.5	-63.2
14	Other mining	-47.1	-45.7	-42.8	-40.2	-38.7
	Total mining	-1787.2	-1505.7	-1452.9	-2311.0	-2327.1
15	Food and beverages production	1197.4	974.0	934.6	848.6	896.0
16	Tobacco product manufacturing	68.3	50.8	30.6	5.7	-1.5
	Total	1265.7	1024.8	965.2	854.3	894.5
17	Textiles manufacturing	-568.9	-620.6	-620.6	-539.4	-500.8
18	Clothes manufacturing	666.8	719.2	670.0	586.0	600.7
19	Leather and footwear manufacturing	-13.3	-8.1	-15.9	-39.8	-69.9
20	Wood processing	70.0	72.0	74.9	38.0	26.9
21	Paper and paper products manufacturing	-381.0	-430.5	-347.9	-409.3	-360.5
22	Publishing and printing	-58.1	-135.7	-67.3	-110.2	-111.6
36	Furniture manufacturing and n.e.c.*	-1.0	-11.5	8.1	-14.5	-2.5
	Total light industry	-285.5	-415.2	-298.7	-489.2	-417.8
23	Petroleum processing and coke production	94.1	94.7	6.6	-29.5	91.9
24	Chemical materials and products	-739.5	-958.6	-1042.5	-873.7	-921.4
25	Rubber and plastic products manufacturing	-214.6	-270.1	-294.9	-320.8	-274.2
	Total chemical industry	-860.0	-1134.0	-1330.8	-1224.0	-1103.6
26	Non-metallic mineral products	-27.0	-64.4	-88.8	-111.8	-133.4
27	Metallurgy	-246.5	-304.4	-289.9	-354.9	-362.9
28	Manufactured metal products	-85.3	-125.2	-157.3	-215.8	-221.0
29	Machinery and equipment	-665.7	-1028.5	-1036.9	-877.6	-929.5
30	Office equipment and computers	-429.8	-451.1	-437.4	-459.5	-467.2
31	Electric machinery and equipment	407.8	380.6	393.9	472.9	606.6
32	Telecommunications products	-424.0	-588.8	-682.3	-948.0	-1181.6
33	Instruments manufacturing	-185.6	-225.8	-230.6	-214.0	-188.3
34	Road motor vehicle manufacturing	-95.4	-625.2	-851.8	-932.5	-1012.3
35	Other vehicle manufacturing	-32.0	-3.7	13.1	-9.7	10.4
	Total engineering industry	-1510.0	-2667.7	-2989.3	-3184.2	-3382.9
40	Electricity, gas, heat	-9.0	16.7	-3.3	-62.9	-75.4
72	Information technology activities	0.0	0.0	-53.6	0.0	0.0
74	Services assisting economic activities	0.0	0.0	-0.5	-0.4	1.0
92	Entertainment, culture, sports	0.0	-0.6	-7.8	-13.1	-18.9
	Grand total	-2966.3	-4502.9	-5187.3	-6499.4	-6365.4
	of which: Manufacturing industry	-2929.0	-4585.7	-4997.5	-5364.1	-5377.5
	Food industry	1758.9	1572.4	1328.3	1252.1	1432.5

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

Table I.1.4.j.: Foreign trade BALANCE by economic sectors
CUSTOMS-FREE ZONES
(million USD)

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					113.0
01	Agriculture and game farming	-0.2	0.0	0.0	0.0	0.0
02	Forest management	-0.8	0.0	0.0	0.0	0.0
05	Fishing	0.0	0.0	0.0	0.0	0.0
	Total agriculture	-1.0	0.0	0.0	0.0	0.0
10	Coal and peat mining	0.0	0.0	0.0	0.0	0.0
11	Crude oil and natural gas mining	0.0	0.0	0.0	0.0	0.0
12	Uranium ore mining	0.0	0.0	0.0	0.0	0.0
13	Metallic ore mining	0.0	0.0	0.0	0.0	0.0
14	Other mining	-0.1	0.0	-0.2	-0.1	-0.1
	Total mining	-0.1	0.0	-0.2	-0.1	-0.1
15	Food and beverages production	-5.2	-4.4	-1.8	0.1	0.5
16	Tobacco product manufacturing	0.0	0.0	0.0	0.0	0.0
	Total	-5.2	-4.4	-1.8	0.1	0.5
17	Textiles manufacturing	-48.2	-48.9	-43.7	-43.0	-28.2
18	Clothes manufacturing	24.9	52.8	62.0	59.8	52.2
19	Leather and footwear manufacturing	2.5	-2.4	-19.1	-1.5	4.5
20	Wood processing	-0.8	2.7	0.8	-5.9	-6.3
21	Paper and paper products manufacturing	-11.4	-15.3	-15.8	-18.1	-10.2
22	Publishing and printing	-4.5	-5.8	-5.6	-16.0	-29.9
36	Furniture manufacturing and n.e.c.*	74.6	126.0	209.2	207.8	575.0
	Total light industry	37.1	109.1	187.8	183.1	557.2
23	Petroleum processing and coke production	-3.0	-7.0	-4.1	-1.8	-2.4
24	Chemical materials and products	-111.5	-276.9	-419.5	-291.3	-222.2
25	Rubber and plastic products manufacturing	-116.1	-185.9	-264.3	-302.3	-301.6
	Total chemical industry	-230.6	-469.8	-687.9	-595.4	-526.2
26	Non-metallic mineral products	15.1	6.1	-2.9	3.9	0.5
27	Metallurgy	-34.4	-79.9	-79.4	-107.2	-114.0
28	Manufactured metal products	-67.0	-113.2	-169.1	-210.2	-190.2
29	Machinery and equipment	-282.7	-558.9	-787.8	-672.2	-600.0
30	Office equipment and computers	837.0	1382.4	1896.0	2099.4	1011.0
31	Electric machinery and equipment	168.1	103.2	-8.1	-196.7	-102.7
32	Telecommunications products	-79.3	3.6	-122.4	-220.0	323.6
33	Instruments manufacturing	-40.7	-57.7	-117.4	-119.1	-20.5
34	Road motor vehicle manufacturing	517.1	1481.8	2088.0	2349.4	2735.6
35	Other vehicle manufacturing	-1.0	-0.5	-0.2	-0.3	-0.9
	Total engineering industry	1051.5	2240.7	2779.0	3030.3	3156.1
40	Electricity, gas, heat	0.0	0.0	0.0	0.0	0.0
72	Information technology activities	0.0	0.0	-0.7	0.0	0.0
74	Services assisting economic activities	0.0	0.0	-1.8	-0.9	-2.2
92	Entertainment, culture, sports	0.0	0.0	-0.5	-2.0	-3.6
	Grand total	832.4	1801.8	2191.6	2511.8	3181.4
	of which: Manufacturing industry	838.7	1806.2	2196.6	2514.7	3186.7
	Food industry	-6.2	-4.4	-1.8	0.1	0.5

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

**Table I.1.4.k.: Foreign trade BALANCE by economic sectors
HUNGARIAN CUSTOMS AREA + CUSTOMS-FREE ZONES
(million USD)**

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					136.1
01	Agriculture and game farming	431.2	489.4	307.5	344.4	485.5
02	Forest management	56.4	51.5	51.1	50.5	50.2
05	Fishing	4.6	6.7	4.5	2.9	2.3
	Total agriculture	492.2	547.6	363.1	397.8	538.0
10	Coal and peat mining	-120.5	-96.5	-95.4	-95.5	-78.8
11	Crude oil and natural gas mining	-1510.3	-1271.9	-1263.8	-2100.8	-2146.4
12	Uranium ore mining	-70.3	-37.2	0.0	0.0	0.0
13	Metallic ore mining	-39.0	-54.4	-50.9	-74.5	-63.2
14	Other mining	-47.2	-45.7	-43.0	-40.3	-38.9
	Total mining	-1787.3	-1505.7	-1453.1	-2311.1	-2327.2
15	Food and beverages production	1192.2	969.6	932.8	848.7	896.5
16	Tobacco product manufacturing	68.3	50.8	30.6	5.7	-1.5
	Total	1260.5	1020.4	963.4	854.4	895.1
17	Textiles manufacturing	-617.1	-669.5	-664.3	-582.4	-529.0
18	Clothes manufacturing	691.7	772.0	732.0	645.8	652.9
19	Leather and footwear manufacturing	-10.8	-10.5	-35.0	-41.3	-65.4
20	Wood processing	69.2	74.7	75.7	32.1	20.6
21	Paper and paper products manufacturing	-392.4	-445.8	-363.7	-427.4	-370.7
22	Publishing and printing	-62.6	-141.5	-72.9	-126.2	-141.5
36	Furniture manufacturing and n.e.c.*	73.6	114.5	217.3	193.3	572.5
	Total light industry	-248.4	-306.1	-110.9	-306.1	139.4
23	Petroleum processing and coke production	91.1	87.7	2.5	-31.3	89.5
24	Chemical materials and products	-851.0	-1235.5	-1462.0	-1165.0	-1143.6
25	Rubber and plastic products manufacturing	-330.7	-456.0	-559.2	-623.1	-575.8
	Total chemical industry	-1090.6	-1603.8	-2018.7	-1819.4	-1629.8
26	Non-metallic mineral products	-11.9	-58.3	-91.7	-107.9	-132.9
27	Metallurgy	-280.9	-384.3	-369.3	-462.1	-476.8
28	Manufactured metal products	-152.3	-238.4	-326.4	-426.0	-411.2
29	Machinery and equipment	-948.4	-1587.4	-1824.7	-1549.8	-1529.5
30	Office equipment and computers	407.2	931.3	1458.6	1639.9	543.8
31	Electric machinery and equipment	575.9	483.8	385.8	276.2	504.0
32	Telecommunications products	-503.3	-585.2	-804.7	-1168.0	-858.0
33	Instruments manufacturing	-226.3	-283.5	-348.0	-333.1	-208.8
34	Road motor vehicle manufacturing	421.7	856.6	1236.2	1416.9	1723.4
35	Other vehicle manufacturing	-33.0	-4.2	12.9	-10.0	9.5
	Total engineering industry	-458.5	-427.0	-210.3	-153.9	-226.9
40	Electricity, gas, heat	-9.0	16.7	-3.3	-62.9	-75.4
72	Information technology activities	0.0	0.0	-54.3	0.0	0.0
74	Services assisting economic activities	0.0	0.0	-2.3	-1.3	-1.2
92	Entertainment, culture, sports	0.0	-0.6	-8.3	-15.1	-22.5
	Grand total	-2133.9	-2701.1	-2995.7	-3987.6	-3184.0
	of which: Manufacturing industry	-2090.3	-2779.5	-2800.9	-2849.4	-2190.7
	Food industry	1752.7	1568.0	1326.5	1252.2	1433.1

Note: *n.e.c. = not elsewhere classified activities

Source: Foreign trade statistics, Ministry of Economy and Transport

**Table I.1.4.I.: Share of foreign trade BALANCE of economic sectors
compared to the sector's total exports
(per cent)**

No.	Economic sector	1997	1998	1999	2000	2001
0	Return goods					83.0
01	Agriculture and game farming					
02	Forest management	-1.4				
05	Fishing					
	Total agriculture	-0.2				
10	Coal and peat mining					
11	Crude oil and natural gas mining					
12	Uranium ore mining					
13	Metallic ore mining					
14	Other mining	0.2	0.0	0.5	0.2	0.4
	Total mining					
15	Food and beverages production	-0.4	-0.5	-0.2		0.1
16	Tobacco product manufacturing					
	Total	-0.4	-0.4	-0.2		0.1
17	Textiles manufacturing	7.8	7.3	6.6	7.4	5.3
18	Clothes manufacturing	3.6	6.8	8.5	9.3	8.0
19	Leather and footwear manufacturing	-23.1	22.9	54.6	3.6	-6.9
20	Wood processing	-1.2	3.6	1.1	-18.4	-30.4
21	Paper and paper products manufacturing	2.9	3.4	4.3	4.2	2.7
22	Publishing and printing	7.2	4.1	7.7	12.7	21.1
36	Furniture manufacturing and n.e.c.*	101.4	110.0	96.3	107.5	100.4
	Total light industry	-14.9	-35.6	-169.3	-59.8	399.6
23	Petroleum processing and coke production	-3.3	-8.0	-164.0	5.8	-2.7
24	Chemical materials and products	13.1	22.4	28.7	25.0	19.4
25	Rubber and plastic products manufacturing	35.1	40.8	47.3	48.5	52.4
	Total chemical industry	21.1	29.3	34.1	32.7	32.3
26	Non-metallic mineral products	-126.9	-10.5	3.2	-3.6	-0.4
27	Metallurgy	12.2	20.8	21.5	23.2	23.9
28	Manufactured metal products	44.0	47.5	51.8	49.3	46.3
29	Machinery and equipment	29.8	35.2	43.2	43.4	39.2
30	Office equipment and computers	205.6	148.4	130.0	128.0	185.9
31	Electric machinery and equipment	29.2	21.3	-2.1	-71.2	-20.4
32	Telecommunications products	15.8	-0.6	15.2	18.8	-37.7
33	Instruments manufacturing	18.0	20.4	33.7	35.8	9.8
34	Road motor vehicle manufacturing	122.6	173.0	168.9	165.8	158.7
35	Other vehicle manufacturing	3.0	11.9	-1.6	3.0	-9.2
	Total engineering industry	-229.3	-524.8	-1321.4	-1969.0	-1391.2
40	Electricity, gas, heat					
72	Information technology activities			1.3		
74	Services assisting economic activities			78.3	69.2	188.7
92	Entertainment, culture, sports			6.0	13.0	15.8
	Grand total	-39.0	-66.7	-73.2	-63.0	-99.9
	of which: Manufacturing industry	-40.1	-65.0	-78.4	-88.3	-145.5
	Food industry	-0.4	-0.3	-0.1		

Note: A “-” balance denotes improvement, while a “+” balance indicates deterioration, expressed in percentages.

*n.e.c. = not elsewhere classified activities

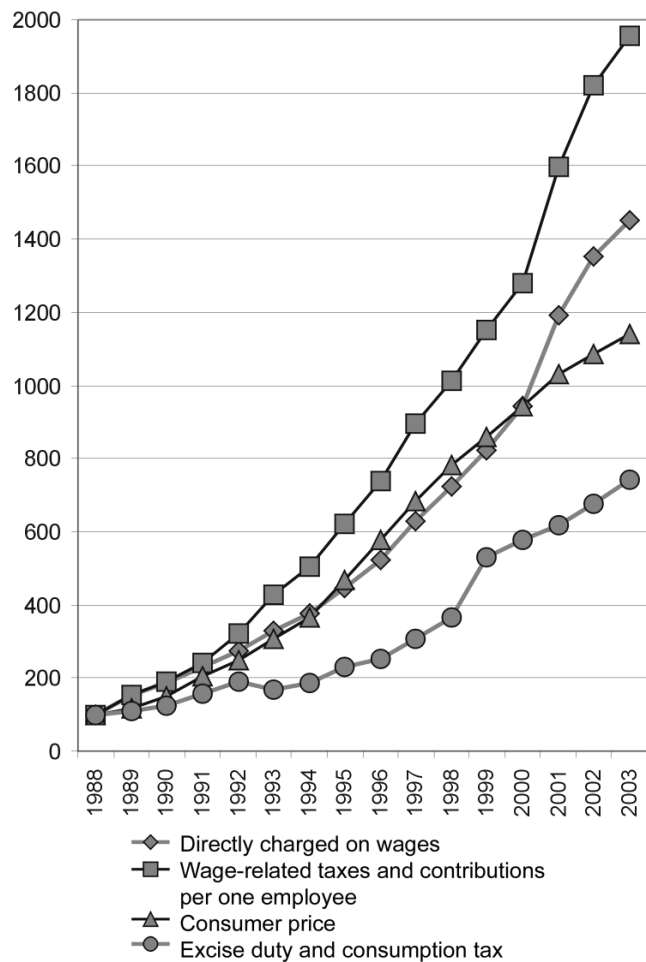
not ensure clear and transparent statistical results. KOPINT DATORG, a Hungarian economic research firm, published the following statement in its report on the state of the economy (No. 1998/2, p.137): “It is important to stress that since the beginning of 1997 trade statistics have included free zones, but ignored trade between the free zones and the area within the customs boundaries. Since that time no information has been available about the contribution of areas within the customs boundaries to the exports of the free zones, and about the rate of further processing or use of products within the customs boundaries.” According to our information from various independent sources, this trade turnover figure may be in the region of USD 100 million annually.

Ongoing processes may be better evaluated if we take into account that the austerity measures have hit the lower tenths of the population the hardest. (Note: consumers / households are divided into ten groups when statistics are compiled on the use of income.) At the same time, the lower tenths primarily consume Hungarian products, whereas the higher income the households have, the higher is the share of imported goods in the consumption. The austerity measures hit mostly the lower tenths of the population (e.g. those who have lost income through the lower real value of their family allowance or pension) therefore the consumption of the domestic goods decreased. The earnings of the higher tenths increased in general (primarily of those operating in the black economy), which they spend largely on imported goods. Hand in hand with the impacts of abolishing the supplementary duty and reducing customs duties, this has further boosted the motivation to increase the imports.

1.5. Unfavourable changes of some elements of the Hungarian taxation and price system

Changes of the Hungarian taxation and price system in the last 12 years have increasingly contributed to promoting wasteful consumption, with an unfavourable composition of goods, and to shrinking legal employment of the workforce. The rate of raising consumption taxes (excise duties) has been usually under the rate of inflation. Therefore also state revenues from these taxes have diminished comparatively (see Table I.1.5.a.). During the same period, the costs charged on wages have considerably increased. Some 1.5 million jobs have been lost in Hungary since 1989; as a result, tax-type costs (personal income tax, social security contribution) have placed a much larger burden on

Figure I.1.5.: Changes in taxes and contributions charged on wages, in state revenues from excise duties and consumption taxes, and in the consumer price index 1988=100



Source: Yearbooks of the Central Statistical Office of Hungary, state budget bills and state budget final accounts

the remaining active earners. Increased tax burdens have most seriously affected those who only have income from earning wages or salaries, and within this group particularly the civil servants, because they could not hide their income from the tax authorities. Moreover, the income level of civil servants, calculated in real value, dropped by over 50 per cent between 1990 and 2001. Figure I.1.5. shows changes in revenues from taxes and contributions charged on wages, and from consumption taxes and excise duties between 1988 and 2003, as well as the consumer price index compared to 1988. The above-mentioned tendency is also reflected by the fact that the rate of increase and the proportion of net wages have been lagging behind those of gross wages, which means in practical terms that the tax brackets have become tightened with the rate of inflation, i.e. tax bracket limits have not been properly adjusted to inflation (see Table I.1.5.b.).

Table I.1.5.a.: Changes in state revenues from main types of taxes, social security contributions and other tax-type sources
(billion HUF, at current prices)

Tax type	1988 fact	1989 fact	1990 fact	1991 fact	1992 fact	1993 fact	1994 fact	1995 fact	1996 fact	1997 fact	1998 fact	1999 fact	2000 fact	2001 fact**	2002 anticipated	2003 estimate
Personal income tax	61.7	94.2	126.8	183.9	220.9	284.3	322.7	392.3	490.8	560.3	656.7	769.6	938.0	1128.9	1279.8	1375.9
Social security contributions and health contribution fee	194.7	296.4	352.4	407.4	481.2	564.1	645.8	749.3	846.1	1053.0	1201.4	1337.0	1477.7	1931.1	2190.7	2347.4
Directly charged on wages (total)	256.4	390.6	479.2	591.3	702.1	848.4	968.5	1141.6	1336.9	1613.3	1858.1	2106.6	2415.7	3059.9	3470.5	3723.3
Value-added tax	123.0	135.1	146.8	149.5	175.7	286.7	336.4	424.0	515.1	674.8	796.9	941.8	1153.8	1251.0	1373	1591.0
Excise duties and consumption taxes	87.5	95.6	108.2	137.3	166.7	148.2	164.3	200.9	222.1	267.5	320.6	463.7	505.9	539.2	591.5	650.8
Customs and import duties (not including customs deposits)	34.4	45.5	51.5	62.8	100.2	118.4	150.4	200.4	214.8	125.5	81.0	97.8	102.1	88.3	92.1	115
Indirectly charged on wages (total)	244.9	276.2	306.5	349.6	442.6	553.3	651.1	825.3	952.0	1067.8	1198.5	1503.3	1761.8	1878.5	2056.6	2356.8
Total taxes directly and indirectly charged on wages	501.3	666.8	785.7	940.9	1144.7	1401.7	1619.6	1966.9	2288.9	2681.1	3056.6	3609.9	4177.5	4938.4	5527.1	6080.1
Corporate tax*	87.4	93.1	94.0	77.3	64.1	55.7	76.0	91.0	110.9	144.7	199.2	248.8	286.0	344.8	383.9	417.3
Local taxes***				9.5	17.2	27.1	34.0	46.4	80.8	111.2	145.8	198.4	209.0	469.3	516.1	560.3
Duties***	9.8	9.7	11.2	13.0	14.1	18.9	24.4	32.4	41.7	50.3	61.1	68.4	81.0			
Motor vehicle tax***	1.1	1.5	1.7	2.0	7.3	6.4	6.2	6.3	13.9	15.1	17.0	22.0	23.0			
Grand total of main tax and tax-type revenues	599.6	771.1	892.6	1042.7	1247.4	1509.8	1760.2	2143.0	2536.2	3002.4	3479.7	4147.5	4776.5	5752.5	6427.1	7057.6
Taxes and contributions directly charged on wages as a percentage of main taxes	42.8%	50.7%	53.7%	56.7%	56.3%	56.2%	55.0%	53.3%	52.7%	53.7%	53.4%	50.8%	50.6%	53.2%	54.0%	52.8%
Total state budget revenues (gross)	898.2	1063	1279	1588.7	1894.4	2249	3060.2	3614.5	4315.5	4571.8	5593.3	6452.9	6759.2	7931.0	8827.4	9570.6
GDP at current prices	1440.4	1722.8	2089.3	2498.3	2942.7	3548.3	4364.8	5614	6894	8450	10087	11394	13151	14824	16800	18550
Taxes charged on wages / Total state budget revenues	28.5%	36.7%	37.5%	37.2%	37.1%	37.7%	31.6%	31.6%	31.0%	35.3%	33.2%	32.6%	35.7%	38.6%	39.3%	38.9%
Employees on payroll (in thousands)	5318	5264	5227	5052	4534	4090	3882	3793	3648	3646	3698	3812	3910	3976	3950	3950
Wage-related taxes and contributions per one employee	94268	126672	150310	186232	252465	342722	417229	518533	627422	735293	826622	947107	1068524	1242050	1399264	1168127
Specific value of wage-related taxes and contributions (1988=100)	100	134	159	198	268	364	443	550	666	780	877	1005	1133	1318	1484	1633
Changes in consumer price (1988=100)	100	117	151	204	251	307	365	468	578	683	781	859	943	1030	1087	1141

Notes:

*Excluding corporate tax of financial institutions

** As from 2001 in "result" approach, as per ESA '95 method; and also other employers' contributions, as well as taxes related to wages and employment

*** As from 1991 property-type taxes, other taxes charged on products and services, as well as other taxes and tax-type revenues all aggregated (state budget balance, as per economic classification)
Source: Statistical Yearbook and Monthly Statistical Bulletins of the Central Statistical Office of Hungary; Ministry of Finance – Memorandum for Bill No. T/276; Final Accounts of the Hungarian State Budget for 2000

**Table I.1.5.b.: Changes in the gross
and net average wages of employees (HUF/month)**

	1994	1995	1996	1997	1998	1999	2000	2001
Gross wage	33289	38900	46827	57270	66398	77187	87645	103558
Net wage	22992	25891	30737	38145	44383	50028	55785	64915
Net wage as a percentage of gross wage	69.07%	66.56%	65.64%	66.61%	66.84%	64.81%	63.65%	62.68%

Note: Calculated without personal income tax allowances

Gross average wage: per capita monthly average of the amounts paid as wage costs in the period concerned

Net average wage: gross average wage less personal income tax, health and pension insurance contributions, as well as employees' contribution, calculated on the basis of the effective personal income tax rates

Source: Yearbooks of the Central Statistical Office of Hungary

1.6. Why is it inevitable to implement a human-ecological-oriented reform to the state budget?

Global tendencies of the past few decades and an increasing number of events posing threat to human health and the environment have proved that today's economic policies will not lead to further development. For instance, the UN Intergovernmental Panel on Climate Change warns that to avoid a world-wide ecological disaster, the emission of carbon dioxide should be reduced by 60 per cent on the Earth without any delay. Hungary's emission is double of the international average, so the rate of reduction required is 80 per cent here. Also the emission of a series of other pollutants should be cut in a similar proportion.

Changes are inevitable; a simple formula may demonstrate this for everyone. (Together with its explanation it can also be found in a publication by Károly Kiss: *Ezredvégi Kertmagyarország*.) P. and A. Ehrlich have developed the following formula to describe the relationship between the world's population, the consumption and their environmental impact:

$I = PCT$, where:

I: environmental impact of economic activities,

P: world's population,

C: per capita consumption,

T: environmental impact, i.e. "intensity" of consumption (comprising all the changes in technology and in the composition of the economic growth factors and of the national product.)

Another version of the above model, elaborated by P. Ekins, assumes that the world's population will double in fifty years from now; meanwhile the environmental impact of economic activities will have been reduced by 50 per cent. (It is to be noted that the model, therefore, is a

catastrophe prognosis rather than a model of sustainability, since the emission of most pollutants is already exceeding the critical load today, and in general, as we have mentioned, it would be necessary to reduce them by 60 to 90 per cent immediately – as opposed to the 50 per cent in the model – so that a large-scale and irreparable further environmental degradation could be prevented. Ekins, of course, is also aware of this fact; his approach and "generosity" just underline his point.)

If consumption and economic performance increase by a slight 2 to 3 per cent annually, they will grow four-fold in fifty years. So the equation needs to be modified as follows:

$$I = 2P \cdot 4C \cdot (T/8)$$

This means that the environmental hazard (the impact and the intensity) of one unit of consumption should be reduced to the eighth, i.e. by around 90 per cent, which is obviously infeasible. Even if economic growth is assumed to be zero (which, of course, is a mere hypothesis), the environmental impact factor should be reduced by 50 per cent.

Since the mentioned processes are dramatically accelerating, it is clear that the sooner a country can adjust to the new conditions and circumstances by taking action to manage the expected changes, the more advantageous position it can acquire.

1.7. Eco-social budget reform — increased state responsibility in a world of intensifying globalization

Thick volumes of literature are available about the expected benefits of an eco-social budget reform. Here we cite a short passage from a book by two German authors (*The Pitfalls of Globalization* by Hans-Peter Martin and Harald Schumann) to illustrate the point of the concept. (The authors write about a tax reform, but the

same statements are naturally true for similar reforms of other systems of state subsidies as well.)

“An ecological tax reform could open up great opportunities; even liberal-minded economists accept this. By making energy consumption more expensive gradually and over the long run through imposing higher taxes on it, environmental hazards could be controlled, and at the same time the demand for labour force would increase. In addition, transnational division of labour would also be restricted by rising freight costs. And it would not really pay off any more to operate never-ending convoys of heavy trucks on the motorways as moving warehouses of suppliers.

The German Economic Research Institute has elaborated a rather conservative model calculation for the tax reform. The model has proved that in ten years after eco-taxes are imposed and gradually increased on heating oil, petrol, natural gas and electricity consumption, over 600,000 new jobs could be created in Germany. To minimize energy consumption it would be necessary to refurbish existing buildings; these tasks, along with a decentralized energy production, would provide work for many people.

Walter Stahel, product researcher, has also found that even more people could find jobs, if consumption and use of raw materials became more expensive, too. His calculations have been published in his work titled ‘The Trap of Acceleration, or, The Triumph of a Turtle’. If prices of resources were higher, durable goods would have a clear cost advantage over disposable products and throwaway junk articles, and this, again, would put higher value on labour. Stahel has shown the possibility to reverse the trend through an example of motorcar manufacturing. The body and the engine block of motorcars are designed to last for about ten years today, although technically it would be feasible to build them to last for even twenty years. The purchase price of a motorcar today (with a ten-year useful life) accounts for an average 57 per cent of the total expenses spent on the car, while repair and maintenance represent only 19 per cent of the total costs. The ratios change drastically if calculated with a twenty-year useful life: the purchase price has a share of only 31 per cent, whereas repair and maintenance make up 36 per cent of the total costs. Assuming that buyers pay the same amounts for the cars with either a ten, or a twenty-year useful life, the value of the mostly automated manufacturing involving little live labour would drop, whereas repair and maintenance activities requiring human work would be more appreciated.

Society needs a lot of human labour in many other areas, too. More hands are needed in healthcare, in the overcrowded higher and lower education, in removing the damage caused to agricultural lands or in rehabili-

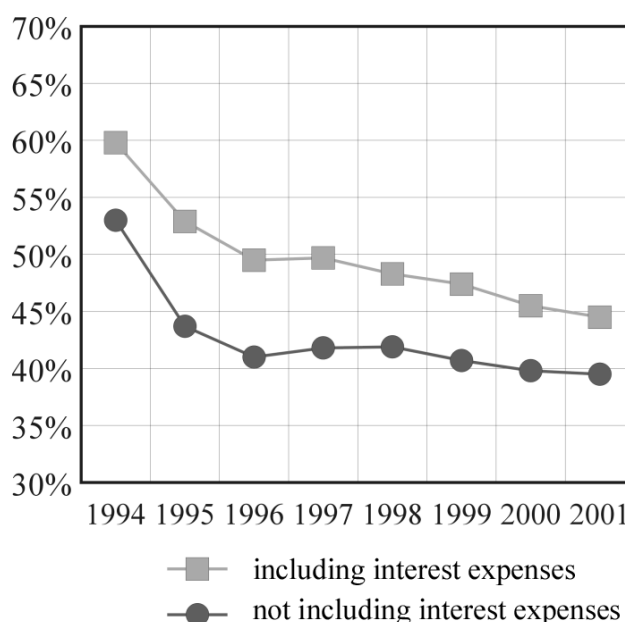
tating the deteriorated housing estates – just to mention a few. Private companies and the market sector are not capable of fulfilling those tasks alone. They need the involvement and assistance of central or local governments to carry out those tasks and effectively provide jobs for a number of people.”

Several surveys and evaluations have been performed recently in the EU to find out the likely impacts of an environmental tax reform on the employment. In May 1998, a study titled Climate Change and Employment in the European Union, financed by the Environmental Directorate-General of the EU, summarized the findings and concluded that such a tax reform would generate much more job opportunities in environmentally sound activities than it would close down in industries seriously damaging the environment.

1.8. What is the optimal rate of state redistribution?

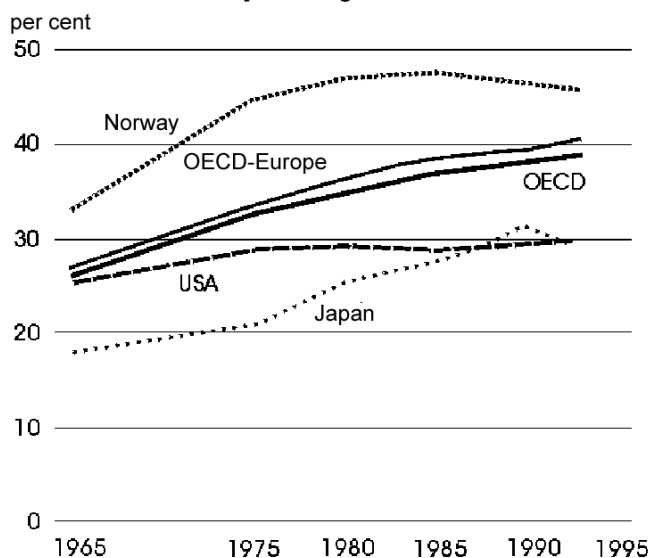
By implementing our proposals, the Hungarian central budget would not be required to increase the share of state redistribution over the rate in 2002. However, some officials of the financial government express intentions to shrink the share of state redistribution even further, which gives cause to worry. We think that several reasons refute the rationality of such objectives. In the last few years, the rate of state redistribution has already diminished significantly, as shown by Figure I.1.8.a.

Figure I.1.8.a.: Rate of state redistribution (expenditures) as compared to GDP (not including private pension funds)



Source: Yearbooks of the Central Statistical Office of Hungary,

Figure I.1.8.b.: Total tax revenues in OECD countries as percentage of GDP



Source: OECD

1. The austerity measures and the subsequent economic policy involved a radical drop in redistribution. The result was a heavy deficit borne by the society and harms caused to Hungary that are barely repairable even in the long run. At the same time, immediate or short-term benefits that had been expected from the measures hardly helped the economic growth. As a consequence of this mistaken economic policy (Hungary has not taken advantage of the economic boom starting in the EU), we reckon that a GDP growth deficit worth HUF 2,465 billion was accumulated between 1995 and 1998, calculated at 2000 prices. (See in Table II.4.a. the line "Percentage growth rate of the GDP volume".) This sum would have made it possible to implement large-scale public health and environmental improvement programmes, which would have brought enormous benefits for the Hungarian society as a whole. A market economy cannot do without systems and in-

Table I.1.8.a.: Proportion and composition of tax revenues in OECD countries in 1997

Country	Tax revenues as percentage of GDP	Personal income tax	Corporate tax	Social security contribution		Taxes connected to consumption	Other taxes	Out of these: charged on wages
				employee's	employer's			
				as percentage of total tax and tax-type revenues				
Austria	44.3	22.1	4.7	14.2	16.8	28.2	14.0	53.1
Belgium	46.0	31.0	7.5	9.5	19.5	26.7	5.8	60.0
Czech Republic	38.6	13.5	8.6	10.1	28.9	32.6	6.3	52.5
Denmark	49.5	52.4	5.2	2.5	0.7	33.0	6.2	55.6
Finland	46.5	33.3	8.1	4.3	19.9	30.9	3.5	57.5
France	45.1	14.0	5.8	12.2	25.2	27.8	15.0	51.4
Greece	33.7	13.2	6.4	17.2	14.3	41.0	7.9	44.7
Netherlands	41.9	15.6	10.5	26.5	6.2	28.0	13.2	48.3
Ireland	32.8	31.4	10.0	3.9	8.2	39.7	6.8	43.5
Poland	41.2	21.4	7.7	0.0	32.1	34.9	3.9	53.5
Luxembourg	46.5	20.4	18.5	10.6	11.5	27.0	12.0	42.5
Hungary	39.4	16.8	4.9	5.6	29.8	39.3	3.6	52.2
Great Britain	35.4	24.8	12.1	7.5	9.6	35.0	11.0	41.9
Germany	37.2	23.9	4.0	18.1	20.9	27.7	5.4	62.9
Norway	42.6	25.7	12.2	7.7	13.3	37.0	4.1	46.7
Italy	44.4	25.3	9.5	6.6	23.5	25.9	9.2	55.4
Portugal	34.2	17.7	10.9	9.6	14.6	42.0	5.2	41.9
Spain	33.7	21.9	7.8	5.6	24.6	28.9	11.2	52.1
Switzerland	33.8	31.2	5.9	11.9	11.3	18.3	21.4	54.4
Sweden	51.9	35.0	6.1	5.0	23.8	22.3	7.8	63.8
Turkey	27.9	21.7	5.7	5.7	7.2	37.1	22.6	34.6
Japan	28.8	20.5	15.0	14.4	18.8	16.5	14.8	53.7
South-Korea	21.4	17.1	10.5	2.5	6.3	45.4	18.2	25.9
Canada	36.8	38.0	10.3	5.1	8.1	24.4	14.1	51.2
Mexico	16.9	..	..	..	..	55.3	..	..
USA	29.7	39.0	9.4	10.4	12.5	16.7	12.0	61.9
Australia	29.8	42.0	14.6	0.0	0.0	27.5	15.9	42.0
New Zealand	36.4	43.2	10.6	0.0	0.0	34.6	11.6	43.2

Source: OECD in Figures, 2000 (OECD, Paris); Central Statistical Office of Hungary: International Statistical Yearbook 2001

Table I.1.8.b.: "Real value" of the state budget's interest expenditures (billion HUF)

Description	1994	1995	1996	1997	1998	1999	2000	2001	2002
Interest expenditures*	360.2	502.9	614.4	835.0	768.5	850.3	796.9	740.3	729.9
Total interest expenditures (M USD)	3426.2	4001.1	4027.0	4471.2	3583.6	3583.4	2823.2	2583.6	2534.4
Inflationary interest (M USD)	2927.9	3593.4	3546.2	3805.7	2697.1	2388.9	1751.1	1563.7	1267.2
Real interest (M USD)	498.4	407.8	480.8	665.5	886.5	1194.5	1072.1	1019.8	1267.2
Assumed changes in the state budget's interest expenditures in case the inflation rate is being reduced									
Reduced interest (%)	18.9	15	12	11	10				
Inflationary interest	309.4	240.2	275.1	427.2	404.5				
Assumed reduction of interest:		211.4	265.9	283.5	173.9				
Total interest-cost-reducing impact between 1995-1998:					934.8				
Interest-cost-reducing impact of cash receipts from the sales of state property									
Cash	0.7	437.8	102.6	317.2	99.2	114.8	16.8		
Cash accumulated	0.7	438.4	541.0	858.2	957.4	1072.3	1089.1		
Interest-reducing impact	0.1	137.7	145.0	184.5	181.9				
Total interest-cost-reducing impact between 1995-1998:					649.1				
Assumed interest-cost-reducing impact between 1995 and 1998 as a consequence of reduced inflation and sales of state property:					1583.9				

Note: M=million

*Billion HUF at current prices

Source: Acts on State Budget Final Accounts, State Budget Act for 2001–2002, National Bank of Hungary, Central Statistical Office

- stitutions that serve social development and ease social tensions, such as healthcare, public education, culture, scientific research, social welfare services, public administration and environmental protection. By shrinking the share of those activities in the GDP, Hungary's tasks in joining the EU will become much more difficult, for the adverse impacts will be even more apparent in the coming years.
- Advanced industrial countries of the world cannot be taken as a basis for comparison in this respect, because their GDP is much higher, and the structure of their economy as well as the state of their society is different, too. And even if we take into consideration the data of foreign countries, the conclusion remains that the rate of state redistribution varies greatly from one country to the other, and that this rate, just like the share of tax revenues in the GDP, are in fact steadily growing in several countries. (See Figure I.1.8.b. and Table I.1.8.a.)
 - Actually, the share of state redistribution in Hungary is extremely low compared to international standards. Pertinent official statistics fail to reflect the reality, since they neglect the share of the black and grey economies within the Hungarian national economy, which is currently estimated at around 20 to 25 per cent (but this implies a much higher share within realized incomes). Therefore, the Hungarian gross domestic product appears to be by 20 to 30 per cent lower and the rate of redistribution accordingly higher than they actually are. We do think that state redistribution should be reduced at the rate of cutting the size of the black economy. It is unacceptable for the Hungarian society to shrink the share of social redistribution, while the share of the black economy remains unchanged (what is more, it acquires a relatively more advantageous position).
 - International comparison is also distorting because, for example, in the United States of America the private pension scheme plays a predominant part, therefore pensions are not included among the expenditures of the state budget practically at all. In Hungary the growing share of the private pension scheme will only reduce the rate of state redistribution statistically, and on account of the guarantees and tax allowances granted as a support, the scheme will only bring profit to the foreign-owned insurance companies.
 - Debt service expenditures amounted to 17.4 per cent of total expenses in the state budget in 1994, and they already reached 30.9 per cent in 1997. Having decreased gradually for a couple of years, the rate of such expenditures came down to 19.7 per cent in 2000, and they are expected to fall to 16 per cent in 2002. This is still a very large share compared to international benchmarks. It is to be noted that in addition to the falling rate of inflation, debt service expenditures were also reduced through the sales of part of the state property, by which Hungary cut back the principal volume of its debt (see Table I.1.8.b.).

6. Data about the share of state redistribution are distorted also by the burden of providing indirect support to foreign capital (see Chapter 9), because these subsidies are not being used for fulfilling public tasks. What is more, according to the accepted practice of international accounts, these should be charged to the expenses side of the current balance of payment, and as a consequence, they reduce Hungary's wealth. This is illustrated by Table I.1.8.c. In 1998, the share of foreign-owned companies in the GDP was 21.1 per cent, and two years later, in 2000, it already rose to 22.9 per cent.
7. It is also important to highlight that public funds devoted to healthcare, public education, culture, scientific research, social welfare services and environmental protection (including public transportation) largely return into the state budget through taxes and contributions, and they immediately find their way into and boost the economy by creating demand for a wide range of domestic products and services. Samuelson and Nordhaus controvert the argument which says that increasing state redistribution drains away resources from economic development: "The macro level impacts are the same if funds are devoted either to public buildings or to private housing projects. Similarly, public expenditures on maintaining public libraries have the same impacts on employment as spending private funds on films or books." (Samuelson – Nordhaus: Economics) Both Hungarian and international experience has proved that the economy may also be boosted up by increasing consumption, and not just by expanding exports.
8. Up to a certain level, social expenditures are of a constant amount. Therefore, countries with a relatively low per capita GDP have to spend a higher portion of their GDP on public expenditures to ensure smooth functioning and development of society, than countries with a high specific GDP.
9. Contrary to universal belief, an economic upturn can best be promoted, even in the short run, just by the sectors that have undergone the most severe curtailments in the past decade, which has in fact created a hindrance to economic development. A study by Judit Hamar, senior associate for Kopint Datorg Co. (an economic research firm) has found that by increasing the redistribution, more funds are available for development: "It may sound odd in Hungary today that better services in education or healthcare could lower the deficit of the balance of payments, nevertheless, it could be a strategically

Table I.1.8.c.: Percentage distribution of added value broken down by ownership subsectors*

Code	Branch of the national economy	1998			1999			2000		
		public	foreign	domestic private	public	foreign	domestic private	public	foreign	domestic private
A+B	Agriculture, forest management, fishing	10.1	2.7	87.2	10.1	3.2	86.7	11.1	4.2	84.7
C	Mining	5.9	32.7	61.4	9.2	33.0	57.8	9.4	24.5	66.1
D	Manufacturing industry	10.6	50.1	39.3	10.3	52.3	37.4	7.3	54.6	38.1
E	Electricity, gas and water supply	91.1	3.0	5.9	89.3	4.6	6.1	91.5	5.1	3.4
F	Building and construction	2.2	10.8	87.0	1.9	10.8	87.3	1.2	9.9	88.9
G	Trade and repair services	0.5	26.5	73.0	0.4	28.3	71.3	0.5	27.9	71.6
H	Accommodation services, catering	8.9	14.4	76.7	9.7	14.2	76.1	8.5	15.3	76.2
I	Transportation, storage, postal services, telecommunications	60.8	8.7	30.5	58.7	9.7	31.6	57.2	9.2	33.6
J	Financial activities	19.0	51.5	29.5	22.2	49.5	28.4	23.0	48.2	28.8
K	Real estate transactions, business services	5.9	10.9	83.2	5.9	11.8	82.3	5.8	12.9	81.3
L	Public administration, defence; compulsory social security	100.0	0.0	0.0	100.0	0.0	0.0	100.0	0.0	0.0
M	Education	87.2	0.2	12.6	86.4	0.2	13.4	84.6	0.2	15.2
N	Healthcare and social welfare services	72.5	1.0	26.5	69.7	1.0	29.3	67.5	0.8	31.7
O	Other community and human services	32.7	3.8	63.5	31.0	4.2	64.8	30.9	4.2	64.9
A–O	Total (at base price)	30.0	21.1	48.9	30.1	21.6	48.3	28.3	22.9	48.8

Note: *Classification into ownership subsectors is based on the principle of majority ownership

Source: Yearbooks of the Central Statistical Office of Hungary

legitimate objective. Education and healthcare are the leading industries in the United States. By improving those services in Hungary, the balance could show a surplus, at least with the countries of the region.” (Published in the Hungarian daily Magyar Hírlap, 19th January 1999.)

10. Also on the consumption side, redistribution may benefit the environment and Hungarian production of a relatively high intellectual content. For instance, if teachers are given higher salaries, there will be a higher demand for intellectual goods. International trends show that products with higher added intellectual content are in an ever-increasing demand; therefore Hungary could reinforce its economic competitiveness by shifting the emphasis towards promoting such activities.
11. Another reason why a reduced rate of state redistribution would jeopardize Hungary’s competitiveness during the process of joining the EU is that Hungary will need to present a sufficient share of own funds to have access to EU funds. The lower the redistribution is, the less own funds will be available, thus running a great deal of risk of not receiving EU funds. However, once Hungary has gained access to EU funds, the share of state redistribution – regarding only the contribution of Hungary – may indeed decrease in actual terms. If that is the way the Government of Hungary is planning to achieve reduction in the share of state redistribution, then we may agree with it.
12. A higher portion of state redistribution in itself does not violate the principles of market economy, unless players of the economy fail to share the burdens equally. It is not the share of redistribution that hinders the development of a modern market economy. We cannot but agree, and even support, that state redistribution should be cut back by eliminating the open and hidden subsidies that give a few players of the economy unjustified and unfair advantages, which are also unreasonable regarding the efficiency of the national economy as a whole. Accordingly, it is, of course, essential to eliminate state redistribution also in areas where the currently granted subsidies – directly or indirectly – finance activities that are especially harmful to the environment (such as motorway constructions, individual preferences given to car manufacturers, etc.). Taking such measures would bring about benefits for the national economy in at least three main areas:
 - direct and indirect pressure on the state budget is eased,
 - state of the environment is bettered, and
 - position of environmentally less damaging activities is improved.

13. Already today, Hungary is receiving warnings from foreign and domestic enterprises saying that harmonizing the Hungarian statutory system with that of the EU is not enough in itself, and that measures have to be taken to ensure also enforcement of these regulations. But this, in turn, requires enhanced efficiency in public administration and establishment of the necessary controlling and monitoring networks.

It is worth calling the attention here to a study by Dr. Ferenc Rabár (former Hungarian Minister of Finance) titled “Welfare state: memory from the past or vision of the future?” (published in the periodical Magyar Szemle, No. 5–6/1999), which provides us with a thorough critique of the views urging reduction of the share of state redistribution. One of the study’s conclusions is that no evidence whatsoever can be found to prove that the reduction of redistribution has in fact improved the economic competitiveness of any country. Just on the contrary: “Both successful and unsuccessful economies can be found among countries having either a relatively high or a relatively low level of welfare expenditures.”

Consequently, the optimal extent of the state redistribution needs to be determined through a series of social and economic impact assessments and appropriate background studies, as well as meaningful discussions involving wide circles of professionals and civil movements.

It seems to us that the reason why from time to time (particularly during debates of the annual state budgets) the Hungarian Ministry of Finance puts great emphasis on the need to reduce the share of state redistribution is just to gain some justification for refusing to satisfy the requests of individual ministries without any solid grounds.

Considering all the above arguments it can be concluded that the Hungarian Ministry of Finance violates both the Constitution of the Republic of Hungary and the Act on Environmental Protection when cutting back the expenditures of the state budget without allocating the available funds for the protection of the environment, for the safeguarding and improvement of human life and the health standard of Hungarian citizens and for maintaining and enhancing the quality of education and culture; what is more, the Ministry continues its practice of curtailing these funds. (The current level of these expenditures is still very much under the 1994 level – i.e. that of the time before the austerity measures of the Bokros package were introduced.) The financial government’s default is made even more apparent by the subsidies that the ministry is granting directly and indirectly to foreign enterprises – in many cases acting against the provisions of the Act on State Finances and circumventing the Hungarian Parliament. These subsidies are often effected without any actual

flow of money, but as to their underlying content, they in fact mean real material values (i.e. money). Consequently, these subsidies are contrary to the provisions set forth in the preamble of the Act on State Finances passed with a unanimous decision by the Hungarian Parliament, which say that **the principles of “completeness, fullness of details, authenticity, transparency and publicity” shall be enforced in matters belonging to state finances. Article 12 of the Act states explicitly: “In the sub-systems of the state budget, all movements of funds shall be accounted for.”** The possibility of the mentioned non-transparent subsidies is also a breeding ground for corruption (See also Chapter 3). All this raises some questions of constitutionality as well.

1.9. How can we fight inflation?

At present, inflation is generated by the underdeveloped structure of the Hungarian economy and the low employment level, which decrease the added value and thereby increase the relative social costs. (A diminishing number of working citizens has to keep a growing number of dependants.) Inflation cannot be combated with a dogmatic approach. It shows a narrow-minded and short-term attitude if distorted prices – alleging inflation as a reason – are not transformed, if external costs are not allowed to become incorporated into the prices, or if unfair wage proportions are not reformed because of the assumed risks of an excessive outflow of incomes. The most efficient and lasting way to fight inflation is to transform the poor structure of the Hungarian economy and taxation system, which generate the inflation, and to start using real prices. Abandoning energy price subsidies and other unreasonable open and hidden forms of state support, making more transparent the pricing methods of natural monopolies, public services, public acquisitions and other activities financed from public funds, reinforcing consumer protection, reducing the excessive level of labour costs, improving the efficiency of live labour and enhancing competitiveness through better use of manpower are the means that **would root out the processes causing inflation**. As a result of all these measures it can be realistically expected that the state debt and the estimated debt service expenditures can be **significantly reduced**.

High wage costs and the fact that – in contrast to the value-added tax – the burdens of social security contributions are placed one upon the other along the whole length of the series of economic actions, make ever more expensive and uncompetitive many activities that are useful and desirable also from an environmental point of view. For example, the tax content of the value of reno-

vations made on condominium buildings may be as high as 75 to 85 per cent, although it is in the interest of the whole national economy to enhance the technical standard of the country's stock of buildings. “Rolling forward” the tax burdens generates inflation, and drives many activities into the black or grey economy.

Inflationary expectations were boosted and are still being boosted considerably by price rises exceeding the rate of inflation in services operated at official prices fixed by local governments, as happened in the case of water and sewer charges, as well as public transportation (the latter saw changes to the contrary only in the last couple of years, but this favourable trend is expected to turn around once again in 2003).

International studies show that environment-conscious budget and tax policies might help curb inflation in the long run. The INFRAS Research Institute in Switzerland had assessed over forty studies about the impacts of an environmental budget and tax reform in Europe, and they publicized their findings during the conference “Environmental Tax Reform in Europe” held in October 1997 in Brussels. What they found was that an environmental budget reform would not increase the rate of inflation. Publications by the European Commission (the Green Paper titled *Towards Fair and Efficient Pricing in Transport* released in 1995 and the White Paper titled *Fair Payment for Infrastructure Use* published in 1998) went further and stated explicitly that an adequate increase of transport prices could lead to lower costs in the aggregate, if implemented in conjunction with a favourable restructuring. It is well-known that the specific costs of railway freight transportation are only a fraction of those of road transportation despite the fact that railways bear the total costs of their infrastructure. Furthermore, higher prices would ease traffic congestions, which cause substantial expenses, and reduce the losses due to damages to health and the environment, which are a heavy burden on the EU economy today. On the other hand, the state could spend the extra tax revenues from transport on transforming the economy, on reducing the need for transportation and on implementing integrated logistical solutions. This would also improve the EU's competitive position. A gradual increase of the prices of transport as described in the Green Paper would ensure that the prices reflect the actual costs already existing but not paid for by the users and/or the polluters. The White Paper also quotes the findings of the EU research programmes TRENEN and EUNET, which have examined the expected impacts of introducing road tolls and other charges in Amsterdam, Brussels, Dublin, Helsinki, London, and Naples. The studies have found that a carefully scheduled introduction and increase of the tolls would contribute to bettering the population's living conditions, to enhancing economic efficiency, as well as to

reducing costs in each city. Benefits of less traffic congestion and fewer accidents, of a lower degree of environment pollution, and of channelling back extra revenues into the economy largely outweigh the “losses” caused by increased prices of transport, which could even be overcompensated by a lowered need for transportation and by a shift towards a more favourable transportation structure (from road to rail).

The reason why green state budget reforms have an anti-inflationary impact is that prices of goods and services are getting closer to the “optimal” value from the viewpoint of the society and the economy.

When prices of energy, for example, are raised, demand for energy-intensive products and activities drops, which reduces the impact of the price rise on inflation on its own. Multiplication effects of the price rise are also less significant than generally assumed, because a large part of the energy consumption is not related to production at all; it appears as personal consumption, and within that, partly as luxury consumption (e.g. in air-conditioning, where the rate of efficiency of the specific energy utilization is six times lower than in the case of heating). Furthermore, the raise of energy prices would promote putting an end to the wasteful use of energy, and would encourage innovation, which would have an overall cost-reducing effect in the entire economy.

It is also evident that when subsidies are cut somewhere, resources will be saved which can be used for reducing taxes elsewhere (including taxes and social security contributions charged on wages), and consequently also for lowering prices. As we are going to demonstrate in later chapters of the present study, currently huge direct and indirect subsidies are granted in Hungary to the consumption of natural gas, petroleum, coal and nuclear energy, as well as to motorization. Curtailment of these subsidies would open up opportunities to lower the social security contribution and personal income tax rates, which, again, would reduce corporate expenses. As a consequence, prices could go down, or at least, could rise at lower rates. Real energy prices would also facilitate a consumption pattern which is fairer socially, because subsidies granted to energy consumption are being utilized at a many times higher rate by richer social groups than by poorer citizens. (Social strata with lower income levels, of course, will have to be compensated – we are going to discuss details of this later.)

Unless users of energy are forced to pay for all the damage and costs they cause, or cover the costs of prevention and/or remedies, these costs will appear in other areas at a multiplied rate. For example, maintenance and renewal costs of buildings and other facilities will surge as a result of the accelerated corrosion, just like the costs caused by environmental damage to agriculture, or the costs incurred because of the deterioration

of human health (reduced work performance, medical care expenditures), etc. **Thus, granting open or hidden governmental support to environmentally hazardous products and activities is not a suitable approach to prevent the national currency from losing its value, but the other way round, it speeds up inflation dangerously.** This, among others, will result in an ever widening gap between the “winners” and the “losers” of the change of regime in Hungary.

The same applies to the consequences of neglecting scientific research, culture and education. Unless facts and tendencies necessary for decision-making are properly identified and understood (and now they are often left unknown in an attempt to save money), wrong decisions are likely to be made, which might result in actions that involve much higher costs than the savings realized during the preparation of the decision-making. The same happens when a country entirely or partly lacks highly qualified and versatile specialists and executives who are capable of finding and giving orientation in a complex world like ours. In simple terms: **besides environment pollution, ignorance and an inadequate standard of qualification and culture, not meeting today’s requirements, are the other most influential factors that generate inflation.**

Increased excise duties, however, will only have a one-off impact on the price level; and their price raising effect on the production is not significant. Beverages or tobacco are obvious examples, but the impacts of the rise in fuel prices for motor vehicles are also expected to be only temporary and moderate, since cars, which account for nearly 70 per cent of the total fuel consumption of transport, are primarily used for private and not for production purposes. What is more, if the possibilities for accounting expenses of car use within the taxation system are restricted, the inflationary pressure can be further alleviated. Increasing the share of railways within transportation would serve the same purpose, for the specific energy-intensity of railway freight transportation is 1/10, and its dependence on petroleum prices is only 1/30 part of that of road transportation.

On the other hand, wages are constant factors of production; therefore, by reducing the costs of wages, total production costs will also diminish. **The cumulative result of all the measures detailed above can be a lower rate of inflation already at the end of the fiscal year.** It is even more important that the reduced wage costs will lead to improved international competitiveness for industries involving a relatively high live labour content. Another reason why this measure is entrepreneur-friendly is that **entrepreneurs who employ more workers will save many times more on the lower social security expenses than what they will spend on higher fuel taxes.**

Measures and proposals listed above restrict primarily those imports into Hungary which have been granted huge preferences since 2001 by removing customs barriers and introducing liberalization. A further advantage of the measures proposed is that by decreasing specific costs they may further reduce the prices of Hungarian exports, and so improve competitiveness considerably. As a result, the state budget's debt burden could have been reduced from the nearly HUF 730 billion projected for 2002 to about 630 billion (because we expect from the proposed measures that the inflation, and especially the interest rates, will go down). Therefore we estimate that in the Debt Service Interest Expenses line of the state budget we may safely reckon with annual savings of **HUF 100 billion**.

Inflation can only be curbed lastingly through a long-term approach. At present, however, the Hungarian Ministry of Finance and the National Bank of Hungary pursue an anti-inflationary policy which is based on an exclusively monetary approach, attempting to take the most possible advantage of the lower inflation rate in order to increase real interest rates (or, at least, to reduce the pace of decrease), which would allow to attract even more "hot money". This approach involves extremely great risks, because in a situation where financial crisis becomes permanent, drastic and destructive austerity measures, on a scale similar to the former "Bokros package", may be forecasted, which would mean nothing less than a catastrophe for the environment and for the majority of the Hungarian society.

It is also necessary to call the attention to the close relationship between inflation and the state budget's interest expenditures. In the last line of *Figure I.1.9.* we have demonstrated how much extra interest burden is

brought about by one per cent inflation. The real interest burden of the Hungarian state budget has increased steadily. In 2002, every 1 per cent inflation growth caused already HUF 60.8 billion extra interest expenses. Foreign portfolio investors are in practice providing credit for the state debt, and its nominal interest leaves Hungary; this is another mechanism through which the high rate of inflation deteriorates the current balance of payments. All the above reasons make it very important and urgent to elaborate an efficient anti-inflationary programme and to implement it in practice.

Based on the principle "little streams make great rivers", and by making use of the multiplying effect, several sub-programmes could be implemented, which could simultaneously aim at curbing the inflation, protecting the environment and raising the employment level. Such programmes may include:

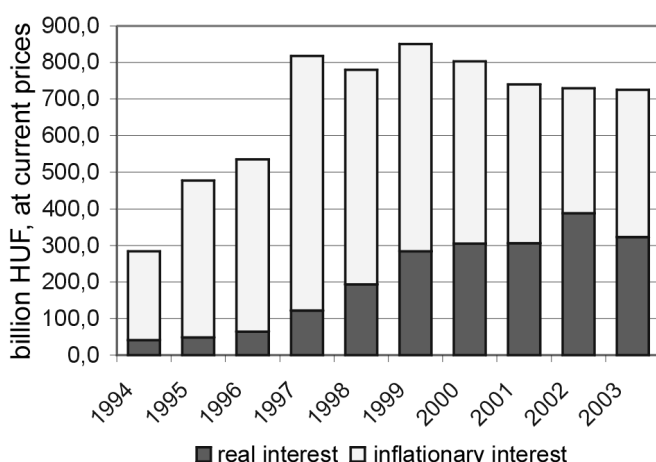
- (a) expanding anew the use of containers with deposit fees, instead of forcing them out of use,
- (b) diverting freight traffic from roads to railways in the case of long-distance transportation,
- (c) giving preference to public transport over individual transport
- (d) providing social allowances through less expensive local services and products

We will discuss these issues in detail later on; here we only wish to mention two points briefly:

Freight transportation on railways involves ten times less environment pollution than road transportation, and it is also much cheaper. Data of the Central Statistical Office of Hungary show that in 1997 railway freight transportation had an average freight charge of HUF 4.60 per one freight ton-kilometre within Hungary, while the same freight cost was HUF 15.10 for road transportation. Therefore the inflation-generating effects of a considerable increase of petroleum prices in the world market may also be alleviated by diverting a part of the freight transportation from roads to railways, because railways use ten times less energy for one freight ton-kilometre than road transportation. Furthermore, 75 per cent of the traction performance of railways is powered by electricity; therefore the impact of rising petroleum prices is thirty times less upon railways than upon road transportation. In addition, it would also be possible to save human lives through this restructuring: firstly because the probability of railway accidents is 33 times less than that of road accidents, and secondly because less congestion on the roads would result in even fewer accidents.

Prices of products in multi-way containers, of course, do not contain the direct costs of disposable packing materials either. As compared to disposable packaging, much less waste is produced, which also contributes to lowering the social costs. It is a further advantage that multi-way packaging is primarily used for Hungarian

Figure I.1.9.: Changes in the state budget's interest expenditures, broken down by inflationary interest and real interest



Source: Acts on State Budget Final Accounts, State Budget Act for 2001–2002, National Bank of Hungary, Central Statistical Office of Hungary

products; therefore consumption of such goods stimulates local production instead of imports.

One of the best examples to demonstrate how inflation is generated (multiplied) is the current Hungarian practice of “waste management”:

- Disposable packaging forced upon consumers is much more expensive than the multi-way packaging.
- Collecting the ever increasing amount of waste materials resulting from disposable packaging has much higher costs than the inflation, and this adds to the cost increase.
- Consumers are compelled to provide gratis most of the labour input needed for selective waste collection (input at the level of the society as a whole is not accounted for); in addition, other costs of these activities again will have to be paid in the end by consumers – in the form of some type of tax.
- Even if waste materials are processed and sold, this is usually a loss-making operation. Finally, these activities, too, will need to be subsidized by tax-paying consumers.
- A large part of the waste materials cannot be processed and resold, so in the final analysis the costs of waste deposition are also borne by consumers; what is more, possible subsidies granted to waste dumping may also be financed from taxes paid by consumers.
- Similarly, consumers are made to pay for the costs of maintaining the waste dumping sites – as well as for the costs of eliminating them in the future.

2. Chief aim of our proposals: environmentally- friendly and solidarity-based development of the Hungarian society

In the past decade, the majority of Hungarian citizens have been forced to abandon the illusion that the change of regime would lead to an improved welfare situation in Hungary. Differences in wage levels and living standards have been rising continuously right from the 1980s up until now. Although Hungary may gain on becoming a member of the EU, this will bring perceptible advantages only for one-third part of the society at most, if the current economic policy is continued. Within the European Union, too, economic policies of different member states ensure wellbeing and desired quality of life for the majority of citizens in a degree varying from one country to the other. Nevertheless, it is a fact that the reinforcement of solidarity and social cohesion is one of the main aspirations of the EU, and a pivotal part of its system of values. However, this can only be achieved in Hungary by Hungarian citizens. Since the change of regime, there have been some changes for the better: the entrepreneurial approach has become stronger, a considerable part of the population now has an increased sense of personal responsibility for their own fate, and advanced work ethics have gained ground in some areas of the economy. Nevertheless, the spirit of competition has intruded also into fields where it should not prevail. According to the Economic and Social Commission of the EU, in order to preserve the fundamental values of the European social model, we must not place all activities on a market basis, and sectors which traditionally provide social welfare type services must preserve their non-profit-making nature; rules of economic competition cannot be applied here (CES Info 06/2002, Brussels).

After World War II, Hungary has undergone a fundamental social transformation, which undoubtedly had many favourable elements as well. The social security system has become accessible to every citizen, standards of education improved, and in the working population the rate of employment was virtually hundred per cent. Following the change of regime, one and a half million Hungarian citizens have lost their jobs, public health indicators have shown a deteriorating standard, training has not kept pace with the needs of the labour market, and ever more and ever bigger holes appeared in the net of the social welfare system. Especially citizens with low qualification levels, pensioners and children

have become losers of the change of regime in large numbers. Hungary will only be able to attain an appropriate position within the EU if it spends increasing amounts of funds, in an efficient manner, upon education, training, healthcare and social security. All this should be clearly reflected by the annual state budgets as well.

Accordingly, Hungary's economic policy and state budget for 2003 should exert their influence through the specific focal points that follow. We are convinced that the conditions we describe in the following paragraphs would perceptibly promote the development of the Hungarian economy and society.

2.1. Reducing the costs of live labour

Reduction of live labour costs needs to be achieved not by cutting wages in real terms, but by modifying the structure of wage costs and by improving efficiency. This way, the national economy could gain a better competitive position both in the short and the long run. On the one hand, this can be attained through cutting the rate of social security contributions and personal income tax charged on wages. Revenues that drop out as a result can be replaced by imposing similar levels of taxes on products and services polluting the environment and wasting energy and materials. On the other hand, enhancement of labour quality, support to creativity and innovation, and better work organization may be the measures to contribute towards achieving the mentioned goal. The value produced by live labour is approximately ten times as much as the total amount of wage-type expenditures. International statistical data clearly demonstrate that capital is not primarily attracted by cheap labour, but by highly qualified workforce with solid work ethics, as well as by well-organized and predictable economic, legal and political conditions and a healthy physical environment.

Consequently, if we want to enhance the competitive position of live labour against raw materials, energy and highly capital-intensive production equipment, then we have to enforce a fairer taxation system as well as the "polluter pays" principle.

2.2. Increasing the share of live labour

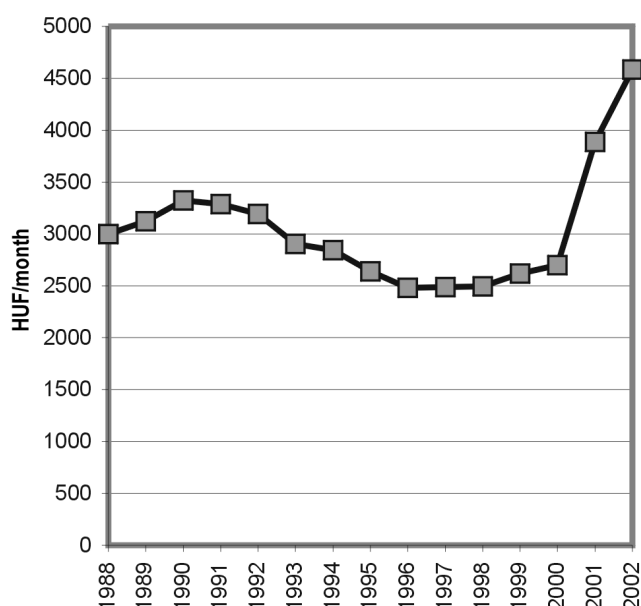
Live labour is the most competitive element of the Hungarian economy, its specific price being only one-seventh of the EU level. At the same time, production activities of high specific capital-intensity are less advantageous here, because the average capital costs in Hungary are higher than in the EU (interests and debt costs are high, foreign capital receives substantial state subsidies, etc.). The accession to the EU, however, makes it imperative to bring Hungarian wage levels closer to EU wages, with a view to ensuring stability. Furthermore, it is necessary to reduce the excessive gap between wages in Hungary, too; for this will strengthen cohesion within the Hungarian society, and one of the EU principles, solidarity, will be better put into effect. All these aims require that the real value of wages be gradually raised, which can be attained by implementing the state budget reform we propose. Higher wages would increase the GNI (Gross National Income) staying in Hungary, and would also improve the balance of payments (they would curb excessively high extra profits, and so the part which can be repatriated). It is to be stressed here that an adequate minimum wage is the fundamental prerequisite of the right to live a decent human life. Additionally, it is an efficient tool to ease social tension, and has favourable impacts on public safety and public health as well.

To obtain a clear picture of the situation, we have examined the development of the Hungarian minimum wage, both in nominal and in real terms, from 1988 to

2002. (For more details see Figure 1.2.2.) Actual data show that the purchasing power of the minimum wage has fallen to values reaching and going under the subsistence level after the change of regime. Between 1995 and 1998, for example, it deteriorated by 12.2 per cent in total. The minimum wage only started to rise substantially from 1999; then the government measures taken in 2001 and 2002 brought a real turn for the better, which resulted in a nearly 84 per cent increase in real value between 1999 and 2002. This is why we welcomed the step by the previous Hungarian Government to raise considerably the amount of the minimum wage, which, as a result, went up to HUF 50 thousand per month as of 2002. We also fully agree with the decision of the present Government to make the minimum wage exempt from taxes. This should be coupled with a reduction in the rate of the social security contribution. Favourable impacts would be multiplied in this manner.

Some financial specialists, with a rather narrow-minded approach, believe that the Government's measures to increase wage levels may endanger Hungary's financial equilibrium. In the long run, anyway, equilibrium can only be achieved by taking into consideration all factors: both the socio-economic and the environmental criteria. The share of live labour can only be raised if the labour supply is made up of a mentally and physically healthy, well-trained and well-educated workforce. Generations growing up in great poverty are a potential burden for the society of the future. "Poverty, either in an absolute or a relative sense, brings about a series of stress situations in families. The husband, under the pressure of financial problems, may start drinking. The wife, in addition to her direct worries about money, may have to suffer new stress effects caused by her husband's alcohol-related rudeness... Financial troubles in families may cause social and emotional problems in children's development... right up to such externalized symptoms as juvenile delinquency and drug consumption, or adolescent pregnancy." (Jenő Ranschburg: *Jellem és jellemtelenség /Character and lack of character/*, Saxum Publishers, Budapest, 2002)

Figure 1.2.2.: Changes in the real value of the minimum wage at 1988 prices



Source: Yearbooks of the Central Statistical Office of Hungary, State Budget Bills

2.3. Abolishing subsidies to environment-polluting and other harmful activities; incorporating external costs into the prices

State subsidies are in many fields indispensable to keep a society functioning properly: e.g. in healthcare, education, research and development, or even in the

case of public transport or disabled citizens. In these fields Hungary, due to its lower GDP, has increasingly dropped behind the practice of the EU. In some cases lack of organization and lower efficiency enlarge even more the gap between the standard of services in the EU and in Hungary.

However, all direct and indirect subsidies should be abolished immediately which finance seriously health-damaging and environment-polluting activities from public funds. This measure would comply with the principles of market economy and also with the expectations of the EU. (Owing to the lower wage costs, Hungarian enterprises can already today enjoy competitive advantages as against member states of the Union.) It is not advisable to continue with today's practice, referring to the alleged reason that Hungary will fall into a disadvantageous competitive position compared with other countries in the region if the subsidies are abolished. Defective price conditions, in fact, may lead to fixing the obsolete structures, making economic players grow lazy, neglecting continuous development and improvement of competitiveness.

Activities harmful to health and the environment place a huge burden on the Hungarian society. The part of the costs not borne by users or polluters is called external costs (externalities). These costs mostly hit the society as a whole and the next generations. It is therefore indispensable to incorporate all these external costs into the prices, preferably where they occur. Once these costs are included in the prices, economic efficiency and living conditions may be improved significantly in Hungary. At the same time these measures would cut back the profits harmful for the society, which are attainable today through polluting the environment.

2.4. Curbing the black economy

Black economy in Hungary is estimated to make up one-third part of the country's economic performance. In some areas of the economy, these activities contribute to alleviating temporarily the anomalies caused by distorted prices and excessive wage costs. Hungarian citizens with low incomes may acquire some products and services cheaper in this manner – primarily due to saving the VAT. Besides, in some labour-intensive branches a large part of the workforce is “employed” in the black sector of the economy. Even in these cases, black economy is detrimental for the society, because it makes employees unprotected, similarly to customers, who, not requiring proper invoices of the work performed, renounce their right to lodge complaints and to have a quality guarantee for the job. If wage costs are

reduced, as we propose, and employment indicators improve, black economy will automatically be forced back in these areas.

Other areas of the Hungarian black economy, however, operate on a much larger scale: fuel smuggling, benefits from unlawful handling of waste materials and from illegal waste deposition, etc. To control these activities, specific measures need to be taken, which, on the one hand, take away black revenues, and on the other, prevent revenues from being generated there.

2.5. Preparation for the EU membership

Effective preparation for Hungary's membership in the European Union – beyond measures having only propagandistic aims – needs to be started in areas and activities which are time-consuming (education, culture, healthcare, scientific research). It is not enough to harmonize the legal regulations; the content behind the legal form also needs to be adapted to EU requirements. On the other hand, during the negotiations with the EU, we always have to give priority to Hungary's interests.

At the turn of 2001 and 2002, financial conditions of the EU membership have fundamentally deteriorated for Hungary (and for the other candidate countries) as compared to the position hoped for up until that time. According to former concepts and preliminary calculations, in 2004 Hungary could already have reckoned with gross revenues of 1760 million Euros (2.2 per cent of the GDP) and with payment of 430 million Euros (0.55 per cent of the GDP), i.e. with a net EU transfer of 1330 million Euros. In contrast to that, under the fundamentally changed new conditions the already attained amount of EU transfer is taken into account as a strict criterion, starting from a “base” approach. This means that the sum of the current EU transfer will always be used as a starting basis in the calculations, which was 100 million Euros both in 2001 and 2002, and can at best amount to 140 million Euros in 2003. Consequently, the EU transfer can at most be raised to 200 million Euros in 2004. On the other hand, Hungary's contribution has a set rate: always 0.55 per cent of the GDP; so it would amount to 430 million Euros. Therefore **Hungary may become a net payer in the EU.**

In this new situation, even in the best possible case (i.e. if Hungary does not become a net payer) the country could only obtain about one-third part of the sum originally hoped for. Starting from this base, Hungary cannot expect but a very slow growth of the net EU transfer. It is to be highlighted that there is a realistic chance that Hungary becomes temporarily a net payer

in the EU. It is evident that our position has substantially deteriorated.

Considering the problems and goals of the European Union's long-term financial policy, especially the adverse impacts of the agrarian subsidies upon the EU as a whole (higher internal food prices, rising export subsidies to food industries, and in the final analysis, stimulation of an uneconomical overproduction), it is not a realistic expectation that regarding the agrarian subsidies any significant shift may take place that puts Hungary into a more favourable position. In this area, too, falling subsidy rates can be prognosticated. Hungary's only chance is to switch over a larger part of its agriculture to the production of organic food, and to provide greater state support and financial assistance to these activities.

2.6. Complex utilization of the possibilities related to environmental protection

In addition to improving the state of the environment in Hungary and the health of Hungarian citizens, the stimulation of activities contributing to environmental protection brings about other beneficial impacts, too:

- it may promote development of a state-of-the-art economic structure,
- it may protect domestic production causing less harm to the environment against import products damaging it,
- through preserving the country's biological diversity it will improve Hungary's competitive position compared to many EU member states.

Therefore it is necessary to use also state instruments for the promotion of activities contributing to environmental protection.

2.7. Global rearrangement of economic incentives to the detriment of environmental criteria

Since the second half of 2001, fundamental changes have started in the Hungarian economy, primarily in the external economy. These tendencies continued also in 2002, and their consequences will have a decisive influence in the years to come. The mentioned changes can be summarized as follows:

- a) Customs duties have been abolished on industrial products (with the exception of food products) from the EU and the associated countries.
- b) From May 2002, the former slow process of revaluating the Hungarian currency was followed by a radical revaluation. This was composed, on the one hand, of the difference between inflation rates in Hungary and the EU, and, on the other, of the Hungarian currency's nominal revaluation. The following data illustrate this: in April 2001 the HUF/EUR exchange rate was 266, and it fell to 238.6 by November 2002, which means that Hungarian companies producing foreign exchange revenues received by HUF 28.4 less for every Euro.

We have analyzed in a quantitative manner the impacts of these tendencies on the national economy in 2002 and partly also in 2003, on the basis of the actual data of foreign trade statistics up until now. Our conclusions can be summarized as follows:

- Regarding Hungarian product exports, the forint revaluation is expected to reduce the revenues of companies within the Hungarian customs boundaries by HUF 570 billion in 2002 alone.
- In export services involving foreign exchange revenues (taking into account the level of 2001, i.e. 8621 million Euros and a revaluation effect of 30 HUF/EUR), revenues are further reduced by some HUF 260 billion (mainly in tourism).
- On the side of product imports, apparent profits resulting from lower prices amount to HUF 814 billion. Some experts hold the opinion that the losses incurred on the export side will be paid back by the price gains realized on the import side. There are several reasons why this statement does not truthfully reflect the real situation and the actual balance of forces. *Firstly*, foreign companies exporting to the Hungarian market have, unfortunately, such superior economic strength and knowledge of the market, that they are capable of making the most of all the possibilities resulting from the revaluation of the Hungarian currency in order to increase their profits. *Secondly*, regarding the impacts of the forint revaluation on the Hungarian consumer prices, global figures show that only some 40 per cent of it materializes as a price reduction. Calculating roughly, this would formally imply a price reducing effect of HUF 326 billion, but it has to be taken into account here that part of the price reduction is made up by the external market price control of the domestic production: e.g. price of the petrol and diesel oil made of Hungarian petroleum is also reduced. Some other sectors of Hungarian production activities (e.g. meat industry) have in fact contributed more to the reduction of domestic prices. Having taken this into consideration, we may con-

clude that not only the remaining HUF 488 billion has disappeared (or stimulated the imports, and consequently increased the profit of the importers), but at least a further HUF 100 billion as well.

- Another serious problem resulting from the above is that swelling imports increasingly squeeze out Hungarian production, and thereby also the Hungarian workforce. For instance, the manufacturing of more environmentally friendly public transportation vehicles is gradually coming to an end in Hungary. (Budapest and Pécs, town in south-west Hungary, use more and more German-made buses to carry out public transportation; on the import of these buses, however, the Hungarian state budget has practically no revenues at all, while in the case of bus manufacturing in Hungary, the state collects personal income taxes, social security contributions, local taxes, etc.) It is a warning sign that at present the rise in the rate of employment can only be perceived within the margin of statistical error.

All in all, the above external economic impacts affect most adversely the Hungarian economy: domestic producers, in addition to the price losses incurred in the export markets, have to face, also in the Hungarian market, a competition of imports which has strengthened due to the revaluation of the forint. What is more, the price-reducing effect of the forint revaluation has not been fed back, and has not had practically any reducing impact on the costs of Hungarian producers, which could have improved their competitiveness.

To sum it up: taking as a basis a one-year period, the impact of the tendencies affecting adversely the Hungarian foreign exchange revenues amounted to approximately HUF 1300 billion, i.e. 7.8 per cent of the GDP.

After a more in-depth analysis of the above impacts, broken down by major areas, we can conclude, for in-

stance, that the **costs of motorization diminished** (because the goods belonging here are mostly imported), and their volume increased as a consequence. On the other hand, **public transport became more expensive** (the situation here was made even more difficult by the rise of Hungarian real wages, which had been long overdue). What is more, these two impacts of opposite direction have reinforced the unfavourable tendencies, almost doubling the adverse effect. (As a consequence, for instance, the volume of car sales increased by 23 per cent in 12 months.) From an environmental viewpoint, instead of the "polluter pays" principle, the practice of "polluters are rewarded, and environmentally friendly activities are penalized" has prevailed recently. This approach is likely to continue in 2003, and unfortunately even in 2004.

In a situation which has been rearranged to so great an extent, the **influence of the former environmental-type taxes has melted away**; what is more, environment-polluting activities have gained huge additional advantages owing to the heavy direct and indirect subsidies they receive. In the chapters that follow, we will demonstrate this in a quantified manner.

Traditional methods of protecting the domestic industries have a limited scope of applicability on account of several factors (WTO and EU requirements, inflationary effect); therefore it would be advisable to implement this task through an environmental-type transformation of the Hungarian system of taxation. This would be particularly desirable, because a taxation system can only be efficient if it follows shifting tendencies in income realization and profit-making.

Consequently, an environmentally-oriented tax reform, besides its other important social benefits, may have a favourable influence on the redistribution of international incomes from Hungary's point of view, and simultaneously, it may also improve markedly the state of the environment.

3. Balance of the Hungarian state budget

Before setting forth our specific proposals, we present the balance of the Hungarian state budget in the form as we elaborated it. Essentially, this budget form aims at showing and making comparable data pertaining to the period from 1994 to 2003 (see Table I.3.a-b.). We will present separately and more in detail the changes occurring in the budgetary expenditures of local governments (Table I.3.c.), in the state budget subsidies made payable

through the social security system (Table I.3.d.), in the budgetary expenditures of state budget agencies and connected institutions (Table I.3.e.), in pre-tax earnings and personal-type expenditures of the entrepreneurial sector (Table I.3.f.), as well as the incomes realized in each of the sectors (Table I.3.g.). In connection with the latter statement, we will compare the share of employees' incomes in the GDP in different countries (Table I.3.h.).

**Table I.3.a.: Balance of the state budget between 1994 and 2002
(million HUF, at current prices)**

REVENUES	1994 fact	1995 fact	1996 fact	1997 fact	1998 fact	1999 fact	2000 fact	2001 fact	2002 preliminary fact	2003 estimate
REVENUES FROM BUSINESS ORGANIZATIONS										
Corporate tax (excluding financial institutions)	75978	90991	110876	144716	199233	248763	273186	319447	364864	373800
Simplified venture tax										16000
Payments owing to special status (mining dues)	17741	31762	16743	16820	11554	11544	13723	13667	14668	16000
Customs and import duties	148796	247885	247171	159904	130582	140174	136566	122925	125731	145000
Revenues on state property	-1126									0
Gambling tax	4266	5301	9088	11867	14437	17382	27935	34293	38822	47764
Other revenues	12300	8901	15142	18711	21350	26280	16920	17745	22162	20010
Total:	257955	384840	399020	352018	377155	444143	468330	508077	566247	618574
TAXES CONNECTED TO CONSUMPTION										
Value-added tax	336371	423954	515080	674770	796921	941770	1153750	1243899	1304871	1587000
Consumption tax and excise duties	164271	200940	222116	267512	320602	463725	505942	539679	590501	640200
Total:	500642	624894	737196	942282	1117524	1405496	1659692	1783578	1895372	2227200
REVENUES FROM INDIVIDUALS										
Gross revenues from personal income tax	305000	383700	490666	536500	656624	769604	938000		1275000	1375909
Personal income tax due to the state budget	243478	290113	389392	424504	477534	578110	695722	830272	940566	970809
Other tax revenues	3526	3036	4080	4028	3256	4215	5012	5232	7114	7000
Revenues from duties	16394	20971	26191	32063	39663	43702	54422	60916	68518	74700
Total:	263398	314120	419663	460595	520453	626026	755156	896419	1016198	1052509
OTHER CENTRALIZED REVENUES								62610	68655	58760
Own revenues of state budget organizations	274328	243092	245860		339530	394505	481626	569682	580612	534442
Own revenues of support target programmes			49398		21008	141964	79523	15046	11910	2591
Own revenues of state budget investments					1036	1230	1565			1954
Total:	274328	243092	295258	0	361575	537699	562713	584728	592522	538987
PAYMENTS ORIGINATING FROM THE STATE BUDGET										
Payments by local governments	839	975	2891	2382	4150	4624	4584	4744	5457	5600
Revenues from separated state funds	5300	234	4700	5599	18910	9990	19817	47038	56426	49410
Revenues from international financial transactions	11604	3601	14957	45693						0
Contribution of Treasury		6387			10036	40387	30001	6721	6968	19657
Corporate tax of financial institutions	7548	12985	16038	19797	18061	13692	19536	32409	31692	42500
Revenues from the National Bank of Hungary	22900	2300	5210		49063	30628	20112	27732	23316	0
REVENUES RELATED TO DEBT SERVICE	62760	38156	44378	193455	123530	88237	108607	87781	78911	92436
International interest revenues	2149	3796	5600							0
Domestic interest revenues	1950	11670	94491							0
Other revenues	2316	3358	25545	17037	14216	12334	12992	9349	8670	9970
REVENUES NOT INCLUDING PRIVATIZATION RECEIPTS										
Privatization receipts	31000	150000	211880	160854	11970	9822	925			0
GRANDTOTAL REVENUES:	1449306	1811246	2285950	2525436	2636404	3237447	3681944	4073890	4365839	4741604
GRANDTOTAL EXPENDITURES:	1695487	1968376	2206508	2703051	3176594	3565177	3788276	4487769	5840489	5310575
BALANCE OF THE STATE BUDGET:	-246181	-157130	79442	-177615	-540190	-327730	-106332	-413879	-1474650	-568972
Balance without privatization receipts	-277181	-307130	-132438	-338469	-552159	-337552	-107257	-413879	-1474650	-568972
Balance without private pension					-520091	-266314	-327158		-405187	
GDP (billion HUF)	4365	5562	6655	8025	10088	11394	13151	14876	16750	18500
Grandtotal revenues as a percentage of GDP	33.20	32.56	34.35	31.47	26.14	28.41	28.00	27.38	26.06	25.63
Balance-deteriorating impact of private pension funds					-32068	-71238	219901		88700	130518

Source: Acts on the Implementation of State Budgets; Bill No. T/3122 for the State Budget of 2001–2002; Act LXII of 2002 on the State Budget of Hungary for 2003

**Table I.3.b.: Balance of the state budget between 1994 and 2002
(million HUF, at current prices)**

EXPENDITURES	1994 fact	1995 fact	1996 fact	1997 fact	1998 fact	1999 fact	2000 fact	2001 fact	2002 preliminary fact	2003 estimate
SUBSIDIES TO BUSINESS ORGANIZATIONS										
Individual and normative subsidies	37183	28310	41137	44892	59910	61525	69283	81618	98747	99850
Other subsidies	2295	1516	572	1100	242	348	401	215	274	300
Subsidies in total	39478	29826	41709	45992	60152	61874	69684	81833	99021	100150
Agro-economic subsidies										0
Market access subsidies	46732	47531	45079	38565	44404	61230	49549	32566	44629	43000
Agricultural production subsidies (including family subsidies)	14888	19073	27266	19132	30223	41012	47516	86882	75951	75470
Total agricultural subsidies	61620	66604	72345	57697	74628	102242	97065	119447	120580	118470
Subsidies to national public broadcasting					7839	12715	12562	13980	17639	42396
Total subsidies to business organizations	101098	96430	114054	103689	142618	176830	179311	215260	237240	261016
CONSUMER PRICE SUBSIDIES	27047	32505	44949	55235	66579	74842	82806	90907	99030	104000
HOUSING SUBSIDIES	29570	59853	51244	53208	42951	41136	49853	60421	72334	81571
GUARANTEE AND CONTRIBUTION TO SOCIAL SECURITY FUNDS					28100	103485	127503	220471	383899	265670
SOCIAL BENEFITS THROUGH SOCIAL SECURITY FUNDS										
Family allowances	144900	137892	132100	134300	162978	185625	207776	221322	254853	290500
Income supplements and subsidies	41156	45718	56909	69865	66746	72394	76855	91253	113824	119100
Allowances under various titles	23966	21312	24076	17000	16345	16890	18948	16460	20512	23400
Total	210022	204922	213085	221165	246069	274909	303579	329035	389189	433000
STATE BUDGET ORGANIZATIONS										
Expenditures covered by subsidies	351753	373205	416965	509318	685156	802879	1050003	1246439	1558486	1847749
Expenditures financed from own income	265376	239461	245102	399111	340566	394505	481626	569682	580612	534442
Expenditures in total	617129	612666	662067	908429	1025722	1197384	1531629	1816121	2139098	2382191
Expenditures subsidized by state support target programmes			16540		56951	86759	145401	258976	339483	166652
Expenditures financed from own revenues of state support target programmes			37764		21008	141964	79523			2591
Target programme subsidies in total			54304	0	77960	228723	224923	258976	339483	169243
Expenditures of state budget investments covered by subsidies	55533	48394	67201	94062	96834	108739	111726	134722	146193	75923
Expenditures of state budget investments financed from own revenues					1036	1230	1565			1954
Expenditures of state budget investments in total	55533	48394	67201	94062	97870	109970	113290	134722	146193	77877
State budget organizations in total	672662	661060	783572	1002491	1201552	1536077	1869842	2209819	2624774	2629311
SUBSIDIES TO CIVIL MOVEMENTS	2582	2704	4996	3394	2496	2866	2930	3001	3059	2659
SUBSIDIES TO LOCAL GOVERNMENTS	298624	320200	327014	348724	405653	448993	428817	508904	620622	726365
SUBSIDIES TO SEPARATED STATE FUNDS	37410	31674	4385	110		228	1132			2448
EXPENSES OF INTERNATIONAL FINANCIAL OBLIGATIONS	1623	28540	14703	36447	2283	1925	2287	2534	1605	2203
OTHER EXPENDITURES	3676	4102	4921	6113	6983	7878	7946	23282	17802	12141
GENERAL RESERVES	0	0	0							27100
PROVISIONS										11400
EXTRAORDINARY GOVERNMENT EXPENDITURES	4176	10978	18804	23353	235898	20730	186142	92926	286321	16482
CALLED STATE GUARANTEES	11263	5581		14087	7883	15429	6489	7251	3405	9650
Relations with the National Bank of Hungary			58100		7130	10110	4217			0
Assumption of liabilities and debts connected to debt service					6286				363250	
DEBT SERVICE INTEREST EXPENSES	295734	509827	566681	835035	774114	850329	796881	723958	737959	725559
GRANDTOTAL EXPENDITURES:	1695487	1968376	2206508	2703051	317659-4.1	356576-6.6	404973-4.2	448776-9.4	5840489	5310575-4
GDP (billion HUF)	4365	5562	6655	8025	10087.5	11393.5	13150.8	14876.4-2	16750	18500
Grandtotal expenditures as a percentage of GDP	38.8	35.4	33.2	33.7	31.5	31.3	30.8	30.2	34.9	28.7

Source: Acts on the Implementation of State Budgets; Bill No. T/3122 for the State Budget of 2001–2002; Act LXII of 2002 on the State Budget of Hungary for 2003

**Table I.3.c.: Changes in state budget expenditures on local governments
billion HUF**

Description	1994 fact	1995 fact	1996 fact	1997 fact	1998 fact	1999 preliminary fact	2000 estimate	2001 guiding figure
Total expenditures, at current prices	762.9	817.4	940.2	1189.4	1348.5	1379.8	1480.5	1504.6
Increment, as compared to previous year, %		1.07	1.15	1.27	1.13	1.02	1.07	1.02
Consumer price (previous year=100)		128.2	123.5	118.3	114.3	110	107	104.5
Arrears, as compared to previous year		0.21	9	-9	1	8	0	3
Expenditures at 1999 prices	1792	1497.7	1394.9	1495.4	1483.4	1379.8	1383.6	1439.8
Cutbacks (at 1999 prices, accumulated)	0	338.8	856.5	1317	1812.2	2262.4	2853.1	3574.6
Expenditures at 1994 prices	762.9	637.6	593.8	636.6	631.5	587.4	589	572.9
Cutbacks (at 1994 prices)		125.3	169.1	126.3	131.4	175.5	173.9	64.7
Cutbacks (at current prices, annually)		160.64	267.68	235.89	280.61	412.22	436.96	499.2
Interest on cutbacks*		24.3	81.3	130.4	169.6	186.8	195.1	254.8
Base of interest		184.9	533.8	900.1	1350.3	1949.3	2581.4	3335.3
Annual cutbacks from local governments (including interests)		184.9	349	366.3	450.2	599	632.1	753.9
GDP	4365	5614	6894	8541	10075	11565	12530	13890
Local government expenditures as a percentage of GDP	17.5%	14.6%	13.6%	13.9%	13.4%	11.9%	11.8%	10.8%

*Real-term rate of interest: 2 per cent (above the consumer price increase)

Source: State Budget Bill of the Republic of Hungary for 2000 (No. T/1658)

**Table I.3.d.: State budget subsidies through social security funds
(predominantly the family allowance)
billion HUF**

Description	1994 fact	1995 fact	1996 fact	1997 fact	1998 fact	1999 preliminary fact	2000 estimate	2001 guiding figure
Total expenditures, at current prices*	210	204.9	213.1	221.2	246.1	320	359.5	405.8
Increment, as compared to previous year, %		97.6	104	103.8	111.3	130	112.3	112.9
Consumer price (previous year=100)		128.2	123.5	118	114.3	110	107	104.5
Arrears, as compared to previous year		30.6	19.5	14.2	3	-20	-5.3	-8.4
Expenditures at 1999 prices	493.3	375.4	316.2	278.1	270.7	320	336	388.3
Cutbacks (at 1999 prices, accumulated)	0	135.6	363.4	657.3	980.7	1274.7	1525.7	1783.2
Expenditures at 1994 prices	210	159.8	134.6	118.4	115.2	136.2	143	154.5
Cutbacks (at 1994 prices)		50.2	75.4	91.6	94.8	73.8	67	5.3
Cutbacks (at current prices, annually)		64.3	119.4	171.1	202.3	173.3	168.3	145.8
Interest on cutbacks**		9.7	34.1	62.6	91.7	101	100.2	123.4
Base of interest		74	227.5	461.3	755.3	1029.6	1298.1	1567.3
Annual cutbacks from social welfare benefits (including interests)		74	153.5	233.8	294	274.3	268.5	269.2
GDP	4365	5614	6894	8541	10075	11565	12530	13890
Social welfare expenditures*** of the state budget as a percentage of the GDP	4.8%	3.6%	3.1%	2.6%	2.4%	2.8%	2.9%	2.9%

*As from 1999, including child allowance as well (in 1999 HUF 36.2 billion, in 2000 HUF 48.8 billion, in 2001 HUF 55 billion)

**Real-term rate of interest: 2 per cent (above the consumer price increase)

***Family allowances, social income supplements and subsidies

Source: State Budget Bill of the Republic of Hungary for 2000 (No. T/1658)

**Table I.3.e.: Changes in state budget expenditures
on state budget organizations and related institutions
billion HUF**

Description	1994 fact	1995 fact	1996 fact	1997 fact	1998 fact	1999 preliminary fact	2000 estimate	2001 guiding figure
Total expenditures, at current prices	617.1	619.1	722.6	908.4	1209.4	1472.4	1731.1	1844.8
Increment, as compared to previous year, %		100.3	116.7	125.7	133.1	121.7	117.6	106.6
Consumer price (previous year=100)		128.2	123.5	118	114.3	110	107	104.5
Arrears, as compared to previous year		27.9	6.8	-7.7	-18.8	-11.7	-10.6	-2.1
Expenditures at 1999 prices	1449.5	1134.4	1072.1	1142.1	1330.3	1472.4	1617.9	1765.4
Cutbacks (at 1999 prices, accumulated)	0	362.8	863.3	1336.1	1628.4	1894.2	1827.1	1708.4
Expenditures at 1994 prices	617.1	482.9	456.4	486.2	566.4	626.8	688.8	702.4
Cutbacks (at 1994 prices)		134.2	160.7	130.9	50.7	-9.7	-71.7	-219.5
Cutbacks (at current prices, annually)		172.02	254.44	244.5	108.37	-22.86	-180.09	-224
Interest on cutbacks*		26	82.9	131.5	157.4	139.9	108.4	99.9
Base of interest		198	535.4	911.4	1177.1	1294.2	1222.5	1098.4
Annual cutbacks from the state budget (including interests)		198	337.4	376	265.8	117	-71.7	-124.1
GDP	4365	5614	6894	8541	10075	11565	12530	13890
State budget expenditures on state budget organizations as a percentage of GDP	14.1%	11.0%	10.5%	10.6%	12.0%	12.7%	13.8%	13.3%

*Real-term rate of interest: 2 per cent (above the consumer price increase)

Source: State Budget Bill of the Republic of Hungary for 2000 (No. T/1658)

**Table I.3.f.: Changes in profits before taxation
and labour costs of enterprises
billion HUF**

Description	1994	1995	1996	1997*	1998	1999	2000
Changes in profit before taxation:							
Profit before taxation	105.4	195.5	391.7	877.3	936.8	1247.8	1601.9
Not including financial activities	35.1	128.1	288.5	782.4	1037.9	1158.1	1233.6
Financial activities	70.3	67.4	103.2	94.9	-101.1	89.8	368.3
Producer price (previous year=1)	1	1.289	1.218	1.204	1.113	1.051	1.116
Profit (at 1994 prices)	105.4	151.7	249.5	464.1	445.3	564.3	649.1
Profit change (at 1994 prices)	0.0	46.3	144.1	358.7	339.9	458.9	543.7
Profit (at 2000 prices)	260.1	374.3	615.7	1145.3	1098.8	1392.6	1601.9
Profit change (at 2000 prices)	0.0	114.2	355.6	885.2	838.7	1132.5	1341.8
Changes in labour expenditures:							
Labour expenditures (not including financial institutions)	1320.6	1525.9	1798.7	2128.9	2429	2760	3145.45
Consumer price (previous year=1)	1	1.282	1.235	1.183	1.143	1.1	1.098
Savings on wages (at 1994 prices)	0.0	130.4	184.5	181.1	183.1	145.6	101.0
Real wages (wage bill of 1994)	1320.6	1190.2	1136.1	1139.5	1137.5	1175.0	1219.6
Labour expenditures (at 2000 prices)	3406.0	3069.8	2930.1	2939.0	2933.7	3030.5	3145.5
Savings on wages (at 2000 prices)	0.0	-336.2	-475.9	-467.0	-472.3	-375.5	-260.6

*As from 1997, the structure of profit accounting has changed

Source: Yearbooks of the Central Statistical Office of Hungary, and Flash Reports of the Hungarian Tax and Financial Auditing Office

**Table I.3.g.: Changes in income as compared to GDP
(billion HUF)**

Description	1994	1995	1996	1997	1998	1999
Gross domestic product (at base price)	3720.4	4713.6	5842.5	7314.2	8628.4	9689.2
Employees' income*	2216.1	2635	3147.4	3838.9	4518	4915.9
of which:						
wages and earnings	1576.3	1905.1	2324	2824.4	3327.2	3691
social security contribution	639.8	729.9	823.4	1014.5	1190.8	1224.9
Employees' income as a percentage of GDP	59.57	55.90	53.87	52.49	52.36	50.74
of which:						
wages and earnings (%)	42.37	40.42	39.78	38.62	38.56	38.09
social security contribution (%)	17.20	15.48	14.09	13.87	13.80	12.64

Source: source: Yearbooks of the Central Statistical Office of Hungary

**Table I.3.h.: Employees' income as compared to GDP
in the European Union, USA and Japan
(per cent)**

European Union			USA	Japan
average	minimum	maximum		
60.5	54.4	66.3	65.9	67.1

Source: Yearbooks of the Central Statistical Office of Hungary; Employment in Europe, 1998; and European Commission 1999

II. Specific proposals to reform the Hungarian taxation and subsidization system

Introduction

“It is to be ensured that the Union’s environmental protection policy is implemented in an integrated manner, making use of all possible means and methods (...) with particular emphasis (...) on the analysis of benefits and costs, taking into account the necessity to incorporate environmental costs into the prices. (...) This requires, among others, that encouragement is given to the transformation of subsidies which have considerable adverse impacts on the environment and which are incompatible with sustainable development. To achieve that, it is necessary, among others, to determine as soon as possible the criteria that will allow keeping records of these subsidies with a view to gradually eliminating them. (...) Utilization of financial instruments is to be promoted, including environmental taxes and incentives at both community and national levels.”

*Resolution No. 1600/2002/EC
of the European Parliament and the Council of the European Union
on the Sixth Environmental Protection Action Programme*

Proposals elaborated by Clean Air Action Group for a comprehensive reform of the Hungarian taxation and subsidization systems do not aim at introducing new types of taxes and additional subsidies, but at changing currently existing structures. This means specifically that on the one hand we wish to ease the burden on live labour and reduce the costs borne by up-to-date and environmentally friendly Hungarian products and activities, and we recommend that budgetary revenues lost as a consequence should be replaced by raising the taxes imposed on gravely environment-polluting activities and on such foreign and domesticated goods. On the other hand we intend to cut back markedly all the subsidies that have an adverse impact on the Hungar-

ian society (and within that particularly on the environment and on human health). We seek a budget-wise neutral solution, i.e. if our proposals were implemented, the overall revenues of the Hungarian state budget would not grow, but would not diminish either, as compared to the original estimates.

When calculating the specific figures of our proposals in the present study, we have taken as a basis the Act on the State Budget of Hungary for 2003: i.e. we have shown how this year’s state budget would have looked like, had the Parliament adopted our proposals. We have done so because we believe that these data may constitute appropriate grounds for starting the green budget reform in 2004, if the needed political will is in place.

A.) Reduction of wage costs and increase of subsidies granted for social tasks that cannot be placed on a market basis

1. Reduction of labour costs

Reduction of the taxes and social security contributions charged upon live labour has been a key element of the programme of both the previous and the current Hungarian Government. We are glad to see that this concept has finally been accepted by government circles, too, and that steps have been taken to put it into practice. By presenting our proposals, we wish to provide support, among others, for the reinforcement of this favourable tendency.

One of the basic tasks of the state budget is to contribute to improving the competitiveness of Hungary's economy. This can be primarily achieved through raising the efficiency and the share of live labour, which in turn could be effectively stimulated by reducing the tax and social security contribution burden placed on live labour. At present this burden is extremely large. Payable personal income tax is deducted from the gross wage, and a health contribution of HUF 4500 and other contributions and fees totalling approximately 50 per cent are also charged on the gross wage (see Table II.1.).

Social allowance levels and the amount of the minimum wage have been practically the same for some time; therefore we have been keeping up our proposal that adequate difference should be created between these levels. This is why we supported the measures taken by the previous Hungarian Government to increase the minimum wage. (It is important to underline that the rise of the minimum wage to HUF 40 thousand as of 2001 was overcompensated at the level of the national economy by the 3 per cent reduction of the rate of social security contribution.) We support the current Government's decision to make the minimum wage exempt from taxes. We have kept proposing for years a programme for the reduction of labour costs, which is now affirmed by the plan of the Medgyessy Government to lower the rates of the personal income tax in two phases: cautiously as from 2003, then radically as from 2004. The rates of the social security contributions are planned to be cut back by 1.5 to 2 percentage points in the next two years. It

is to be noted that in the European Union the difference between minimum wage and average wage is smaller than in Hungary, therefore the aforementioned measures will also assist Hungary's adaptation to the EU through the moderation of social differences. This, however, can only be achieved by decreasing the gross costs of wages. Simultaneously with the reduction of social security contributions (which make up a substantial part of the total wage costs) and of personal income taxes, part of the lost budgetary revenues should be replaced from other sources.

We would like to emphasize here that the burden on live labour has to be alleviated in the aggregate. Accordingly, it is important that measures such as the justified extension of the scope of taxes and social security contributions do not neutralize the impacts of steps lessening the total volume of labour costs.

Reduced wage burdens also make it possible to strengthen to some extent the public sector without increasing the expenditures of the state budget. With a view to the EU accession, too, Hungary has to reinforce its public sector. In Hungary 785 thousand employees work in the public sector, which only accounts for less than 19 per cent of the total number of employed, whereas in Western European countries this proportion is 20 to 25 per cent – and they have a significantly higher total employment rate than Hungary. If this employment level drops further, it may have the consequence that the Hungarian public sector will not be able to fulfil its fundamental tasks, especially in the fields of environment protection and healthcare. (For instance, in order to meet EU requirements in the performance of their tasks, regional environment and nature protection agencies should augment their staff numbers by 1600.)

Part of the needed extra wages in the public sector can be produced by strengthening the service-providing character of the sector. For example, in customs clearance the staff should be given wages corresponding to the EU level, and all these expenditures should be charged to the imported goods as customs clearance fees.

Table II.1.: Changes in the proportions of wages and public charges as a function of wage increase in 2002

Employer's costs HUF/month	Contribution to vocational training 1.5%	Employer's contribution on 3%	Social security contribution 29%	Health contribution 4500 HUF/month	Gross wage HUF/month	Pension contribution 8%	Health insurance contribution 3%	Employee's contribution 1.5%	Personal income tax	Net wage HUF/month	Net wage as a percentage of gross wage	Net wage as a percentage of wage costs	State budget burden upon 1 HUF net wage	Employer's costs, under conditions of 1998	Change of employer's costs
71250	750	1500	14500	4500	50000	4000	1500	750	6000	37750	75.50	52.98	1.89	74752	3502
138000	1500	3000	29000	4500	100000	8000	3000	1500	20000	67500	67.50	48.91	2.04	147002	9002
204750	2250	4500	43500	4500	150000	12000	4500	2250	42000	89250	59.50	43.59	2.29	219252	14502
271500	3000	6000	58000	4500	200000	16000	6000	3000	61052	113948	56.97	41.97	2.38	291502	20002
338250	3750	7500	72500	4500	250000	20000	7500	3750	76844	141906	56.76	41.95	2.38	363752	25502

Note: As a consequence of declaring the HUF 50,000 minimum wage exempted from taxes in September 2002, net earnings of HUF 37,750 changed to HUF 43,750.

All employees earning less than HUF 128,000 per month are entitled for the tax allowance.

Personal income tax rates are being reduced in two stages: from 2003 slightly, then from 2004 radically.

Social security contribution rates are planned to be decreased by 1.5 to 2 percentage points in 2003–2004.

Source: Hungarian tax laws

1.1. Reduction of social security contribution

High levels of social security contributions are among key factors causing strong adverse effects on the Hungarian employment rate and competitiveness. Reduction of the social security contribution already formed part of the previous Hungarian Government's programme, and under that scheme a significant cut-back was effectively implemented. We were glad to read that the documents of the current Government (they projected a decrease of 1.5 to 2 percentage points for the social security contribution rates, which they plan to start implementing as from 2004) contain the very same argument that we have been stressing in our budget proposals since 1992: namely, that lower social security burdens contribute to alleviating unemployment and to raising the employment level.

Social security contribution payable by employers decreased from 39 per cent in 1999 to 33 per cent in 2000, which (calculating also with the relatively small cost increase due to higher health contribution) resulted in an overall drop in the level of wage costs by HUF 210 billion in 2000. In 2001, social security contribution to be paid by employers was further cut down to 30 per cent, and in 2002 to 29 per cent.

A significant rise in the total number of employed workforce may open up the opportunity to reduce further social costs to be borne by one active earner.

In case our proposals are implemented, the rate of the social security contribution may be reduced by a few percentage points.

1.2. Reduction of personal income tax

Taking into account inflation and the number of active earners, Hungarian laws pertaining to personal income tax should be modified in a manner that on the average the per capita income tax becomes lower in real terms. Within that, we attach particular importance to increasing the tax allowances applicable according to the number of children or other dependants in a family, which was included in the State Budget Acts for 1999 and 2000, as well as in those for 2001 and 2002. All in all, higher rates of tax allowances will lead to lower personal income tax levels for those concerned. These tax allowances are one of the possible solutions to achieve our aims; therefore we think that it is advisable to keep using them in the future, too.

In our view the Court of Constitution of Germany passed an exemplary resolution declaring it a constitutional right to obtain tax exemption for all the costs of bringing up and educating children. We think that Hungary should follow the same path.

Moreover, we recommend that the tax allowance should be extended to specified expenses for educational purposes: payments to funds supporting compulsory education should be deductible from the personal income tax even if the payment is made by individuals who are personally concerned (e.g. close relations).

During the term of the previous two governments, however, the increase of the family allowance has been much lower than what would have been necessary and feasible – *see Section 2.2*.

We welcome the current Hungarian Government's plan to cut further back the rate of personal income tax in 2003 and 2004. At present we do not propose a larger decrease, because we intend to alleviate wage burdens by reducing the social security contribution (*see the previous Section*).

2. Increasing state contribution to activities indispensable for the Hungarian society and its development but practically unfeasible under pure market conditions

2.1. Increasing state contribution to cultural activities, education, healthcare and scientific research

With a view to accelerating Hungary's advancement and improving the quality of life of Hungarian citizens, we recommend that expenditures on cultural activities, education, healthcare and scientific research should be increased by HUF 300 billion. We are going to set forth in detail our reasons in the sections that follow.

2.1.1. Education and culture

“(1) The Republic of Hungary ensures for its citizens the right for education.

(2) The Republic of Hungary enforces this right through the propagation and extension of general education, through free and compulsory primary school education, through secondary and higher education which are accessible to every citizen according to their faculties, and through financial support granted to those receiving education.”

Art.70/F of the Constitution of the Republic of Hungary

Clean Air Action Group fully agrees with the following statement of the Government's Economic Policy Programme: “The Government attaches topmost importance to the comprehensive and systematic development of education and training, which strengthens competitiveness, builds up equality of chances and lessens regional differences.”

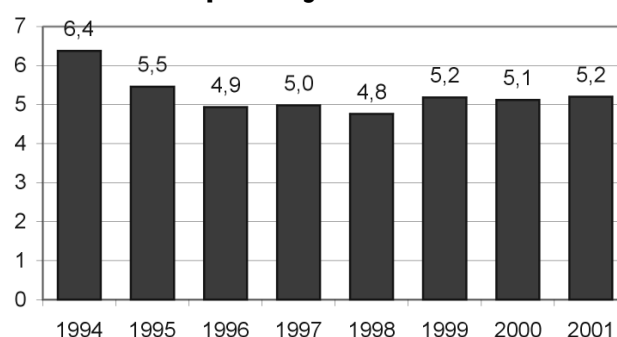
It has already become an oft-repeated commonplace that the standard of a country's life and economy depends on the “multitude of its highly educated citizens”, i.e. on the level of education and culture. Countries achieving outstanding economic performance have devoted, almost without exception, extremely great attention and substantial funds to raising the standard of education as high as possible.

In Hungary, similarly to the healthcare system, education is one of the losers of the change of regime. The austerity measures of the so-called Bokros package inflicted a huge additional blow on this sector, which is demonstrated in *Figure II.2.1.1.a.* The state budgets for 2001 and 2002 have abandoned the characteristic practice of the previous years, namely the curtailments in relation to base values, but still have not increased adequately the expenditures to be spent on the human sector. This is why we have welcomed the current Government's step to raise by 50 per cent the wages of employees working in the public education sector as of September 2002.

Today, however, this is already far from being enough. The so-called PISA Report, which summarizes the findings of an international survey assessing the knowledge level in 31 OECD countries, has revealed that the performance of Hungarian pupils was appalling. Education in Hungary is undergoing a crisis right in its key area: Hungarian children cannot read well. This means that they have serious problems in understanding the texts they read – which is the indispensable foundation for any efficient learning later on. The report shows a serious decline in the knowledge level in mathematics and science, where Hungarian students had formerly achieved great international successes (see *Figures II.2.1.1.b. and c.*).

These results are presumably closely related also to the fact that the living and working conditions of teach-

Figure II.2.1.1.a.: Public education expenditures as a percentage of GDP



Source: Central Statistical Office of Hungary, Ecostat; Hungarian News Agency

Figure II.2.1.1.b.: Mathematics performance level of students from countries participating in the PISA 2000 Survey, as compared to international average



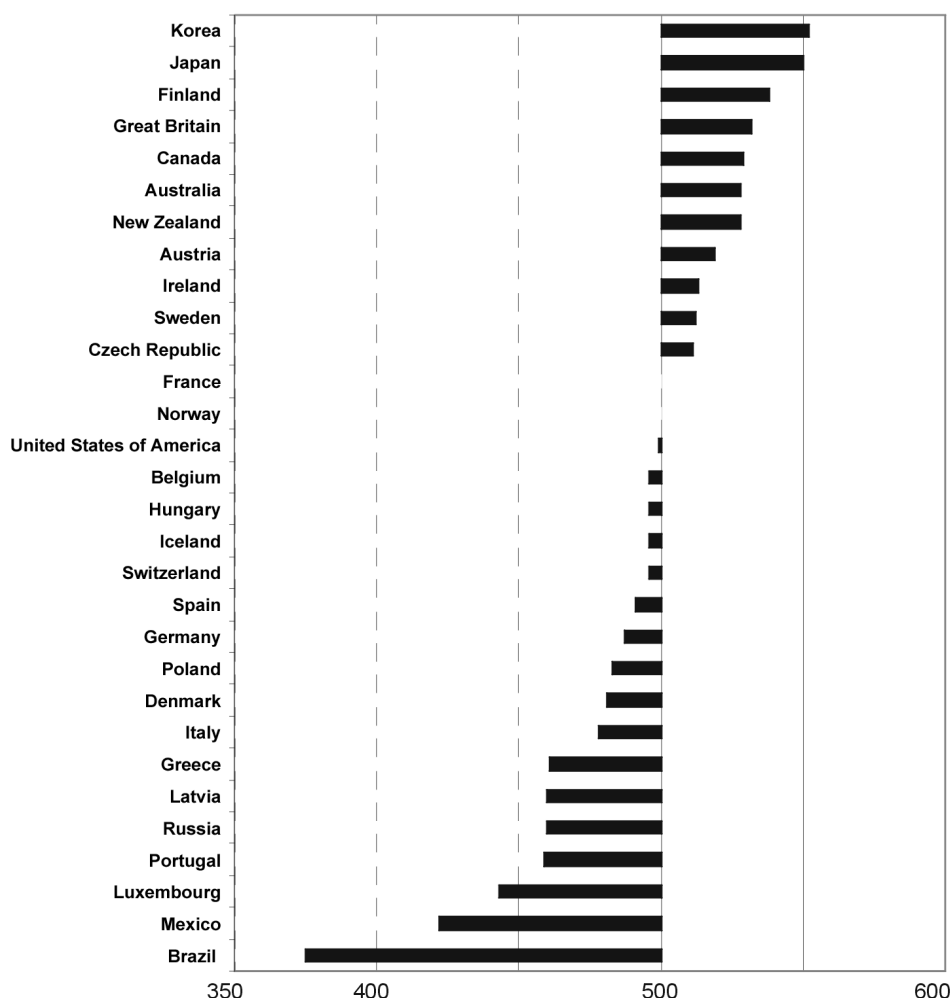
Source: www.pisa.oecd

ers and workers of cultural institutions and public collections have been subjected to the most severe deterioration among professional groups in recent years. It is not possible to set right what had already happened, but by providing increased additional support, repeated occurrence of such serious losses can be avoided and the situation can gradually be improved.

“Only 11 per cent of all primary and secondary schools meet the hygienic requirements, and more than 1000 schools have conditions which pose explicit risks of accidents. During a recent survey, the National Public Health and Medical Officer’s Service has found in every fifth Hungarian school building some sort of condition which involves risks of causing accidents. In some cases there are tiles falling from the roof, in other buildings the coat of plaster is coming off the facade and the stairs are broken. They have also found school buildings that are sinking, or have sopping wet walls posing direct danger of electric shocks. Seventy per cent of the doors and windows are decayed in the buildings. The survey qualified only 35 per cent of all Hungarian school buildings as being in proper technical state; the

others are in urgent need of repair or renovation, or, in the worst cases, of both. The water and sewer system is obsolete in 40 per cent of the educational institutions. Distracting environmental conditions (primarily noise and air pollution) are more difficult to be remedied – work is hindered by such circumstances in every fifth school (22 per cent). Twenty-one per cent of the buildings are not regularly cleaned, and the hygienic standard of toilets and showers is seriously objectionable in 29 per cent of the schools. The survey has also revealed that in half of the secondary school buildings (49 per cent) there is at least one class where student number is above the upper limit allowed by the Act on Public Education; even the teachers themselves think that 35 per cent of the buildings are overcrowded. Lighting in the class-rooms is often not satisfactory, despite the obvious detrimental effect on the eyesight of pupils. One third part of Hungarian schools has such problems, and in 10 per cent of all school buildings there is at least one class-room where neither the artificial nor the natural light is adequate. In some 700 schools the windows were constructed by such design that ventilation is prob-

Figure II.2.1.1.c.: Natural science performance level of students from countries participating in the PISA 2000 Survey, as compared to international average



Source: www.pisa.oecd.org

lematic, and in nearly 160 schools the desks are of a size which damages students' health." (Published in the Hungarian daily "Magyar Hírlap", 12th August 2002.)

Hungary needs a workforce which is highly qualified, open-minded, versatile and healthy. Only such workforce can be employed in adequate numbers in an advanced economy heading towards the European Union. This is demonstrated by the Hungarian labour situation: the overwhelming majority of the unemployed lack any qualification or have only a low-level qualification. Unfortunately Hungary does not have a genuine labour programme to provide for the training and employment of the large number of passive (officially not registered) unemployed. This deficiency should be remedied urgently; at the same time it is advisable to adapt training to the needs of the demand.

When highly-qualified workforce is unemployed, it means structural unemployment, either in Hungary or in the advanced countries, i.e. these people are only temporarily out of employment, because they are fit for retraining, so they do not remain jobless for a long time.

On the other hand, finding employment for a workforce with inadequate qualification and poor health is hopeless even in the long run. Consequently, if less expenditure is devoted to education, culture, social welfare services, healthcare and – also in connection with the latter – to environmental protection, then Hungary will have an increasing shortage of labour force capable to promote economic progress; parallel with that the number of (mostly passive) unemployed will further increase, placing a large burden on the state budget and on the entire society.

Only a highly qualified workforce can produce goods of above-the-average technical standard, prices of which have been growing steadily in the international markets recently. The European Union has plans to create 12 million new jobs in the next five years, and to lower markedly the level of average unemployment. Within that, they wish to reduce by half the current number of jobless young people. This programme can only temporarily be retarded by the recent slow-down of economic growth.

In preparation for a knowledge-based information society, more funds should be allocated for the education.

Spending more on education, culture, scientific research, social welfare, healthcare and environment protection, however, does not only entail the above-mentioned long-term advantages, but it will also result in immediate direct economic benefits. On the one hand, a large part of these expenditures will soon return to the state budget through taxes. On the other, spending these sums will create a substantial demand partly directly (e.g. new orders in the industrial sector, in building and construction and in services), and partly through wages. Special emphasis should be laid on intensifying the state subsidization of R&D activities, because this could become the driving force of a competitive economy.

Therefore "economizing" in the mentioned sectors will reduce demand, which in turn will bring about a fall in production levels for the concerned enterprises, and as a result less tax will be paid into the state budget. In the final analysis, this means that budgetary revenues may even drop by more than the amount of expenditures they originally wanted to save through the restriction.

It is important to note that the majority of workers laid off from the budgetary institutions cannot find new jobs in the competitive sector; consequently they will only add to the number of unemployed. On the whole, state expenditures will not diminish, but Hungary's most important resource, its labour force, will be increasingly wasted, and parallel with that, social tensions will also be aggravated.

General education institutions and public collections form an organic part of the basic cultural services. Act CXL of 1997 on Culture places the ultimate responsibility for those services on the central and local governments. In practice, however, local governments lack the financial resources to fully complete their compulsory tasks, therefore in recent years the situation has become extremely difficult for such public institutions and for their small and underpaid staff of culture-mediating professionals and assistants. This is something that should be changed radically. To do so, the current 60 per cent rate of normative state budget contribution to public education and related services needs to be raised to 80 per cent. This short-term increase in the budget expenses would be more than offset by the development of local-government-run institutions, civil movements and everyday cultural standards in the long run. This would help bringing up innovative citizens with a broader knowledge range, who are capable not only to adjust to the ever-changing circumstances but also to bring about and define the direction of that change, from which the entire Hungarian society would benefit.

As social security contributions are reduced, more funds will be available to promote culture and education. Additional sources can be made accessible through funds being released in other areas of the state budget. This is part of a process which would bring both the prices and the wages closer to the EU average.

Financial situation of the education should be further improved by making payments to funds supporting compulsory education deductible from personal income tax even when the payments are made by personally interested individuals (e.g. a close relative).

The Hungarian state budget for 2003 devotes more funds to culture and education, a considerable part of which has been used for raising the low wages.

2.1.2. Healthcare

"(1) All people living in the territory of the Republic of Hungary have the right to enjoy physical and mental health at the highest possible standards.

(2) The Republic of Hungary enforces this right by organizing the system of labour safety, of healthcare institutions and of medical services, by ensuring possibilities for regular physical exercise and by protecting the built and natural environment."

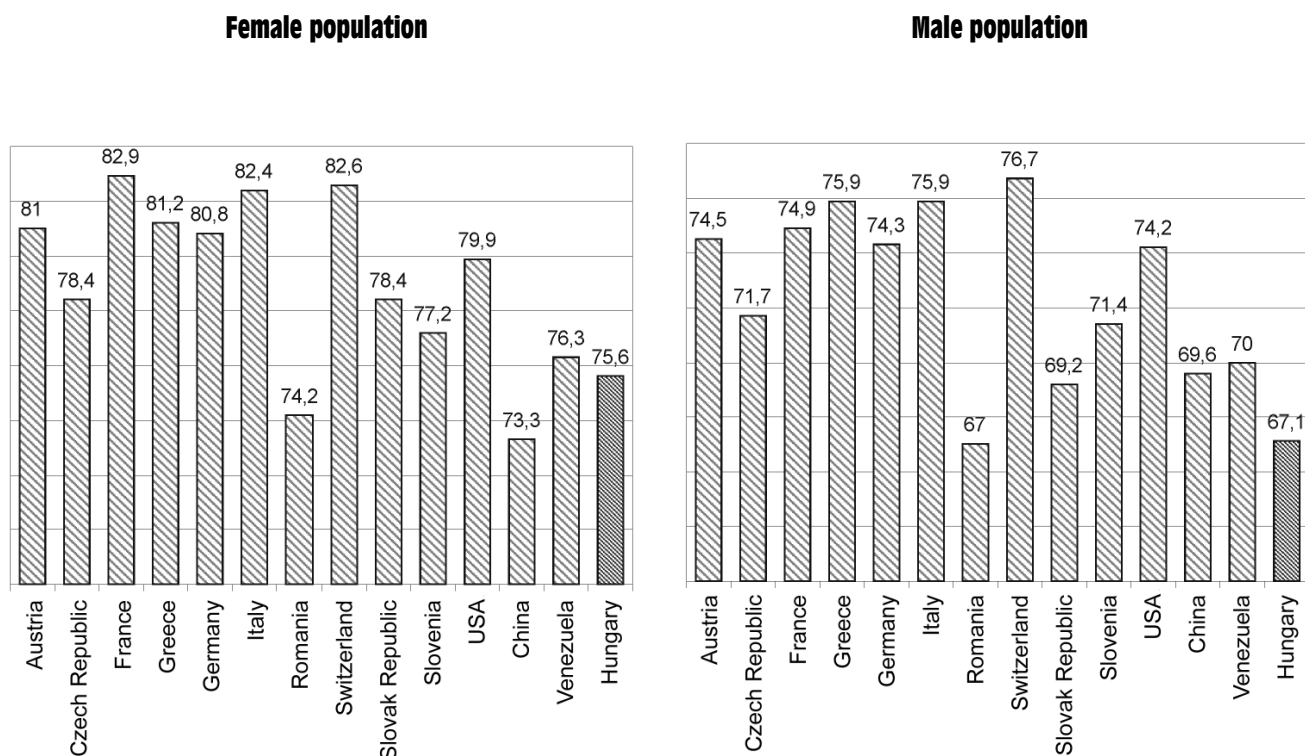
*Art. 70/D of the Constitution
of the Republic of Hungary*

One of the most important indicators of a country's health standard, the average life expectancy at birth, is extremely low in Hungary in international comparison. In each EU member state the population's average life expectancy significantly surpasses the Hungarian value, but also the CEFTA countries of the first round have better indicators (see Figure II.2.1.2.a.). Although in the countries included in the figure the average life expectancy at birth is higher than in Hungary, this value has nevertheless grown much more in the past decade than the Hungarian indicator (primarily thanks to the advancement of medical sciences). So, as a consequence of its lagging behind, Hungary has experienced an additional relative diminution of life expectancy. It should be an alarming reminder for us that around the middle of the 1990s, life expectancy at birth for Hungarian men was by 8 years lower and for Hungarian women by 5.5 years lower than in the neighbouring Austria. It has to be stressed that the shortening male life expectancy figure came from the average of statistical data which primarily reflect the impact of men's mortality in the most fertile age group.

Rates of occurrence of some diseases have shown dramatic deterioration in the last few years (see Figures II.2.1.2.b. and c.).

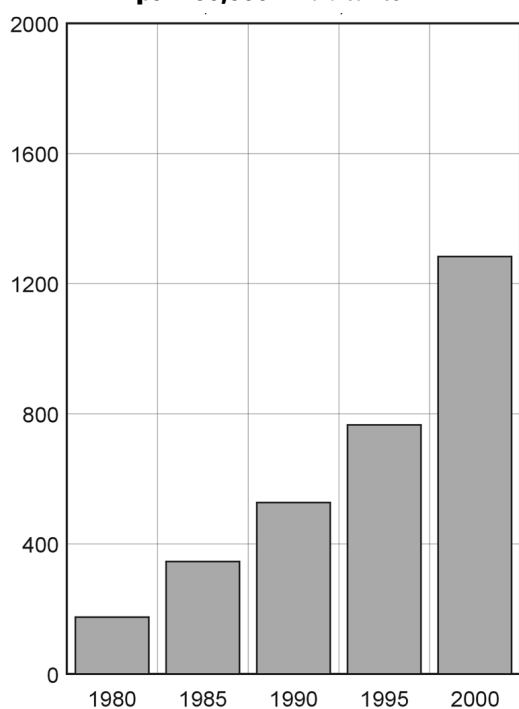
Consequently, the health standard of the Hungarian population is relatively lower; therefore cutbacks in

**Figure II.2.1.2.a.: Average life expectancy at birth
in some selected countries of the world
(years)**



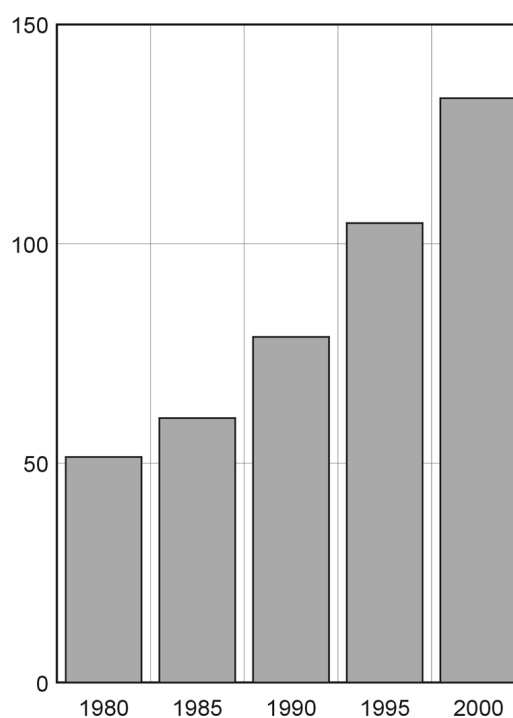
Source: Statistical Yearbook of Hungary, 2001

**Figure II.2.1.2.b.: Changes in the number of registered
bronchial asthma patients in Hungary
between 1980 and 2000
(per 100,000 inhabitants)**



Source: Hungarian National TBC and Pulmonology Institute

**Figure II.2.1.2.c.: Changes in the number of registered
lung cancer patients in Hungary between 1980 and 2000
(per 100,000 inhabitants)**



Source: Hungarian National TBC and Pulmonology Institute

healthcare expenditures will cause more damage than in other countries. On the other hand, if expenditures are increased in real terms, the situation may improve to a greater degree.

Only healthy individuals can build up a healthy society and a healthy economy. Therefore we cannot but agree with and support the following statement of the Hungarian Government's Economic Policy Programme: "The Government wishes to pay special attention to the stabilization and modernization of the healthcare sector, to the elimination of inequalities now existing in the accessibility of services and to the alleviation of the population's health problems."

We welcome that Act XXIII of 2002, also modifying the state budget expenditures, raised healthcare expenditures in 2002 by HUF 104.5 billion in total, as compared to the original estimates. This means a rise of 7 per cent in real terms. So the current Government has now affirmed what we have been claiming and advocating for many years, i.e. that the Hungarian healthcare system is largely underfinanced and that this situation must be changed. However, this cannot be regarded as the final solution – only as the first step. The ministry responsible for the healthcare system claims that in order to attain an acceptable health service standard, additional financial resources worth HUF 300 billion per annum are needed in the next few years.

In each member state of the EU, healthcare expenditures represent a higher proportion within the GDP – and these countries have a much higher GDP than Hungary (see Table II.2.1.2.a.).

It may come as a surprise that in almost every EU country (exceptions being only Greece and Portugal), within total expenditures spent on healthcare, the proportion of state expenditures is much higher than in Hungary. This shows that as regards the healthcare sector, liberalism does not prevail within the EU: human lives take priority over the monetary approach.

Between 1990 and 1997, funds devoted to healthcare services decreased by 50 per cent in real terms. Table

II.2.1.2.b. shows that expenditures of the Health Insurance Fund had been sinking steadily since 1994 (from HUF 1123 billion calculated at 2001 prices) until 1998, when they touched bottom with a value of HUF 834 billion. Since that time there has been a very slow rise in the expenditures, but their current level is still far below the level of 1994. Share of these expenditures in relation to the GDP shows an even greater gap: from the 9.1 per cent in 1994 it went down to 6.3 per cent in 1998, then to 6.1 per cent in 2002. The budget estimate for 2003, expressed in percentage of the GDP, shows already an increasing proportion of 6.8 per cent, but a large part of the increment is made up by wage settlement in the healthcare sector. Findings of a worldwide health assessment by the World Health Organization (WHO), published in "World Health Report 2000", show that among the 191 countries surveyed, Hungary is in the 105th position regarding the quality of healthcare services and the population's health standard. This means that Hungary is left behind not only by all Central European countries, but also by Iraq, the Ukraine and Bangladesh. At the same time the study describes international experience which proves that it is possible to achieve considerable progress in a fairly short period of time by developing the healthcare service system. This is why we urge a substantial rise in healthcare expenditures.

Within the healthcare sector, we attach special importance to prevention, which today receives far too little attention and only almost negligible financial resources. It would be much easier and cheaper though to prevent and avoid illnesses and diseases than to treat and cure people who have already fallen ill and have lost their capability to work.

2.1.3. Scientific research and development

Another commonplace to say is that the development of the Hungarian society essentially depends on scientific research and development (R&D) activities. This is now affirmed also by the Hungarian Government's Eco-

Table II.2.1.2.a.: Healthcare expenditures in selected countries

Country	Healthcare expenditures as a percentage of GDP in 1997	Expenditures on healthcare USD/person (PPS*)	State expenditures as a percentage of all healthcare expenditures
Hungary	6.5	642	69.1
Austria	8.3	1905	73.0
Belgium	7.6	1768	87.6
Germany	10.7	2364	77.1
Italy	7.6	1321	69.9
Czech Republic	7.2	943	91.7

*purchasing power parity

Source: International Statistical Yearbook, Central Statistical Office of Hungary, 2001

**Table II.2.1.2.b.: Expenditures of the Health Insurance Fund
(billion HUF, at current prices)**

Description	1994 fact	1995 fact	1996 fact	1997 fact	1998 fact	1999 fact	2000 fact	2001 fact	2002 preliminary fact	2003 preliminary data
Total expenditures*	397.8	445.1	509.0	554.0	632.2	701.2	797.7	914.9	1019.5	1266.0
Increment (previous year=100)		111.9	114.4	108.8	114.1	110.9	113.8	114.7	111.4	124.2
Consumer price (%)*		128.2	123.5	118.3	114.3	110.0	109.8	109.2	105.3	105.0
Arrears (% , compared to the previous year)			-16.3	-9.1	-9.5	-0.2	0.9	4.0	5.5	6.1
Change as compared to the previous year (at 2001 prices)			-159.9	-83.0	-79.0	-1.5	7.7	34.5	36.2	56.0
Accumulated cutbacks (not including interests)			-159.9	-242.9	-321.9	-323.4	7.7	42.2	78.4	126.8
Funds needed to eliminate the arrearage			142.9	215.4	288.0	289.4	282.4	252.1	208.3	155.0
Expenditures (at 2001 prices)	1123.- 2	980.3	907.8	835.2	833.8	840.8	871.1	914.9	968.2	1145.1
Cutbacks (accumulated, at 2001 prices)		164.5	441.4	827.6	1245.1	1660.0	2064.0	2418.4	2860.8	3138.5
Expenditures (at 1994 prices)	397.8	347.2	321.5	295.8	295.3	297.8	308.5	324.0	342.9	405.5
Cutbacks (at 1994 prices)		50.6	76.3	102.0	102.5	100.0	89.3	73.8	54.9	-7.7
Cutbacks (at current prices, annually)			64.9	120.8	191.1	219.4	235.6	230.9	208.3	303.9
Interest on cutbacks**		9.8	34.4	65.1	97.1	110.5	139.1	146.1	162.0	168.0
Base of interest of the above-listed amounts		74.7	229.9	486.1	802.7	1148.7	1518.7	1873.1	2338.9	2630.5
Annual cutbacks from the Health Insurance Fund (including interests)			74.7	155.3	256.2	316.6	346.0	370.0	354.4	465.9
GDP	4365	5614	6894	8541	10087	11394	13151	14876	16825	18600
Expenditures of the Health Insurance Fund as a percentage of GDP	9.1	7.9	7.4	6.5	6.3	6.1	6.4	6.2	6.1	6.8

*In the main commodity group concerning the Health Insurance Fund, prices have increased more dynamically (e.g. pharmaceuticals by 53.5 per cent in 1995)

**Nominal interest rate: (rate of consumer price increase + 2 % interest)

Source: State Budget Bill of the Republic of Hungary for 2001 and 2002 (No. T/3122); and Act CXXXIII of 2000

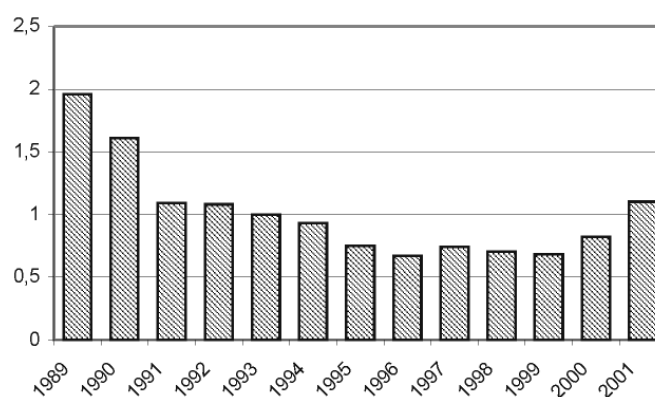
conomic Policy Programme: "Research and development, as well as technological policies are key instruments for the enhancement of economic competitiveness and the development of human resources." Despite that, the real value of Hungarian R&D expenditures went down by 64 per cent between 1990 and 1996. Since that time their level has slightly increased, but it is still lower than it was even in 1990 (*Figure II.2.1.3.*). At present the per capita R&D expenditures are just slightly higher than one fifth to one sixth part of the average in advanced industrial countries. The fall was even greater in real terms, because after 1989 the GDP declined markedly, reaching only in 2000 the level it showed 11 years before.

Another important specific qualitative indicator of R&D is the number of scientific researchers per 10 thousand inhabitants, which is in Hungary only one third to one fifth part of similar indicators in developed countries (see *Table II.2.1.3.a.*).

Also the Hungarian Government came to acknowledge that R&D activities may become one of the key driving forces for the development of the Hungarian society in the future, therefore it plans to increase the amounts to be spent on these activities. *Table II.2.1.3.b.* shows details of the actual data of state budget support granted to R&D activities in 2000, as well as of the estimates for 2001 and 2002.

The Hungarian pharmaceutical industry plays an outstanding role in keeping the social insurance system in operation. As proved by *Table II.13.c.*, the medicine subsidization allocation has been substantially underplanned every year in the past 10-year period. For instance, the 2002 budget estimate of the Health Insurance Fund included medicine subsidization in the value of HUF 153 billion, whereas the preliminary actual data was HUF 209 billion. This trend continues in 2003 as well. It will only be possible not to exceed the allocated amount if among

**Figure II.2.1.3.: R&D expenditures in Hungary
(as a percentage of GDP)**



Source: Central Statistical Office of Hungary

different medicines of the same effect, the one with the lower price will be subsidized as a rule. (These are mostly Hungarian-made medicines, because they have an average price per packet which is approximately only 25 per cent of that of imported medicines.) As a result, the Hungarian pharmaceutical industry, by squeezing out imports, would realize additional revenues worth at least HUF 10 billion, and this amount could provide supplementary funding for the R&D activities.

It is to be noted that owing to its high intellectual product content and high productivity, the pharmaceutical industry causes by two orders of magnitude less environmental load than would be caused if the heavy chemical industry was developed in order to achieve the same result. Such structural improvements are the most efficient way to ease industrial environmental pollution. (Despite huge investments, environmental pollution caused by the existing heavy chemical industry can only be reduced to a limited degree.)

For pharmaceutical research at least HUF 2 billion should be provided annually from the state budget, too. Resulting favourable effects would not only include the extension of research activities, the rise in the number of employees in the research sector and the efficient expansion of exports through the improved competitiveness of the Hungarian pharmaceutical industry, but also the reduction of prices of medicine imports, which may contribute to stopping the extremely quick rise in medicine prices. Another favourable consequence is that all in all this may lower the level of social security expenditures. We consider it a favourable condition that double of the amounts spent on R&D activities can be accounted as expenses.

An assessment carried out by independent experts found that in 1996, imports in the value of USD 150 million could have been wholly replaced with Hungarian products. Spending the USD 150 million on more expensive import products (prices of imported medicines are 3 to 4 times higher than prices of Hungarian medicines) led to the following consequences:

- social security and Hungarian consumers spent by HUF 20–30 billion more than they would have spent on buying domestic products,
- market of the Hungarian industry contracted by some HUF 30 billion,
- Hungary's balance of foreign trade deteriorated by USD 150–200 million.

The solution, as we have mentioned, is very simple: only generic medicine with the lowest production price for a given medical effect should be given social security subsidization. Similar schemes are used in several EU member states. Corruption, a consequence of the current Hungarian system, can also be avoided in this manner.

Table II.2.1.3.a.: Number of R&D workers per 10,000 inhabitants in selected countries

Country	Number of research workers
Japan	49
Sweden	38
Slovenia	37
United States of America	36
Finland	33
Denmark	31
Germany	28
France	27
Great Britain	25
Ireland	23
Netherlands	22
Slovak Republic	18
Poland	14
Romania	14
Italy	13
Spain	13
Czech Republic	13
HUNGARY	10
Turkey	3

Source: National Technical Development Commission of Hungary, 1999

2.1.4. Modification of tax laws to favour education, healthcare and R&D activities

Act XLII of 2002 on the Modification of Laws on Taxes, Contributions and other Budgetary Payments contains several modifications of the value-added tax which have adverse effects on education, healthcare and scientific research. Therefore we recommend that these amendments should be reviewed and revoked.

We propose that the activities listed in Table II.2.1.4. remain under the 12 per cent VAT rate.

Economic, social and environmental usefulness of R&D activities, expert assessments and laboratory investigations justify that they are ranked under the preferential VAT rate. In the EU member states, expenditures on R&D activities account for 2 per cent of the GDP on the average, whereas in Hungary this portion is only 1 per cent – of a much lower GDP. This provides particularly strong reasons to maintain the former tax preferences of the R&D activities and the expert assessment work.

We recommend that the scope of products and services ranked under the category of material tax exemption should be complemented (in conformity with the former situation) with the following items:

26. expert assessment activities of juridical experts designated by courts and authorities (Service Reg. No. 74.11.17.0);

**Table II.2.1.3.b.: R&D resources of the state budget
(facts for 2000, and estimates for 2001 and 2002)**

Function	Description	2000			2001			2002		
		Itemized breakdown			Itemized breakdown			Itemized breakdown		
		Expenditures	Revenues	Subsidies	Expenditures	Revenues	Subsidies	Expenditures	Revenues	Subsidies
F10	Agricultural research institutes	4594.5	2825.5	1769.0	3948.5	1888.9	2084.6	4347.8	1953.8	2394.0
F10	Agricultural R&D	7.2		7.2	100.0		100.0	100.0		100.0
F10	Agricultural research subsidies	346.8		346.8	536.0		536.0	536.0		536.0
F01.c	Office of the National Technical Development Commission	44.0								
F13.b	National Labour Centre	1450.0	1360.1	89.9	696.1	646.5	49.6	680.4	629.7	50.7
F01.d	Hungarian Space Research Agency	84.1		84.1	84.9		84.9	85.6		85.6
F12.d	Ministry of Environment Protection and Water Management research tasks	0.0			410.0		410.0	450.0		450.0
F01.d	László Teleki Foundation	0.0			95.7		95.7	95.7		95.7
F04.d	Research and service institutes	12904.8	7736.5	5168.3	7258.2	4545.2	2713.0	7712.6	4904.2	2808.4
F04.c	Doctorands' student scholarships	20.5		20.5	21.5		21.5	21.5		21.5
F04.c	Széchenyi professors' scholarships	689.8		689.8	896.2		896.2	1199.4		1199.4
F04.c	Ministry of Education - Hungarian Academy of Sciences: research programmes outside the country borders	0.0			30.0		30.0	30.0		30.0
F01.a	Technical development target estimates	6974.4	2228.1	4746.3	9529.0	779.0	8750.0	11719.0	779.0	10940.0
F01.d	Hungarian-Austrian Scientific and Cooperation Fund	52.0		52.0						
F01.e	EU-FP 5 Skeleton Programme	2536.7	774.7	1762.0	3123.0	1518.0	1605.0	4728.0	1518.0	3210.0
F01.d	National R&D Programme	0.0			5752.0		5752.0	10000.0		10000.0
F01.d	Higher education research programme	643.7		643.7	884.0		884.0	2300.0		2300.0
F01.d	Scientific research policy subsidies	0.0			30.0		30.0	30.0		30.0
F04.d	National Priority Social Science Research Programmes Public Foundation subsidies	90.0		90.0	90.0		90.0	90.0		90.0
F05.a	Ministry of Education sectoral R&D	0.0			188.0		188.0	240.0		240.0
F08.b	Cultural research and service institutes	0.0			755.2	60.6	694.6	789.7	66.6	723.1
F08.b	Operational subsidies for R&D activities	0.0			43.0		43.0	43.0		43.0
F08.b	Hungarian Creative Arts Public Foundation	0.0			800.0		800.0	800.0		800.0
F01.d	Central and Eastern European Social Studies Research Institute	175.0		175.0	275.0		275.0	307.0		307.0
F01.d	Central and Eastern European social science research programmes	25.0		25.0	25.0		25.0	25.0		25.0
F08.f	Sports science subsidies	30.0		30.0	30.0		30.0	42.0		42.0
F01.d	Central Statistical Office, Population Research Institute	107.9	37.8	70.1	88.9	29.0	59.9	90.9	29.7	61.2
F01.d	Central Statistical Office, Economic Research Institute	212.8	117.8	95.0	219.0	96.8	122.2	224.3	99.1	125.2
F01.d	Hungarian Academy of Sciences (HAS), PhD Council	2165.5	14.0	2151.5	2175.1	27.2	2147.9	2278.4	28.3	2250.1
F01.d	HAS, Széchenyi Literature and Arts Academy	12.7	1.6	11.1	14.2	2.1	12.1	14.6	2.2	12.4
F08.b	HAS Library	358.1	61.7	296.4	378.6	70.9	307.7	387.9	75.4	312.5
F01.d	HAS Mathematics and Natural Sciences Research Institute	9032.3	4710.5	4321.8	8175.0	4228.1	3946.9	8524.2	4497.7	4026.5
F01.d	HAS Biological Research Institutes	5099.5	2730.7	2368.8	4281.2	2189.7	2091.5	4471.0	2346.3	2124.7
F01.d	HAS Social Studies Research Institute	3373.8	1343.9	2029.9	2819.8	1095.1	1724.7	2964.9	1201.4	1763.5
F01.d	HAS Regional Academic Research Centres	170.1	46.4	123.7	162.5	49.6	112.9	167.6	53.1	114.5
F01.d	HAS research servicing organizations	1351.0	477.0	874.0	1303.7	582.5	721.2	1341.4	614.1	727.3
F01.d	HAS Office for Research Centres Support	1236.3	186.3	1050.0	1055.5	88.4	967.1	261.2	95.8	165.4

Source: Act on the Final Accounts of the Hungarian State Budget for 2000; Act on the State Budget of Hungary for 2001 and 2002

**Table II.2.1.3.c.: Changes in pharmaceutical subsidies
(billion HUF, at current prices)**

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003*
Pharmaceuticals subsidies, estimate	50.7	68.5	72	85.4	102.6	122.9	135	147	153	217.0
Pharmaceuticals subsidies, fact	61.6	70	84.2	100.9	135.5	140.4	150.7	179.1	209.0	232.0
Fact as a percentage of the estimate	121.5	102.2	116.9	118.1	132.1	114.2	111.6	121.8	136.6	106.9

*anticipated

Source: State Budget Acts and Final Accounts of State Budgets

**Table II.2.1.4.: Activities recommended to be classified
under preferential VAT rate**

No.	Description	Customs tariff number
89	Research and experimental development	Services Reg. No. 73.10.1, 73.20.1
90	Water management planning and expertise	ex Services Reg. No. 74.14.23.2
91	Postal and telecommunications planning and expertise	ex Services Reg. No. 74.14.23.3
92	Environmental protection professional planning and expertise	Services Reg. No. 74.14.23.5
93	Laboratory investigation and analysis of environmental elements	Services Reg. No. 74.30.11.2

- 27.expert assessment activities in connection with the protection of historic monuments (Service Reg. No. from 74.14.23.9);
- 28.healthcare planning, methodological tasks (Service Reg. No. from 74.14.23.4);
- 29.organization of scientific research conferences and meetings (Service Reg. No. from 74.84.15.0);
- 30.collective acquisition and propagation of knowledge (Service Reg. No. from 92.34.13);
- 31.services provided by libraries, archives, museums and other cultural services (Service Reg. No. 92.51.1, 92.52.1).

Courts cannot reclaim the VAT to be charged on expert assessment activities later on; so it is an expense for them, which cuts further back their already restricted budget allocation to be spent on experts by the value of the VAT connected to the expert activities. This situation should be changed in order to comply with what was undertaken by Péter Medgyessy, Prime Minister of Hungary (security based on law, improved financial conditions for Hungarian courts). This provides justification for the VAT exemption of item No. 26.

Items No. 27 to 31 above are socially and economically important activities which serve public interests; maintaining their VAT-exempted status is definitely justified. Cultural and scientific services are granted financial preferences in almost all countries of the world. It would also weaken Hungary's international reputation if conditions for such activities became less favourable.

2.2. Restoration of the real value of family allowance to its 1994 level

Real value of the family allowance has fallen back to half of its 1994 level. On the other hand, it is a welcome fact that since 1999, families with children receive a gradually increasing tax allowance. This possibility, however, cannot be a solution for those who do not have an adequate income level to be able to make use of the tax allowance. In fact, usually the families falling into this category are just the ones who are most in need of support. We are convinced that every effort should be made to ensure that all children start their life with equal chances, regardless of what family they were born to. Therefore we deem it necessary to restore the 1994 real value of the family allowance as a first step, and afterwards to increase it gradually. Accordingly, we welcome the decision of the present Hungarian Government to raise state expenditures devoted to the family allowance by HUF 9.2 billion in 2002 (they made payable two months' family allowance before the start of the school year, and raised the amount of the monthly family allowance by 20 per cent as of September).

We recommend that HUF 15 billion should be spent on social allowances aimed at assisting Hungarian families (e.g. free school books, meals in schools, provision of "school milk", teaching foreign languages, swimming lessons, etc.).

2.3. Improvement of pensions and other social welfare services

All members of society have the right to live without uncertainties of existence. Therefore we deem it essential to preserve and, as much as possible, to raise the real value of pensions, as well as to create better conditions for the equality of chances, with special regard to the disadvantaged, the disabled and to people with impaired health.

2.3.1. Raising the real value of pensions and reviewing the system of private pension institutions

Introduction of the private pension system in Hungary has considerably increased the risks borne by those insured (inflation and investment uncertainties). Moreover, the Hungarian society has not been properly informed about the serious contradictions (described briefly in the following passage) related to that system.

On the one hand, the funds needed for private pensions have been raised by placing additional burdens on the state budget. The remaining part of the funds has been supplied for the system by moving up the retiring age by 2 years in the case of men who retire in the near future, and by 7 years in the case of women. This step is rather questionable from an ethical point of view, for it has forced this part of the population into an unexpected case of necessity. This, in turn, has led to further problems: since measures to increase substantially the level of employment have not been adopted parallel with the above steps, those who continue to work until reaching the raised retiring age limit, have deprived several hundreds of thousands of young people, just at the age of starting to work, of the possibility to find jobs.

At the same time the Bokros package has considerably reduced the real value of pensions (see Tables II.2.3.1.a. and b.). This step was not only unethical and unfair, but it did not promote Hungary's economic development either. This can be illustrated by comparing how pension levels altered in the five Central-Eastern European countries changing their regimes (Czech Republic, Poland, Hungary, Slovenia and Slovakia) in the period between 1994 and 1998. Development of the pension levels is shown in USD (see Table II.2.3.1.c.), because this allows us to give a fairly correct picture of the changes in the real values of pensions. (Data expressed in USD are comparable also because each of the five countries pursued a slightly revaluating foreign exchange policy at that time.) These data reveal – and it may come as a surprise for many – that in the mentioned period the real value of pensions per one pensioner only declined in

Hungary (and to a fairly great extent at that), while in all the other countries it rose significantly.

Analyzing the total financial resources devoted to pensions, it is worth noting that the amount of the increases of pensions since 1994 totalled USD 21 billion in Poland, 5 billion in the Czech Republic, 1.3 billion in Slovakia and 0.5 billion in Slovenia. In contrast, during the same period the funds spent on pensions went down by USD 1.8 billion in Hungary. On examining the level of pensions per one pensioner, we may conclude that in 1998 only Slovakia had a lower value than Hungary, while in the other four countries these values were significantly above the Hungarian level. At the same time, in these countries also the economy in general showed a tendency of positive development over the mentioned period. Poland, for instance, had an exceptionally high GDP growth; and only the Czech Republic saw a small temporary setback in 1997 and 1998. (See Table II.2.3.1.d.) It is also extremely important in this respect that from this group of countries only Hungary sold a large part of its national wealth to foreigners; the other four countries did not do that – they did not use up their assets.

Also from an environmental aspect, we attach great importance to restoring the real value of pensions in Hungary. It is because pensioners usually do not spend their money on imported goods (which are, in many cases, over-packed and are produced by using a great quantity of raw materials and energy), but mainly on domestic products. Through their increased demand they could contribute in a greater extent to enhancing the local supply of goods and services, thereby making some settlements (or parts thereof) more attractive.

By the end of 2002, the real value of Hungarian pensions reached and slightly surpassed the level of 1994, their proportion in relation to real wages, however, deteriorated – mainly due to the increase of real wages that took place in the meantime.

The Hungarian Government has promised to maintain the real value of pensions, what is more, to adjust their level to earnings, in compliance with the Swiss indexation method. Because of the slowing inflation, we think that it would be advisable to switch over gradually to a system of adjustments made to earnings.

2.3.2. Improving social opportunities for disabled Hungarian citizens

Around 635 thousand people live with some sort of physical deficiency in Hungary. Among them, however, only about 30 thousand have a job – that is less than 5 per cent! Act XXVI of 1998 on the Rights of the Dis-

**Table II.2.3.1.a.: Expenditures of the Pension Insurance Fund
(billion HUF, at current prices)**

Description	1994 fact	1995 fact	1996 fact	1997 fact	1998 fact	1999 fact	2000 fact	2001 fact	2002 preliminary fact	2003 guiding figure
Total expenditures*	452.4	511.9	585.1	623.4	801.1	915.6	1021.2	1174.9	1419.3	1501.5
Increment (previous year=100)		113.2	114.3	106.5	128.5	114.3	111.5	115.1	120.8	105.8
Consumer price (%)*		128.2	123.5	118.0	114.3	110.0	109.8	109.2	105.3	105.0
Arrears (% , compared to previous year)			-15.0	-9.2	-11.5	14.2	4.3	1.7	5.9	15.5
Expenditures (at 2001 prices)	1166.8	1029.9	953.1	860.6	967.6	1005.3	1021.2	1174.9	1234.3	1243.6
Cutbacks (accumulated, at 2001 prices)		157.6	406.7	775.4	1068.4	1334.7	1580.6	1785.1	2000.6	2435.2
Expenditures (at 1994 prices)	452.4	399.3	369.6	333.7	375.1	389.8	395.9	417.2	478.6	482.2
Cutbacks (at 1994 prices)		53.1	82.8	118.7	77.3	62.6	56.5	-17.9	-109.0	-148.5
Cutbacks (at current prices, annually)			68.1	131.2	221.8	165.0	147.1	145.6	99.3	98.9
Interest on cutbacks**		10.3	36.7	71.4	101.4	105.5	124.4	124.0	128.1	135.7
Base of interest of the above-listed amounts		78.4	246.2	539.5	805.8	1058.4	1328.4	1551.7	1778.7	2234.9
Annual cutbacks from the Pension Insurance Fund (including interests)			78.4	167.9	293.2	266.3	252.6	270.0	223.3	227.0
GDP	4365	5614	6894	8541	10087	11394	13151	14876	16825	18600
Pension Insurance Fund expenditures as a percentage of GDP***	10.4	9.1	8.5	7.3	8.0	8.0	8.2	7.9	8.4	8.1

Notes:

*In the commodity groups directly and indirectly concerning the Pension Insurance Fund, prices have increased more dynamically (e.g. pharmaceuticals by 53.5 per cent in 1995)

**Nominal interest rate: (rate of consumer price increase + 2 % interest)

***Whereas the number of pensioners (compared to 1994) increased by 1.6 per cent in 1995, 3.4 per cent in 1996, 1.6 per cent in 1997 and by further 0.9 per cent in 1998, the proportion of their share from the GDP has decreased!

As from 2002, working pensioners do not have to combine their income from work with their pension, i.e. pensions are tax-exempted incomes. As a consequence, incomes of pensioners have risen by HUF 15 billion.

Source: State Budget Bill of the Republic of Hungary for 2001 and 2002 (No. T/3122)

**Table II.2.3.1.b.: Annual changes in the value of total pensions as compared to the level of 1994
(million USD, not including interests)**

Year / Description	Czech Republic	Hungary	Poland	Slovenia	Slovak Republic
1995	653	-192	3563	213	266
1996	1462	-526	5568	182	302
1997	878	-673	5267	-43	322
1998	2038	-426	6744	185	404
1995-1998 total	5032	-1818	21142	537	1294
Amounts cut back from, or granted to, pensioners (USD/person) as compared to 1994	2007	-582	2254	1158	1102
Changes in the value of pensions in Hungary					
Changes compared to the level of 1994 (billion HUF, including interests):					
Interests included (computing with 6 per cent annually)	1995 and 1996	751			
	until 1997	1490			
	until 1998	2018			
	until 1999	2139			
Debt resulting from the arrearage (USD/person)		685			
Debt resulting from the arrearage (HUF/person)		184920			

Source: Central Statistical Office of Hungary, Final Accounts of State Budgets, CESTAT

Table II.2.3.1.c.: Changes in pensions in CEFTA countries

Description	Czech Republic	Hungary	Poland	Slovenia	Slovak Republic
Average monthly pension					
1994					
In national currency	3248	13977	331.53	49025	2628
In USD	115.79	132.95	136.03	387.67	84.02
1995					
In national currency	3655	16030	438.84	53747	3045
In USD	137.41	127.54	177.81	426.60	102.98
1996					
In national currency	4498	18113	535.33	59515	3367
In USD	164.58	118.72	186.17	420.66	105.55
1997					
In national currency	5022	21473	643.16	64286	3717
In USD	144.98	114.98	182.82	379.99	106.87
1998					
In national currency	5450	26100	685	67808	4148
In USD	182.52	121.71	195.49	420.65	112.38
Exchange rate (national currency/USD)					
1994	28.05	105.13	2.4372	126.46	31.28
1995	26.6	125.69	2.468	125.99	29.57
1996	27.33	152.57	2.8755	141.48	31.9
1997	34.64	186.75	3.518	169.18	34.78
1998	29.86	214.45	3.504	161.2	36.91
Number of pensioners (in thousands)					
1995	2519	2963	7107	456	1168
1996	2498	3082	9254	461	1170
1997	2507	3123	9380	464	1174
1998	2545	3157	9451	467	1187
Total impact between 1995 and 1998 : cutback (-) or surplus (+) as compared to 1994 (million USD)					
Monthly, per person (USD)	29.18	-17.97	46.79	-7.69	22.86
Annually, per person (USD)	350.20	-215.61	561.49	-92.23	274.28
Annually, in total (million USD)	891.27	-680.67	5306.63	-43.07	325.57

Source: CESTAT Statistical Bulletin 1997/4 and 1999/1 (Central Statistical Office of Hungary, CSU, GUS, SURS, SUSR)

Table II.2.3.1.d.: Gross domestic product (GDP) in selected Central and Eastern European countries (changes in percentage as compared to the previous year and accumulated up until 1999)

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	1990-1999
Hungary	-11.9	-3.0	-0.8	2.9	1.5	1.3	4.6	5.1	4.3	4.5	5.0	1.028
Czech Republic	-11.5	-3.3	-0.9	2.6	5.9	3.8	0.3	-2.3	-0.5	1.4	2.3	0.933
Poland	-7.0	2.6	3.8	5.2	7.0	6.0	6.8	4.8	3.5	5.2	5.8	1.428
Romania	-12.9	-8.8	1.5	4.0	7.2	3.9	-6.6	-7.3	-5.0	-1.0		0.684
Slovak Republic	-14.5	-6.5	-3.6	4.8	6.9	3.9	6.5	4.4	2.0	1.5		1.017
Slovenia	-8.9	-5.5	2.9	5.3	4.1	3.1	3.8	3.9	3.5	3.6		1.118
Ukraine	-8.7	-9.9	-14.2	-22.9	-12.2	-10.0	-3.2	-1.7	-1.0			0.405

Source: OECD Economic Outlook, CESTAT, Kopint-Datorg Market Trends Report 1999/4

abled and the Enforcement of Equal Chances declares: "Disabled people are members of the society with equal dignity and standing, who are capable only with great difficulties, if at all, to exercise the rights, and make use of the possibilities, due to all citizens ... The purpose of the present law is to define the rights of the disabled and to identify the means of enforcing these rights, as well as to regulate the complex rehabilitation to be provided for disabled individuals, and, as a result of all the above, to ensure for them equal chances and the possibility to lead an independent life and participate actively in public matters."

International law and practice requires, and it is also in the vital interest of Hungary, to implement the objectives described in the above law. Among these goals one of the most important is to increase the number of the employed disabled. In this manner they become less dependent on state support, and it improves their general state of wellbeing and brings more meaning to their lives.

Real value of the minimum wage in Hungary rose considerably in 2001 and 2002. As of September 2002, the new Hungarian Government abolished the taxes imposed on the minimum wage, which in practice resulted in a further enhancement of its real value. This has partly solved the problem posed by the general rise of the minimum wage, which had put disabled people into a more disadvantageous position than before, because the enterprises and institutions concerned did not always manage to raise the funds needed.

To achieve further improvement in the employment of the disabled we recommend that the Act on Public Procurement should declare that goods produced by people with altered work capabilities shall be given priority, in case these goods comply with other requirements of the law, over merchandise of other producers.

We propose additional financial resources worth HUF 2 billion to support employment of the disabled.

2.4. Improvement of public safety

We agree with the spirit of the state budget when it gives high priority to public safety. At the same time we have to underline that granting financial support to improve conditions for the operation of the police is an essential but not sufficient tool to achieve this goal. We think that other proposals outlined in the present study may also contribute to better public safety: international experience proves that, for instance, steps towards a sound environment or a more intense involvement of non-government organizations and citizens' groups in local issues have an indirect but beneficial impact on

public safety. In other chapters of this document we discuss these subjects in detail.

Two Hungarian environmental NGOs, the Hungarian Traffic Club and the Clean Air Action Group prepared studies on the issue of public safety in Budapest in 1997 and 1998 respectively. Most of the findings and conclusions in these studies are valid outside the Hungarian capital as well; therefore we recommend them as valuable reading for anyone interested in the subject.

With a view to improving the living standard and the work conditions of those working for public safety we recommend that a specified part of the fines they collect should be used through a fund for the betterment of their housing conditions. This would result in more discipline and more revenues; therefore the extra revenues would more than compensate for the expenses. We recommend that the amount of this fund should be set at about HUF 3 to 4 billion in the beginning.

2.5. Support to underdeveloped and disadvantaged regions in Hungary

It is in the interest of Hungary, and also a requirement of the European Union, to promote that backward regions catch up with the more developed ones. Comparative advantages resulting from the lack of former industrial development, however, should not be sacrificed for the alleged benefits of a growth scheme based on globalization. For regions of slower development, special strategies should be elaborated, which are differentiated by individual regions but have common values in their focus. In these strategies the key goals are: nature-friendly infrastructure, ecological building methods, natural materials and foods, use of renewable energies, biodiversity and preservation of local cultural traditions worth surviving. What these objectives above all necessitate is to enable people living in the regions concerned to carry out these tasks themselves. It is to be noted that some of the budget modifications we propose would already in themselves assist the catch-up process of the relatively underdeveloped Hungarian regions (use of railway rebates, reduction of burdens imposed on wages, increase of funds devoted to research and development, etc.).

We believe it is crucially important that the primary way to promote that underdeveloped regions catch up with the more advanced ones should not be the extension of the road network. A much more efficient tool in the long run is to encourage that the regions concerned make the best possible use of their existing favourable

features (cultural and environmental characteristics, attractive factors).

Further key areas (not discussed here in detail) are:

- offsetting the slower development which is more advantageous from a nature protection point of view,
- technological development which is nature-friendly and at the same time guarantees increasing quality of life,
- promoting the development and marketing of high-quality ascertained goods,
- supporting the preservation of characteristic local features (products, culture, landscape, customs),
- improving the population-retaining capacity of the regions concerned by ensuring the possibility of free choice (IT and educational network, guaranteed taking over for the production of renewable raw materials, processing capacity and R&D for environmentally friendly technologies).

We recommend that from the extra state revenues generated by restricting the so-called fuel tourism HUF 10 billion should be spent on development of the concerned border regions, primarily in the fields of education and culture, and through environmentally friendly investments (e.g. energy efficiency enhancement).

2.6. Transformation of the Hungarian housing policy

The European Union does not have a uniform housing policy, but the member states reinforce social cohesion through their national housing policies and make efforts to protect the natural and built environment. Appendix 1 to the present document contains our detailed housing policy proposals. Its key elements, also relevant for the annual state budget, are as follows:

1. It should be a civic right of every Hungarian citizen to obtain dwelling allowances, depending on their per capita income and financial standing.
2. By the end of the term of the current Hungarian Government, the country's stock of social tenements should reach at least 400 thousand dwelling units. It should be made compulsory for towns (for settlements with more than 8 thousand inhabitants) to elaborate a medium-term social housing concept, which would ensure that the aggregate share of tenements (and official residences provided by companies, „nesting” houses and other special home accommodation) rise to 20 per cent by 2010. In case local governments fail to comply with the social housing programme, they should not be allowed to receive any state subsidies (apart from normative state subsidies).
3. An appropriate legal regulation framework should be prepared for the renovation and operation of flats constructed by industrial technologies (housing estates). There should be organizational and financial guarantees in place so that the part of the stock of flats constructed by industrial technologies which is worth preserving, and the connected public areas should be renovated by 2020 through mixed financing.
4. Condominiums should only be granted non-repayable renovation subsidies for urgent technical intervention work (emergency repairs) ordered to be carried out to preserve the building's stability. When utilizing local government funds, priority should be given to the renovation of communal buildings (schools, hospitals, etc.) and to the improvement of public areas.
5. Homeowners should be encouraged by tax allowances (VAT and personal income tax) to spend their savings on the renovation of existing buildings. Proceeds of the sale of real properties should be given the same tax allowances in the case of renovation as in the case of purchase of new flats.
6. The energetic quality of buildings in Hungary should reach the average value of EU countries with similar climatic features by 2020. Through temporary financial support and appropriate regulation, district heating should be aided to become modernized and competitive with a view to improving the environment and reducing dwelling costs and subsidies.
7. Support should be granted to the establishment of non-profit-making urban rehabilitation organizations in order to provide information for inhabitants and entrepreneurs, and to coordinate urban rehabilitation development projects. We recommend that HUF 1 billion should be allocated for this purpose annually, in 60 per cent from state funds and in 40 per cent from local government resources.
8. Brown fields should be made more competitive through economic instruments and regulations, by establishing an appropriate institutional background and by elaborating a national brown field programme. It should be guaranteed that Hungary's required own part in the financing of projects as well as the necessary programmes are available in due time to be eligible for obtaining support from the EU Structural Funds.
9. In pursuit of protecting the natural areas of Hungary, preserving the compact structure of towns and villages and improving the efficiency of infrastructure, in a portion of at least 70 per cent, construction of new flats should only be permitted in already used areas (brown fields).

10. On the basis of the principle of ploughing back (public) expenditures, proportionate land protection fees should be imposed, which are differentiated by types of areas. For the construction of new flats, subsidies should only be granted in accordance with the local housing programme.
11. A building policy coordinating organization, subordinated to the Government, should be established and operated to coordinate the building authority tasks of the ministries.
12. Building supervision authorities should be given back their legal standing, as can be expected in a state respecting the rules of law, in conjunction with the necessary financial resources and institutional background.

Accordingly, subsidies granted from the state budget to the housing sector should be raised to the EU average, i.e. to 1.6 per cent of the GDP instead of the current 0.9 per cent in Hungary. At least 50 per cent of this support should go to the renovation of existing buildings and the revitalization of public areas. This means HUF 130 billion extra expenditures in 2003. (At the same time the state will also realize substantial revenues from that. The employment level may also be expected to grow, because the whole vertical complex of the building and construction industry predominantly employs Hungarian workforce, imports being less important.)

2.7. Higher state contribution to environmental protection and healthcare

“The Republic of Hungary recognizes and enforces the right of all people to live in a healthy environment.”

Art. 18 of the Constitution of the Republic of Hungary

On 17th September 1997 the Hungarian Parliament unanimously adopted the National Environmental Protection Programme (NEPP), and the Second National Environmental Protection Programme (NEPP-II) for the period 2003–2008 is now under preparation. It is an urgent task to implement the Programme in practice. We believe that the goals set in the Programme can be accomplished principally through a budget reform which takes into account the environmental aspects, and within that particularly through the abolishment of subsidies granted from public funds to environment-polluting activities. Furthermore, laws and regulations need to be adjusted to meet current requirements, and the standard

of public tasks related to environmental protection (work of authorities, awareness raising) needs to be enhanced as well, which, again, are inconceivable without financial contribution by the state. We think that providing direct (not normative) state support to individual economic entities is generally not the most efficient means of improving environmental quality. However, under current circumstances, we accept that such subsidies are also needed occasionally to better the environment. Therefore we agree with the intention of the Hungarian Government's Economic Policy Programme stating that resources devoted to environmental protection purposes should be increased, but we do not think that the planned rate of the increase is adequate.

Direct state support for environmental and health protection purposes should be granted mainly through the budgetary channels of the Ministry of Environmental Protection (allocated funds titled *Environmental Protection Fund Target Tasks /KAC/*), and through other estimated funds and separate state funds. Distribution of funds should be efficiently coordinated at the level of ministries, and EU funds should be involved to maximize the support available.

We think it is also necessary that a significant portion of the funds devoted to public works should finance projects which contribute to the protection of the environment (e.g.: sewer network development). Local governments should be given proper information and incentives to carry out these tasks.

The draft version of the Second National Environmental Protection Programme (NEPP-II) contains a detailed statement about the needed environmental subsidies. Therefore we will only highlight some key elements in the sections that follow.

2.7.1. Environmental and health protection awareness raising, information, education and culture

Within awareness raising we attach particular importance to making known and promoting ways and means of forming a healthy and thrifty individual and family lifestyle through regular educational advertising and informative media programmes, as well as to incorporating these into the curriculum of educational and cultural institutions.

Revenues of commercial advertising have been rising extremely quickly since the early years of the market economy in Hungary, and in 2002 they already exceeded HUF 200 billion. A considerable portion of the commercials advertises activities that are harmful to the environment and human health (such as tobacco, alcoholic beverages, motorcars, etc.). At the same time, educational advertising and communica-

tion to sustain or better our environment and health are hardly given any money. The whole Hungarian society suffers from the damages caused by this situation; therefore radical changes should be implemented as soon as possible.

Non-commercial communications, and primarily, educational advertising should be granted financial support to shift the emphasis towards human values, promote cultural standards of the population and encourage meaningful leisure activities (such as sports), give guidance for leading a healthy and environment-oriented way of life, and improve the environmental awareness of people, which is today, unfortunately, still very low.

The following is a list of the benefits achieved through non-commercial communications and educational advertising in countries where the needed favourable conditions have been given to these activities:

- Family protection, life and property safety, prevention of accidents and injuries, consumer protection, health protection, healthy way of life, environmental protection and energy saving are areas where educational advertising brought very positive results.
- State budgets saved on healthcare expenses, for instance, owing to the improved health standard of the population.
- Economic efficiency grew at the level of the national economies (e.g. in energy use).
- Citizens started to take a more active part in local and public issues, which opened up enormous new resources – left unused earlier – for social development.
- People started to feel healthier and more contented.
- Information spread by the media became more balanced and objective, which reinforced democracy.
- Governments became more popular and their support basis expanded.

From the extra revenues of the National Cultural Base Programme HUF 25 billion should be allocated to educational advertising and non-commercial communications. In compliance with our proposals, such amount of extra revenues would be generated by raising the rate of cultural contribution. To that end, the following passage should be added to the regulations on the use of the funds of the National Cultural Base Programme:

“...awareness raising and educational activities promoting preferred ways of consumption and environmental culture.”

Once that modification is adopted and implemented, democracy will benefit from it through more powerful civil awareness, which is indispensable for the development of the society.

Civil movements and non-governmental organisations could have an extremely important role in this awareness raising work and they need to be supported in their activities by every possible means.

Another reason why we think it is important to involve non-governmental organizations in the preparation and organization of educational communications, is that this provides more guarantee that the public will indeed receive the proper messages, and not manipulated ones. (A typical example of manipulated educational advertising is the publicity campaign financed by the tobacco industry, allegedly to force back smoking among young people, which had the following slogan: “Smoking is a custom of adults”.)

We are fully aware that today it would be hopeless to demand as much funds for educational advertising as the amounts spent on commercial advertisements. Nevertheless, it is unacceptable that thousand times as much is devoted to the latter than to educational advertising. It is also unacceptable for us that media programmes and printed materials containing violence and pornography receive a much higher share of the resources produced by the society as a whole, than works and programmes promoting a desirable way of life. With a view to changing these proportions we have proposed (see Sections 7.3. and 7.4.) that the rate of cultural contribution imposed on advertisements (which is currently 1 per cent) should be raised considerably, just like the amount of cultural contributions levied on works containing violence and pornography, and that the collected extra revenues should be entirely spent on educational advertising and non-commercial communications. In the case of the written and electronic press we recommend that the raised amounts should be returned in full to the newspaper or media that they had been collected from. In this manner no damage whatsoever would be caused to any newspaper, radio or television; on the contrary, they would become more vibrant and interesting, and provide more balanced information.

2.7.2. Offsetting energy price rises; improving energy efficiency

a) Pecuniary compensation

Price rises of electricity and natural gas in the previous years should have been implemented in conjunction with a fair compensation. This is why we supported the proposals of the Energy Interest Representation Council about social offsetting. Individuals and public institutions must be entitled to compensation. Pecuniary compensation is indispensable from an environmental protection and energy saving point of view as well,

**Table II.2.7.2.a.: Household electricity use on the basis of data of 1996,
and anticipated impact of the raised VAT rate**

Use / Consumer	up to 1000 kWh	1001–2000 kWh	2001–5000 kWh	5001–10000 kWh	above 10000 kWh	Total
Quantity and share of annual consumption						
million kWh	502.65	1005.3	4322.79	1910.07	2312.19	10053
%	5	10	43	19	23	100
Number and share of consumers						
thousand	1237.41	1008.26	1741.54	458.3	137.49	4583
%	27	22	38	10	3	100
Annual use per one consumer						
kWh/consumer	406.2	997.1	2482.2	4167.7	16817.2	2193.5
HUF/consumer*, net	6824.35	17624.9	45841.8	78604.31	100902.9	
Impact of raised VAT rate						
Impact/consumer**, HUF	887.17	2291.24	5959.43	10218.56	13117.3	
Total amount***, million HUF	1097.79	2310.16	10378.59	4683.17	1803.5	20273.21

*At prices of 1st January 1999, as per tariff "A" (Decree of the Ministry of Economy No. 23/1998), not including VAT

**Annual impact of raising the VAT rate from 12 per cent to 25 per cent (in HUF)

***The amount pertaining to consumers using more than 10,000 kWh is estimated, because the effects of several tariffs combine in this category

Source: Own calculations based on data of the Central Statistical Office of Hungary

because energy taxes can only be increased in this manner (otherwise, social tensions would grow and social resistance would probably prevent taxes from growing at the required rates).

As a specific sample, in the following section we describe our proposal for a possible way of offsetting the effects of moving the VAT rate of electricity from 12 to 25 per cent (see Table II.2.7.2.a.).

Data of UNIPED for 1996 contain the number of Hungarian household consumers broken down by main categories of electricity use. This has not significantly changed in recent years; therefore we can use it as a starting basis.

After an analysis by the quantity of consumption, we may draw the following conclusions:

1. Consumers with a used quantity up to 1000 kWh per year account for 27 per cent of all household consumers, whereas the electricity they used makes up only 5 per cent of the total household consumption.
2. Those consuming between 1001 and 2000 kWh represent 22 per cent of all consumers, while the electricity they used accounts for 10 per cent of the total household consumption.
3. Consumers of a quantity between 2001 and 5000 kWh represent 38 per cent of the total number of consumers, and the electricity they used is 43 per cent of the total household consumption in Hungary.

As regards compensation, consumers who used a quantity above 5000 kWh per year should not be taken into account, because some of them primarily use night-time electricity with Category B preferential tariff, and part of them have such income levels that they are not in need of compensation.

Our calculations show that total budgetary revenues – assuming unchanged consumption – from a possible rise in the rate of VAT would amount to some HUF 30 billion (calculating only with household consumption). Out of that sum, at most HUF 20 billion should be spent on compensation, which would affect approximately 4 million consumers. From the above figure we should deduct the number of consumers having two metering points (e.g. resort homes), which can be estimated roughly at 500 thousand metering points. As a consequence, compensation should be granted in the case of around 3.5 million metering points.

We think that the compensation should have been implemented primarily through the increase of pensions and of the family allowance.

According to the Yearbook of the Central Statistical Office, in 1998 there were 3.1 million pensioners in Hungary. Within the population, those under 18 years of age numbered 2,337 thousand, and there were 153 thousand daytime students in higher education institutions, so the total number of Hungarian citizens entitled to receive family allowance was 2,490 thousand.

Accordingly, 5.6 million people should be given compensation in total. To this end, pensions and the family allowance should be raised by an annual per capita amount of HUF 2500.

As a consequence, the rise in the VAT rate could be offset in a manner that it does not involve any additional administrative work. The overwhelming majority of those concerned would not find themselves in a more disadvantageous position than they are now; on the contrary, most of them would clearly benefit from the changes.

In the case of public institutions and public services, it would be advisable to offset the total impact of the price rise. However, it would be well worth considering that 50 per cent of this amount should be returned automatically, and the other 50 per cent through funding energy efficiency projects, because in this manner the compensation would come to its end in 5 years' time (i.e. as a result of the savings from the reduced energy consumption, no further compensation would be necessary.) This would give considerable encouragement to energy efficiency measures, and would also diminish imports and create new jobs in Hungary, which could improve the country's foreign trade balance.

For natural gas, the change of the VAT rate could not be implemented in the mentioned way, for only a part of the Hungarian population uses natural gas. It would also be difficult to make people accept the fact that earlier government measures encouraged the conversion to natural gas (which was in most cases beneficial also environmentally), and now the new measures would do just the contrary. Therefore in this case compensation should be partly implemented by using a preferential social tariff: under a specified consumption level, preferential fees should be paid according to the number of household members (e.g. up to an annual per capita consumption of 500 cubic metres). Out of the extra revenues from the rise in the VAT rate, the state budget should reimburse gas service providers for the losses they incur as a result of the measures. So the inflation-generating impact can be avoided.

As a result, major household consumers will be doubly interested in energy saving. On the one hand, higher prices will encourage them to do so in the first place, and on the other, the extra VAT revenues may allow the government to grant larger subsidies for energy efficiency enhancement. To increase further the anti-inflationary impact, this could be achieved by, for instance, granting someone HUF 100 thousand for energy efficiency improvement through allowing them to deduct an annual HUF 20 thousand from their natural gas bill for 5 years (i.e. the state remits this amount to the service provider).

b) Support to energy efficiency enhancement

Within the target limits of compensation, energy efficiency enhancement should receive as large a share as possible. This method should be applied in the case of public institutions and public services. We think that a steadily increasing share of the compensation should be made payable through energy efficiency enhancement schemes because it is the only way to reduce, in a fairly short time, the need to continually pay compensation, while modernizing the economic structure and creating large numbers of new job opportunities. Besides compensation, energy efficiency enhancement is a useful tool to improve economic efficiency, and thus to increase Hungary's chances to catch up with the European Union. It is important to note that although they exist, other methods of boosting economic growth (such as pure banking incentives) may involve the risk that growth is achieved at the expense of efficiency.

Compensation through energy efficiency schemes is also extremely beneficial due to its lasting anti-inflationary impact. This method may cut energy imports, the share of which has been increasing gradually, coupled with a considerable price rise. Furthermore, the costs of the environment pollution caused by a growing energy use, the investments needed to remove environmental damage and other related activities may also become avoidable in this manner; and this, again, has an anti-inflationary effect. Another reason why energy efficiency enhancement requires quick implementation is that the mentioned costs will grow exponentially over time.

Energy efficiency enhancement means that the same or even better results are achieved, while less energy is used. So energy efficiency is not about austerity measures or irrational saving. The energy efficiency enhancement programme should be promoted from Hungarian state funds. At present, practically no energy efficiency programmes can be financed from ordinary bank loans because of the high level of internal interest rates. Therefore, it would be essential to ensure **preferential rates of interests** for this purpose by re-allocating available funds (a few examples, also in Hungary, have already proved that this works), as well as to transform the national financial policy so that **speculative financial activities could be controlled** and to force the Hungarian banking system to operate at minimum interest margins. Energy efficiency enhancement is the most effective tool of promoting economic modernization and development, since it combines efficiency and economic stimulation with higher employment.

The energy efficiency enhancement programme should be incorporated into the system of government measures aimed at bettering the housing situation in

Hungary. In this manner the two programmes could multiply each other's beneficial impacts.

The measures needed in this field were correctly determined by Government resolution No. 399/1995 on the National Action Programme Promoting Energy Saving and Energy Efficiency Enhancement. Resolution No. 1107/1999 (X.8.) of the Hungarian Government was also right in setting the necessary steps for the energy saving and energy efficiency enhancement strategy of the period up until 2010. Measures taken in connection with energy issues usually exert a medium or long-term influence, so the 10-year programme meets this real economic requirement. Unfortunately, from the tasks described in the resolutions only a negligible part has been put into practice.

When Government resolution No. 1107/1999 was adopted, even the following year's Hungarian state budget was prepared in the hope and on the assumption that the rise of energy prices would only be temporary in world markets, and that they would not reach such levels as they eventually did. As a consequence, also the revenues from VAT imposed on energy saw a substantial increase. Part of these sums should definitely be devoted to the energy efficiency enhancement programme. Coupled with the raised VAT rate and with other available resources (German loan, Environmental Protection Fund, etc.) this makes up funds which, although far from being sufficient, already enable making some headway.

Implementation of the energy efficiency enhancement programme over a period of several years could **provide numerous people with jobs**. It could increase the GDP as well as improve the balance of the state budget by several tens of billions of HUF (through additional payments of taxes and contributions).

Energy efficiency enhancement is far from being a fully exploited opportunity. This is true even if the efficiency of investments in this field is measured at current prices of energy.

A joint study titled *Macroeconomic Impacts of Energy Efficiency* (published in Budapest, 1998) of the economic research firm GKI and the energy development and research company EGI has found, among others, that at prices of the time, the following measures could be implemented most economically:

They assume that electricity generation is partly replaced by energy efficiency measures and compare the marginal costs of investment for saving energy with the costs of establishing one unit of extra capacities. When only the costs of starting up an extra capacity are considered, the marginal costs of replacement are lower than those of establishing extra capacities for up to 600 MW. When operating costs of the new capacities are also considered (primarily the costs of fuel consumption), the

above figure moves up to 650 MW. (Additional costs are determined presuming 30 years of useful life.)

Assuming a payback period of ten years at most after improving the efficiency, it is more worth saving energy than using additional energy supplies up to the following proportion (in percentages of total primary energy consumption in the given sector):

- households: 15.1 %
- communal sector: 4.7 %
- industry (not including energy generation): about 18 %.

We would like to underline once again that the above numbers reflect prices of 1998, when energy prices in world markets reached their lowest level of the past 10 years. With energy prices that are in line with current world market prices and also incorporate the external (environmental, etc.) costs of energy generation, saving can show its benefits on a much larger scale. It is also important to take into consideration that environmental protection requirements are expected to grow stricter, which will lead to additional cost increases. On account of the 8 per cent rate of return on assets, ensured for foreign-owned companies of the energy sector, energy efficiency enhancement brings about even more benefits for the Hungarian society. The energy policy should be elaborated accordingly.

Energy efficiency enhancement is a precondition as well as a stimulus of any modernization scheme in Hungary. Governments all over the world are ready to provide financial support for energy efficiency enhancement.

District heat supply services are essential elements of the energy issue; therefore we attach particular importance to the need and possibility of improving them. Enhancement and modernization of district heating services may alleviate the environmental problems of even the most polluted areas.

Under the direction of the Hungarian Energy Office a specific programme has been elaborated to enhance energy efficiency in public institutions. However, implementation is stuck due to the law on state guarantees. It is an absurd management practice that the state budget undertakes general guarantee without any limits for energy imports (see Art. 36 of Act CXXXIII of 2000 on the State Budget of the Republic of Hungary for 2001 and 2002), while no guarantees whatsoever are assumed for energy efficiency enhancement.

The state budget should undertake a guarantee for energy efficiency improvement projects as well.

Hungary's commitment taken on by signing the Energy Charter Convention also requires the country to improve energy efficiency. Section 19 of the Conven-

tion calls for the Signatory States to “give priority to the improvement of energy management efficiency and to the use and development of renewable energy sources.”

The aforementioned Government resolution No. 1107/1999 estimated HUF 1 billion for 2000 as a state support for improving energy efficiency. In 2001, the Hungarian Ministry of the Economy already devoted HUF 5 billion to this purpose. In our opinion, this is still a very small amount. As a consequence of the actual price rise of imported energy, in the first six months of 2000, the price of the total Hungarian energy imports expressed in HUF increased by nearly 86 per cent as compared to the same period of the previous year. This means that Hungary paid by almost USD 1 billion (i.e. by HUF 280 billion) more than a year before. In 2001, the overall energy price level did not fall significantly, because natural gas prices went up, while petroleum prices came down. In 2002, a slightly decreasing price level prevailed. On the other hand, also the quantity of imports is expected to rise because Hungarian production is gradually shrinking, and the volume of domestic energy use is prognosticated to increase with economic growth. Enhanced energy efficiency, however, makes it possible to tackle this dual impact and to achieve substantial savings.

The government resolution set the target to save 75 PJ/year by 2010, i.e. to save an annual 7.5 PJ on average in the next 10 years. This means that new savings amount to some HUF 7 billion per year, calculated at current prices. This is seven times as much as the annual HUF 1 billion that the state is planning to invest! Since this programme is implemented on an accumulative basis (i.e. it is increasing every year), the amount of realized savings will gradually grow over the years (see Table II.2.7.2.b.). Also the savings from the avoided environmental pollution should be added to the above-mentioned sum. These are substantial savings: in a period of 11 years, among others, the quantity of emitted sulphur-dioxide will drop by 300 thousand tons in total and carbon-dioxide emissions will diminish by 30 million tons, as compared to similar values without any energy efficiency enhancement programme (see Table II.2.7.2.c.).

Since benefits at the level of the national economy are exceptionally high in relation to investments, and also because this efficiency has almost doubled from one year to the other owing to the price rise in world markets, we think that the Hungarian state should provide increased support to these activi-

Table II.2.7.2.b.: Efficiency of energy savings, expressed in pecuniary value

Description	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2000–2010 total
Savings in PJ*												
Annual	6.82	6.82	6.82	6.82	6.82	6.82	6.82	6.82	6.82	6.82	6.82	
Accumulated	6.82	13.64	20.45	27.27	34.09	40.91	47.73	54.55	61.36	68.18	75.00	450.00
Savings in million USD**												
2.21 million USD/PJ	15.1	30.1	45.2	60.3	75.3	90.4	105.5	120.5	135.6	150.7	165.8	994.50
3.53 million USD/PJ	24.1	48.1	72.2	96.3	120.3	144.4	168.5	192.5	216.6	240.7	264.8	1588.50
Improvement	9.0	18.0	27.0	36.0	45.0	54.0	63.0	72.0	81.0	90.0	99.0	
Savings in million HUF**												
500.7 m HUF/PJ	3414	6828	10242	13655	17069	20483	23897	27311	30725	34139	37553	225315
942.2 m HUF/PJ	6424	12848	19272	25696	32120	38545	44969	51393	57817	64241	70665	423990
Improvement	3010	6020	9031	12041	15051	18061	21072	24082	27092	30102	33113	
Expenditures in million HUF***												
Annual	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	
Accumulated	1000	2000	3000	4000	5000	6000	7000	8000	9000	10000	11000	11000
Rate of return****												
Annual	6.42	6.42	6.42	6.42	6.42	6.42	6.42	6.42	6.42	6.42	6.42	38.54
Accumulated	6.42	12.85	19.27	25.70	32.12	38.54	44.97	51.39	57.82	64.24	70.67	423.99

*Government Decree No. 1107/1999 (X.8.) on Energy Savings up until 2010 ...

**Based on actual imports of the period January–May 1999 and January–May 2000, calculated at prices of January–May 2000

***According to the Government Decree, annual subsidies total HUF 1000 million

****Rate of return of the programme was calculated at prices of 2000, not including interests, because the amount of expenditures is constant

Source: Own calculations based on Energy Management Reports

Table II.2.7.2.c.: Pollutant emission eliminated through energy savings

Description	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2000–2010 total
Sulphur dioxide thousand tons/year												
Annual	4.55	4.55	4.55	4.55	4.55	4.55	4.55	4.55	4.55	4.55	4.55	
Accumulated	4.55	9.09	13.64	18.18	22.73	27.27	31.82	36.36	40.91	45.45	50.00	300.00
Carbon dioxide million tons/year												
Annual	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	
Accumulated	0.45	0.91	1.36	1.82	2.27	2.73	3.18	3.64	4.09	4.55	5.00	30.00

Source: Own calculations based on data of the Energy Balance and the Central Statistical Office of Hungary

ties. To that end, in order to realize the beneficial impacts of energy efficiency enhancement, we recommend additional expenditures worth HUF 30 billion in 2004 by using part of the revenues from mining fees imposed on hydrocarbons and from the extra VAT revenues.

c) Aiding the depressed north-eastern region of Hungary through energy efficiency enhancement

From the above funds, among others, the following activities could obtain financial assistance.

The rise of energy prices will have unfavourable impacts on the siderurgy and heavy chemical industry in *Borsod* county (in north-eastern Hungary). Crisis management so far has not reckoned with the inevitable energy price increases. Therefore on the basis of the former heavy industry plant DIGÉP, **energy efficiency enhancement and environmental protection machine manufacturing** should be implemented by involving German loans and cooperation. The Public Procurement Act needs to be modified so that employment is increased in the county and in other under-developed regions. We propose that a modification requiring a **minimum 30 per cent share of products made by workers employed in the region in fulfilling public procurements** should be incorporated in the Act. To make these criteria even stricter, the share of labour's tax and wage burdens should be taken into account. The Ministry of the Economy should take the necessary steps to provide protection for these new sectors in a manner complying with WTO requirements. A similar measure would meet WTO requirements, so it would

be a suitable way of protecting Hungarian jobs and promoting domestic and foreign capital investments which are beneficial for the country.

d) Using the stockpiling fee of crude oil and petroleum products for environmental protection

Government funds are not the only possible financial resources for the enhancement of energy efficiency. The Crude Oil and Petroleum Products Stockpiling Association increased the rate of the stockpiling fee for petrol from 2.58 HUF/litre in 1998 to 4.12 HUF/litre by 2002, and for Diesel oil from 2.67 HUF/litre to 4.21 HUF/litre over the same period. Overall fee revenues are close to HUF 40 billion (see Table II.2.7.2.d.).

Stockpiling itself pollutes the environment heavily, and involves products which pose especially high risks of damages. This justifies that half of the amount of the above fees should be set aside for energy efficiency and environment protection purposes.

A particularly serious environmental catastrophe could be caused by the fuel storage facilities owned by ÖMV which are situated within the boundaries of Budapest, on the northern side of Csepel Island. These facilities should be eliminated as soon as possible, because this does not belong to the sphere of market competition – this is endangering the population of the Hungarian capital.

The Hungarian Crude Oil and Petroleum Products Stockpiling Association has undertaken a stockpiling

Table II.2.7.2.d.: Changes in the stockpiling fee of the Crude Oil and Petroleum Products Stockpiling Association (HUF/litre)

Description	1998	1999	2000	2001	2002
Petrol	2.58	3.53	3.73	3.73	4.12
Diesel oil	2.67	3.65	3.85	3.85	4.21

Source: MOL Co.

commitment for Slovenia as well, which leads to additional pollution and implies added risks. Besides these, shipment causes further environmental loads.

Our calculations show that it would be advisable to impose as environmental load fee 1 per cent of the value of the Crude Oil and Petroleum Products Stockpiling Association's stock. This totals more than HUF 1 billion annually.

2.7.3. Support to environmentally friendly means of transport

Motor vehicles cause severe harms to the environment, health and the economy. To ease the damage, it is vital to give priority to developing and promoting alternative means of transport.

2.7.3.1. Improved public transport services

Public transport is a public service; therefore, its performance should not be measured only by efficiency ratios used in the private sector. (It is, of course, not that we disregard the necessity of efficient and rational operations of public transportation companies.) As a public service, public transport should operate efficiently to obtain the most social, economic and environmental benefits that financial ratios and corporate accounts can hardly reflect. Therefore, besides existing state support, we propose that public transport should be improved through a series of measures described below, which affect the state budget as well. Simultaneously with those actions an appropriate system of requirements should also be specified. The importance of public transport has been recognized in the EU member states as well. Accordingly, they assist these activities through a range of measures, including various preferences (see Table II.2.7.3.a.).

1. We propose that some allowances (e.g. consumer price subsidies) be granted only on condition that the given public transport company meets, among others, the environmental requirements and standards set by law, and harmonizes its schedules with the other public transport companies concerned to satisfy travellers' needs as well as environmental considerations. In the case of local public transport it should be an essential precondition that public transport is given priority and traffic calming measures are introduced. (It is unreasonable to support public transport stuck in traffic jams.)

2. Employers should be given the right to account as expenses the costs of local public transport contributions granted to their employees. Government decree

No.78/1993 (V.12.) on travel allowances differentiates between expensing the costs of inter-town services and local public transport journeys. This is unreasonable and, in our opinion, unconstitutional, especially when companies are allowed to expense many thousands of HUF a month for the use of one car. On the other hand, reimbursements of local public transport fares are regarded as personal income, and therefore, are subject to income tax. This is unfair, economically irrational and environmentally harmful, since it favours financially a means of transport that is more damaging to the environment against other, less polluting transportation services.

3. We recommend that the system of consumer price subsidies should be revised. The current regulation on allowances in public passenger transport (decree No. 287/1997 [XII.29.]) discriminates users of local public transportation against those using inter-town services. Preferences now applied in inter-town services should be extended uniformly on all public transport services regardless of town boundaries.

4. Today, users of public transport services aged over 65 and/or 70 are entitled to travel free of charge. A 95 per cent allowance (instead of free travel) could encourage people to use public transport vehicles more rationally, give a more accurate picture on travel needs and allow remitting the prescribed price subsidies to the companies concerned.

5. Local public transport companies (and future regional transport alliances) should be encouraged and given the authority to operate the parking and, if introduced, the road charge payment systems on their area. The resulting extra revenues should be devoted to improving the public transport services.

6. We recommend that public transport companies should be granted normative subsidies on the basis of their revenues from fares (i.e. they should receive a specified percentage thereof from the state). This is a solution which can be fairly simply put into practice; and the more so, because granting of price subsidies to public transport passes of students and pensioners is being made similarly. We are convinced that this could be an efficient method to promote that as many (paying) passengers use public transport services as possible – as a matter of fact, this is just what all state support granted to public transportation should encourage.

We do not agree with the proposal that for buses used in local regular public transport services, a part or the whole of the excise duty on Diesel oil should be made reclaimable. Such a measure would grant an unjustified advantage to Diesel oil-fuelled vehicles against electricity-operated ones, which is questionable from the point of view of both the Constitution and the principles of

**Table II.2.7.3.a.: Tax allowances granted to public transport
in the European Union and Norway**

	VAT charged on fuels used by public transport	Excise duties imposed on fuels used in public transport	Costs of commuting to work can be accounted as expenses even in the case of using public transport	Exemption from energy/CO ₂ tax	Exemption from payment of motor vehicle tax
Austria	10% instead of 20%	On gas used in local public transport: 0			
Belgium	6% instead of 21%	Railways: 0; regional public transport: allowance*	yes		
Denmark	0% (except for tourist buses)	On mineral oils: 0		Mineral oils, electricity	Vehicles operated in scheduled service
United Kingdom	0%				
Finland	6% instead of 22%				
France	5.5% instead of 20.6%				
Greece	8% instead of 18%				
Netherlands	6% instead of 17.5%		yes		
Ireland	0%				
Luxembourg	3% instead of 15%				Motor vehicles used by local governments and public institutions, or used for public purposes
Germany	7% instead of 16% (within a distance of 50 km)	For methane and condensed natural gas: allowance**	yes		
Norway		0			Buses (also exempted from import duties)
Italy	10% instead of 19%, urban public transport: 0%				
Portugal	5% instead of 17%	On gas used in public transport: 0			Public transport motor vehicles
Spain	7% instead of 16%			Mineral oil used by railways	State-owned motor vehicles, passenger transport
Sweden	12% instead of 25%			Energy types used by railways other than mineral oils	

*Excise duty payment by regional public transport companies: 238 ECU/thousand litres instead of 287.2 ECU/thousand litres

**Excise duty imposed on methane used as engine fuel: 9.5 ECU/MWh instead of 24.2 ECU/MWh. Excise duty levied on condensed natural gas: 122.3 ECU/ton instead of 310.9 ECU/ton

Source: Database of environmental taxes in the European Union Member States, plus Norway and Switzerland. Evaluation of environmental effects of environmental taxes. European Commission, 1998; www.oecd.org/env/policies/taxes/index.htm

fair economic competition. In addition, it would encourage public transport companies to prefer running buses, and to cut back their fixed-line services. (Already today, buses are given indirect subsidies, because the track they use should not be paid for by the bus-operating companies, whereas in the case of tramway services the companies do have to pay those costs.) This may lead to serious consequences in Budapest, too, making the capital's traffic situation and environmental state even more unbearable. In some Hungarian country towns such measures might even result in closing down tramway and trolley bus services (e.g. shutting down the operation of tramways in Szeged, South-Hungary). If the state intervened in the market processes and made bus operation more profitable, it would also deteriorate the competitiveness of railways, which would be detrimental for the environment and the entire national economy. (Among other consequences, it would lead to an increased need for state subsidies to be granted to the railways.) With the possibility of reclaiming the excise duty of Diesel oil, more "reward" would be granted to companies which use up larger quantities of fuels. This would be an economically, energetically and environmentally erroneous stimulation.

Such a measure would render the state subsidization system even less transparent, which is contrary to the aims declared in the programme of the Hungarian Government.

We recommend that high-priority support worth HUF 40 billion should be devoted to improving the public transport situation in and around Budapest in a comprehensive manner, to enhancing the standard of services of the Budapest Public Transport Company (BKV) and of the Hungarian State Railways Company (MÁV), as well as the inter-town bus services (Volánbusz companies), to bettering their cooperation and to setting up a tariff alliance. These funds should be spent on improving the existing BKV and Volánbusz services, and on making the railway lines of Budapest and its environs more capable of carrying regular suburban passenger traffic. The three companies should only have access to the funds if they make a firm commitment to set up the tariff alliance (at least partially) in 2004. If they fail to do so, they should pay the amount back in accordance with the rules applicable to overdue tax obligations.

We understand that public transport needs improvement all over the country; still we propose that most of the support should be devoted to improvements in Budapest and its surroundings. The reason is that 18 per cent of all inhabitants of the country (or 23 per cent, if we include commuters from other places) live here, and nearly 25 per cent of the air pollution from vehicles is generated in Budapest, an extremely small area rep-

resenting only 0.5 per cent of Hungary's entire territory (see Figure II.2.7.3.b. and c.).

In our opinion the development of the suburban railway network requires special attention. Data of the traffic count carried out in 2000 revealed that nearly 390,000 people in 230,000 motorcars crossed the boundaries of Budapest every day. Those cars are responsible for about 65 per cent of the air pollution from cars in Budapest. At the same time, parallel with almost all the main roads going into the centre of Budapest, there are railway lines which are suitable for suburban transport (practically the only exceptions are the roads leading into the Erzsébet Szilágyi Avenue on the Buda side, where there is no railway line, but traffic there is assisted by a very efficient tramway line).

As a consequence, Budapest and its surroundings represent the area where transport-related environmental damage and traffic tensions can be moderated in the most cost-efficient way. The above measures could improve noticeably the living conditions of nearly 3 million people in and around Budapest.

We recommend that public transport services should also be improved outside the capital. For this purpose additional subsidies worth HUF 20 billion could be granted (over and above the support given to railways).

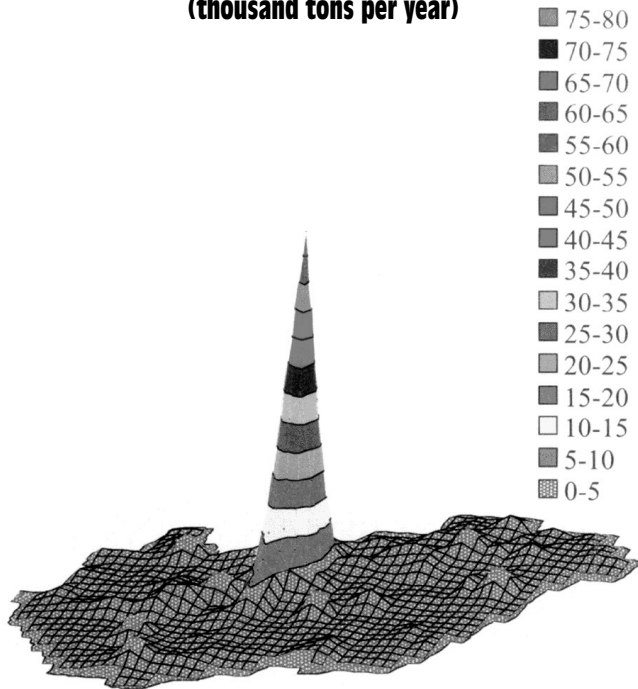
2.7.3.2. Improved railway transport services

Increasing energy prices and stricter environmental protection requirements make it an urgent task to improve the standard of passenger and freight transport services of the railways, and to attain a higher share within the performance of the transport sector. This could be promoted by coordinating more efficiently – with state assistance – the activities of the German, Austrian and Hungarian railways.

Within railway transport, we think that priority should be given to completing the neglected renovation projects, to improving suburban passenger transport services and to developing combined freight transportation. The railways' arrearage in renovation and modernization worth HUF 1300 billion has accumulated through the fault of former Hungarian governments; therefore we consider it the state's responsibility to make up the arrears.

Railway passenger transport has always been regarded as a public service. Earlier the state ordered the services it deemed necessary, determined the fares, and from the state budget it allocated the subsidies needed to cover the difference between the receipts from ticket sales and the actual expenditures of the railways. This system, however, in practice ceased to exist at the be-

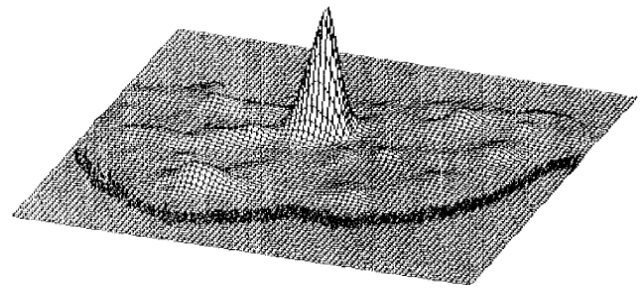
Figure II.2.7.3.b.: Regional distribution of carbon monoxide emission by road transport in Hungary in 1998 (thousand tons per year)



Source: Ministry of Environment Protection

ginning of the 1980s. The state kept ordering the services, but failed to pay for them since 1983 (see Figure II.2.7.3.d.). Therefore the passenger transport branch of the Hungarian State Railways Co. (MÁV), and together with that also the whole company, has become heavily loss-making. As a consequence, it was hardly

Figure II.2.7.3.c.: Regional distribution of particulate matter emission by road transport in Hungary in 1993

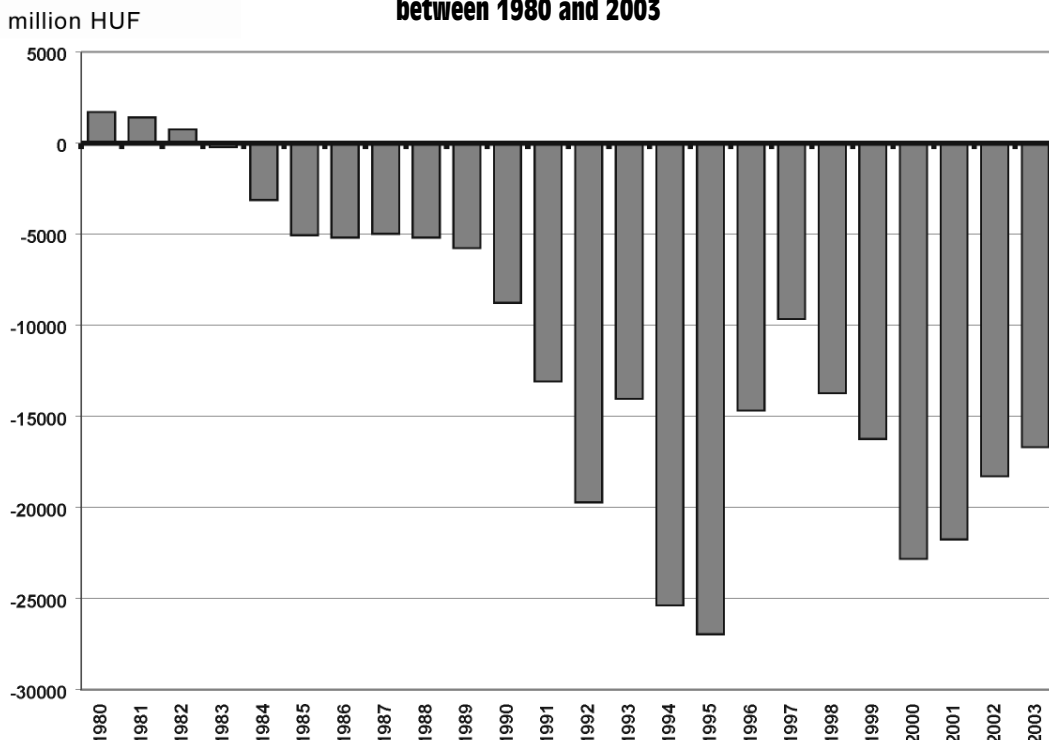


Based on emission data by 20×20 km regions

Source: Ministry of Environment Protection

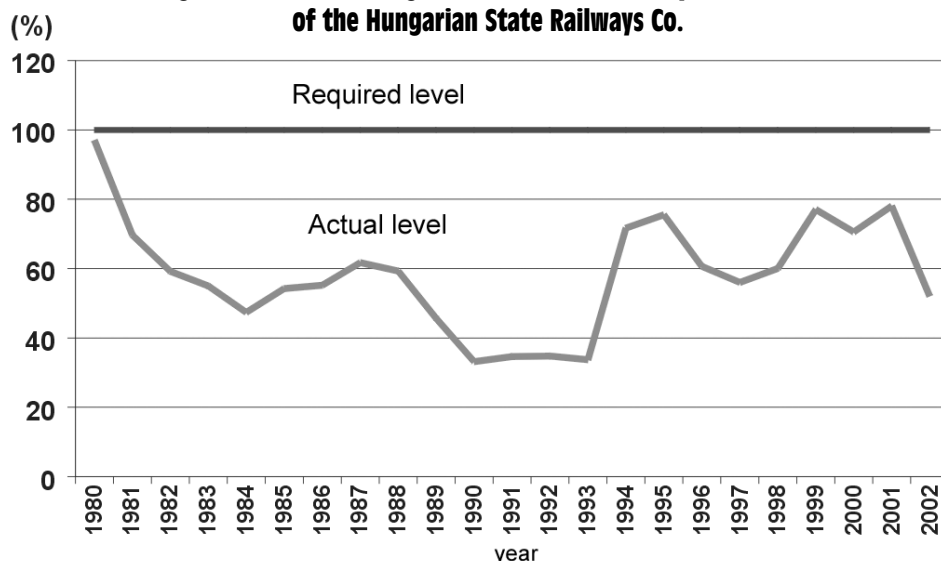
possible to effect new investments to improve the competitiveness of the railways; what is more, there was not, and even today there is not, enough money for the necessary maintenance and renovation tasks either. Thus, MÁV was forced to reduce substantially the funds to be spent on upkeep, maintenance, renovation and modernization. Even today only less than 80 per cent of the necessary investment resources are available at MÁV Co., but in the past decades this level of resources has characteristically been under 60 per cent (see Figure II.2.7.3.e.). This practice of the Hungarian state is contrary to EU Council decree No. 1191/69, saying that if the state orders public transport services, and the receipts from fares do not cover the costs, then the state has to pay for the loss. (Decrees of the EU Council are statutes with mandatory effect for all member states.)

Figure II.2.7.3.d.: Changes in passenger transport profits of the Hungarian State Railways Co. between 1980 and 2003



Source: Hungarian State Railways (MÁV) Co.

Figure II.2.7.3.e.: Changes in the level of development funds of the Hungarian State Railways Co.

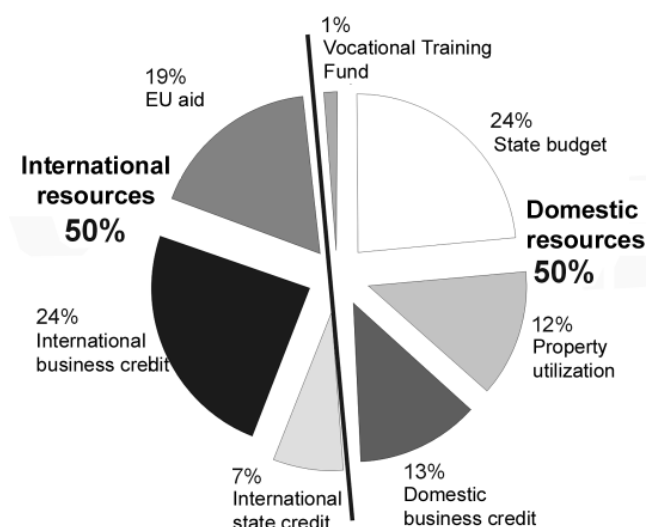


Source: Hungarian State Railways (MÁV) Co.

We think it is a mistaken policy that the state, instead of allocating sufficient resources from the central budget, forces the railway company to take up international loans (see Figure II.2.7.3.f.). MÁV Co. is unable to pay back the loans, so from time to time it needs rehabilitation by the state. Consequently, the amounts used for renovation and other investments will have to be paid after all from public funds anyway, at the cost of taxpayers. In addition, tax-paying citizens will have to pay also for the interests of the loans, making foreign banks even richer. What is more, international financial institutions set as a precondition, among others, that the number of trains and railway stops should be reduced and at least one-seventh part of the railway

network should be closed down. This is a grave interference in the internal affairs of Hungary, and the Hungarian Government acted irresponsibly when it provided state guarantees for such loans. (The loan contract, of course, does not mention shutting down railway lines, only handing them over to other entities; nevertheless these steps will in practice lead to closing down the concerned railway sections. Fortunately the banks did not take this stipulation seriously, because the deadline set for the implementation expired already a long time ago, but the affected railway lines are still in operation. If adequate funds are not available for the renewal of those sections, though, it is to be feared that they will simply reach such level of physical deterioration that closing them down will become inevitable.)

Figure II.2.7.3.f.: Planned resources for investments in 2001 by the Hungarian State Railways Co.



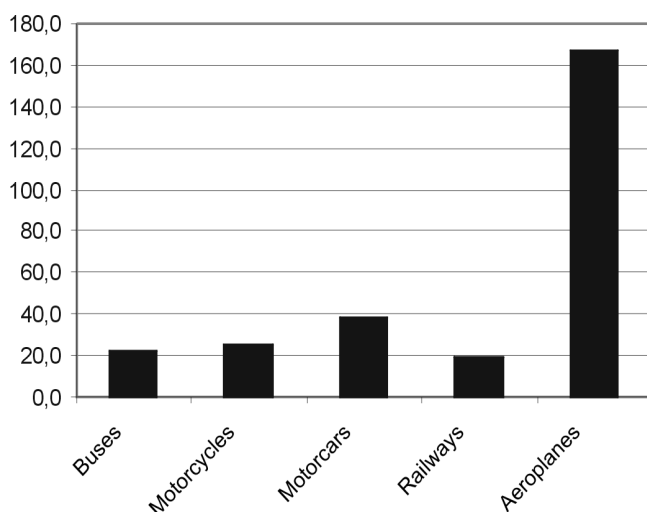
Source: Hungarian State Railways (MÁV) Co.

During the last two decades, transport-related measures at the level of state politics have repeatedly hit the more environmentally friendly railway transportation, placing it into an ever more disadvantageous position. Among such interventions one of the most important was that up until 1991 the tariffs of freight transportation into COMECON countries were kept at an extremely low level in order to promote integration of these countries into the COMECON. As a result, in 1990 alone, MÁV incurred losses worth some HUF 80 billion at current prices. Considering the whole period under review, revenues lost by MÁV owing to the above factor may be estimated at several hundreds of billions of HUF.

Another major political decision affecting the Hungarian railways was the Yugoslav embargo, which caused direct losses totalling about HUF 50 billion for the Hungarian State Railways Co.

In connection with Yugoslavia, MÁV suffered losses due to other political reasons as well. MÁV's international accounting system is based on multilateral inter-

Figure II.2.7.3.g.: Specific energy use of passenger transport in the European Union (petroleum ton-equivalent/million passenger-kilometres)



Source: European Commission, 1999

national and bilateral interstate agreements. These agreements can only be modified with state approval. Towards the former Yugoslavia, the Hungarian state delayed taking the necessary steps for political reasons, which resulted in outstanding debts due to MÁV in the value of some HUF 30 billion, which is still unsettled today. Since this loss, again, is incurred as a consequence of a state decision, the Hungarian state should purchase immediately the obligations of such origin from MÁV Co., in one lot, at full price with accrued real interests. (Payment of the interests is even more justified because MÁV was compelled to take up substantial loans for lack of appropriate state measures.) It is to be noted that although repayment of the Yugoslav debt has started recently, this is an extremely slow process and is made in very small instalments.

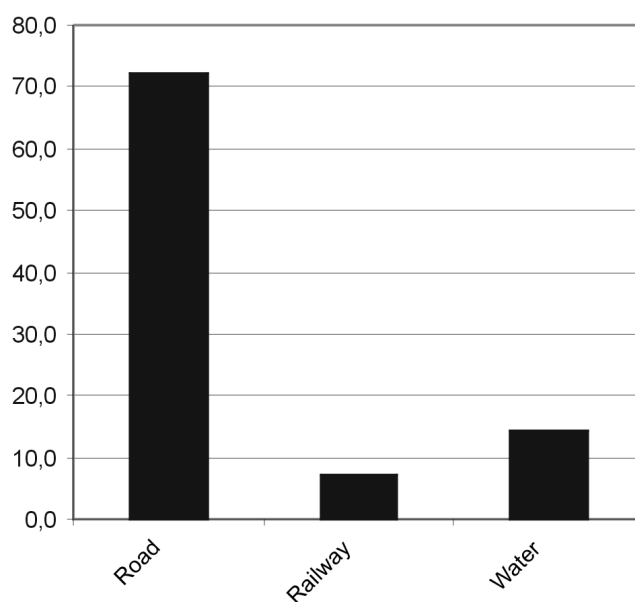
Introducing the system of free travels for Hungarian citizens aged between 65 and 70 was once again an entirely political decision. This causes MÁV to lose revenues worth about HUF 2 billion every year. (This amount is higher than the savings MÁV could achieve annually by closing down 1000 km secondary railway lines – plans for such steps appear from time to time among the news.)

To avoid misunderstandings, we have to underline that we do not want to dispute whether the mentioned decisions were politically right or not. “All” we want to call the attention to is that these government decisions had nothing to do with the market economy (they were taken at a purely political level), but the resulting losses had to be borne by an economic enterprise, the Hungarian State Railways Co., operating in keen market competition. And that is unacceptable for us.

While the state failed to pay the railways for the services it had ordered, and made the railway company pay for a large part of its decisions taken for state political reasons, ever larger preferences have been given to road and air passenger and freight transportation (see Chapter II.3.). These steps have been taken in spite of the fact that railway transportation has proved to be much more favourable than its mentioned competitors regarding energy consumption (see Figure II.2.7.3.g.) and the related air pollution (see Figure II.2.7.3.h.), as well as land occupation (see Figure II.2.7.3.i.), accident ratios (see Figure II.2.7.3.j.) and noise emission.

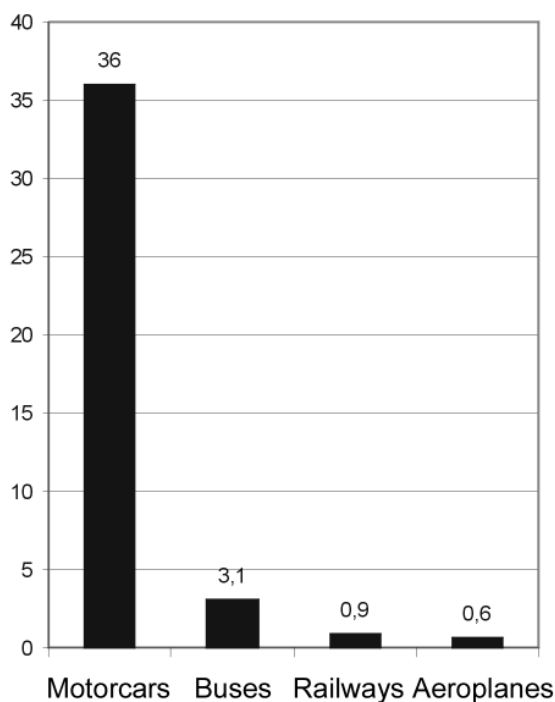
MÁV Co. has elaborated its detailed concept about the future of the Hungarian railways. The concept has divided the railways into two main parts: about half of the network will remain in the primary network, while the other half will form part of regional railway networks. The issue of financing has been a key problem in elaborating the concept. Only the primary network may count upon state funding, and even that support will depend on the financial standing of the Hungarian state budget. Within the concept, the part concerning funding is unacceptable because it is contrary to the provisions of the Act on Fair Economic Competition that the rival road freight transportation receives huge direct and indirect subsidies, although its operation has a specific environmental pollution level which is by more than a whole order of magnitude higher than that of the railways. What is more, road transportation uses the infrastructure virtually free of charge. Owing to the practice of cross-financing, these costs are paid by car-owners, constituting

Figure II.2.7.3.h.: Specific energy use of freight transportation in the European Union (petroleum ton-equivalent / million ton-kilometres)



Source: European Commission, 1999

Figure II.2.7.3.j.: Average costs of traffic accidents in the European Union, Norway and Switzerland (EUR / thousand passenger-kilometres)



Source: Infrast, IWW, 2000

the overwhelming majority of Hungarian citizens, and – through taxes – by the whole population.

Manufacturing of railway vehicles in Hungary is a closely related issue, and the government should treat it as a high-priority task. (Clean Air Action Group prepared a study on the subject and published it as an appendix to the 1998 budget proposals. At request a copy will be sent to anyone interested.)

We propose that an additional HUF 100 billion be spent on improving railway services in Hungary. Once these funds are available, the EU might be ready to grant Hun-

gary a support worth at least the same amount, because this will contribute to bettering the environment, and enhancing the competitiveness, of the European Union as well. However, to restore the competitiveness of railways, of course a much larger amount of funding is needed, and the market-distorting subsidies granted to road freight transportation should also be eliminated.

2.7.3.3. Aiding the depressed north-eastern region of Hungary through support to railway transportation

It is a well-known fact that Hungary's western part has already established strong trade relations with the EU countries. However, eastern regions of the country are increasingly lagging behind. North-East Hungary is practically a crisis zone, an economically backward area. Therefore various preferences should be applied to make those regions capable of catching up with the developed parts of Hungary and the EU. Offsetting partially the costs of using environmentally friendly means of transport (such as railway and combined freight transportation) by applying rebates (refunds of freight) could be an efficient way of giving a boost to those regions and promoting the least polluting means of transport. (Actually, a similar technique was already used about a hundred years ago in Transylvania to boost economic development.) The amount refunded could be the difference between the tariffs of road and railway transportation, which is approximately HUF 5 per freight ton-kilometre. Assuming that one million tons of goods are transported a year, and taking into account the distance of the transportation, the refund would cost the government approximately HUF 5 billion. But this measure would decrease the rate of inflation and the level of environment pollution, and railways would obtain orders to carry goods, which could result in lower needs for state subsidies. As demand for railway transport in-

Figure II.2.7.3.i.: Land occupation of modern railways and motorways, calculated for equal transportation performance



creases in Hungary, EU railway companies could also realize extra revenues. (Such a programme meets several EU criteria, so it could open up ways to have access to substantial EU funds.) If it is appreciated and accepted by EU countries, the system of freight rebates could be applied to transit of goods from Eastern European countries as well. It is worth mentioning that this way, competitiveness of these underdeveloped regions (i.e. eastern Hungary) could improve, whereas by constructing motorways the costs of goods produced in these regions would go up (among others as a result of paying large amounts of tolls) and aggravate further their economic backwardness compared to the European Union.

2.7.3.4. Significantly improved system of logistics

Inadequate logistics (low service levels and uncoordinated operations of interrelating systems) are one of the main reasons of the already mentioned excessive use of freight transportation. To avoid this, Hungary's central and local governments should provide sufficient assistance to improving significantly the system of logistic services, which would contribute to reducing the need for transport at the level of the national economy, as well as to lessening environmental pollution. Doing so, spectacular results can be expected in freight transportation within town boundaries. International experience has proved that with good systems of logistics in place, 30 to 50 per cent of the goods transport traffic of lorries and trucks can be avoided in the densely populated inner areas of cities and towns. The number of vehicles used may drop by 40 per cent, while their rate of utilization may go up to 80 per cent on average. In addition, such measures may reduce to the minimum the roadway area occupied by transport vehicles during loading and unloading. All the above impacts could lead to alleviating people's health problems and to making towns more attractive again.

2.7.3.5. Promoting the general use of traffic calming measures

It is especially important to assist and encourage local governments in elaborating traffic calming programmes as well as safe and pleasant conditions for pedestrians and cyclists in densely populated areas. Legal regulations, Parliament resolutions and also Hungary's international commitments demand such measures; however, in practice virtually nothing has been done for the implementation. To change this situation, state measures and means should also be involved. They should provide local governments with sufficient and high quality professional directives, introduce new

technical specifications, supply extensive information to the general public and give financial support to specific development projects through tenders.

2.7.3.6. Abolishing financial discrimination against bicycle use

It is worth considering that cyclists and pedestrians should be granted the same non-taxable travel allowance as motorists, when they travel or walk the same distance to work. It is unjustified and, presumably, unconstitutional that a means of transport which is seriously harmful to the environment is favoured against other, less polluting transportation methods. A measure ensuring equal financial conditions for cyclists and pedestrians could benefit the entire community in several ways: environment pollution would be reduced, motorcars would be used in smaller number, thus easing congestion and land occupation, and people could live a healthier way of life. The idea is quite feasible: the municipality of a town in England, for instance, has used this incentive successfully to persuade its employees to use a bicycle instead of a car when travelling to work.

In the Netherlands, tax allowances have been available since 1995 for employees who ride a bicycle when going to work. If employees use their own bicycle for their daily travel to work, the employer may grant them a non-taxable allowance worth NLG 0.12 per km (1 NLG = 0.45 EUR), or this amount may be deducted as an expense from the income tax. The employer may give the employee a bicycle in the maximum value of NLG 1500 in every third year, which, in taxation, will be regarded as an allowance in kind worth NLG 150. If the bicycle is not given into the possession of the employee for five years, but only made available for them, then there is no tax-payment obligation concerning the allowance. Bicycles under the value of NLG 1000 may be written off in the year of acquisition, and those of a value between NLG 1000 and 1500, over a period of three years. In addition, once in every three years the employer may also grant the employee financial assistance, exempt from taxes, to purchase bicycle fittings. Insurance costs may also be paid to the employee free of any taxes. (Source: Ecological Tax Reform, Vol. II, published by the Hungarian Centre for Environmental Economics /MAKK/ in 2000)

In Hungary, too, employees should be entitled to purchase bicycles for their daily travel to work, and to deduct such expenses from their personal income tax, in line with some international examples. Simultaneously, it would be worth assessing the possibility to introduce a system of bicycles to be used free of charge in Budapest, similarly to the practice of several Euro-

pean cities. The resulting one-off demand for a large quantity of bicycles should be coupled with the need to boost Hungarian manufacturing and employment ("Csepel" bicycles), in a manner that, for environmental protection reasons, the Csepel Bicycle Manufacturing Company should be allowed deferred payment or a preferential, interest-free payment for its tax and social security contribution obligations.

Another possible solution would be to give employers the right to purchase bicycles for their staff to use for going to work, without having to pay personal income tax and social security contribution on those purchases. It is also advisable to promote that safe bicycle storage facilities are established.

In our view, the task of bringing cycling into general use should be treated as a complex programme, and adequate incentives should be given to each element of the programme. More funds should be allocated to creating the conditions needed for safe bicycle traffic and to establishing appropriate bicycle storage facilities as well.

We propose that an additional HUF 12 billion be devoted to propagating the use of traffic calming measures and to improving the conditions for bicycle traffic.

2.7.3.8. Giving preferences to the use of taxis

Using cabs is much more beneficial both economically and environmentally than a practice when everyone drives one's own car. Using more cabs could reduce congestion on the roads, traffic jams and parking problems. In some cases even public transport can benefit from the widespread use of taxis (e.g. when people cannot use public transport services at night to return home, and they rather use their cars to be on the safe side). Therefore we recommend that the use of cabs should be given preferential treatment in Hungary as well, similarly to several EU countries. There are many possible methods for such preferences; below are only some examples of the available options.

Public institutions in Budapest may reduce their fleets of motorcars to half of their current size on average, and use a portion of the money spared for travelling by cabs. (This would also have an enterprise-promoting impact.)

Taxi drivers pay substantial amounts of taxes (excise duty, VAT, personal income tax, social security contribution, local tax on trade, etc.), which reduce their net revenues. So they have low real incomes and, as a consequence, low pensions (besides, they can earn less when they are older, because taxi driving is a hard work).

Therefore we recommend that the Hungarian Tax and Financial Auditing Office (APEH) should transfer, let's say, a five-percent share of the total accounted tax payment of taxi drivers to their individual pension account. It could strengthen the tax-paying moral as well. At the same time, stricter conditions should be set for taxi-driving (environmental specifications, professional and ethical requirements, etc., announced in advance).

2.7.3.9. Abolition of motorway tolls

We recommend that the motorway tolls should be entirely abolished.

Abolition of motorway tolls is justified by the fact that costs caused by road transport are particularly high in densely populated areas. This is highlighted also in the study titled *Efficient Transport for Europe – Policies for Internalization of External Costs*, published by the European Conference of Ministers of Transport (ECMT). Emission of 1 kg pollutant causes much more damage in urban areas than in the country, because much more people are affected by the same pollution. Also the noise emission per one vehicle-kilometre has significantly greater adverse impacts within densely populated areas than outside towns and villages. On the other hand, the construction and maintenance of roads and connected facilities cost huge amounts of money in urban areas, too; and to make matters worse, in such areas motor vehicle traffic severely damages the buildings and the public utility infrastructures as well. In some cases traffic congestions aggravate considerably the damage, and they primarily affect towns and cities.

According to the European Conference of Ministers of Transport, in order to make the participants of road transport pay for all the costs and damage they cause, it would be necessary to raise significantly the taxes and charges imposed on cars and trucks. At the same time, additional charges should be imposed on vehicles used in urban areas; as compared to the amounts payable outside populated areas, these charges should be by 55 per cent higher for cars, and by 110 per cent higher for trucks. This would mean an average difference of EUR 3.5 for cars and EUR 13.4 for trucks per 100 km (see Figure II.2.7.3.9.).

Consequently, through the motorway tolls, the state imposes more burden just on the less harmful part of transport. What is more, as a consequence of the tolls, motor vehicle owners who are more price-sensitive tend not to use the motorways, but rather to choose the roads going through towns and villages. As a result, traffic and environmental conditions often become almost unbearable in the settlements along these roads. Thus, the motorway tolls cause also innocent inhabitants of the towns and villages concerned to pay with the dete-

rioration of their health and their environment, although they usually do not receive any share of the benefits brought about by the transit traffic.

Operating a sticker system for payment of motorway use is also unreasonable, because stickers are valid for a set period, so there is no correlation with the length of travel on the motorway. This means that motorists driving less will partly pay also for drivers who use the motorway more frequently.

In 2002, revenues of the state budget from the sales of motorway stickers amounted to some HUF 12 billion, while the connected state expenditures totalled HUF 2 billion. So the Hungarian state only had net revenues of HUF 10 billion. The M5 motorway involves particular problems. The AKA Co. operating the M5 had revenues of nearly HUF 7 billion from motorway tolls, but operating and maintaining the toll payment system also caused large expenditures for the company. Consequently, by abolishing all motorway tolls, the amount of lost revenues would not exceed HUF 17 billion, which should be assumed by the state in a manner that these funds are raised from another source. And, for the entire amount, this source should be the road charge to be imposed on heavy trucks, because these vehicles cause the largest part of the road maintenance costs. (We will discuss this subject more in detail in the chapters that follow.)

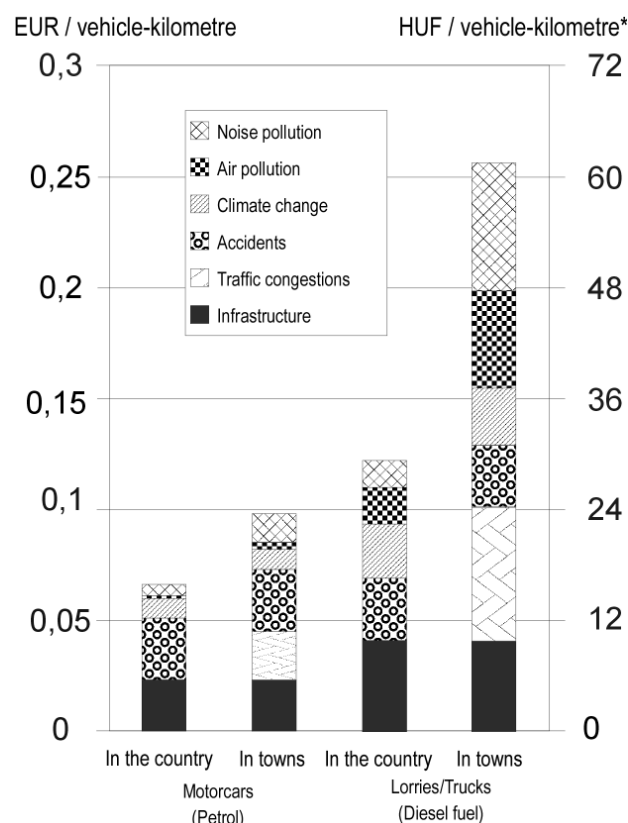
All that has been said above does not imply that Clean Air Action Group supports the construction of new motorways in Hungary. A forced motorway construction programme must not be financed from loans. The already limited resources should rather be spent on vocational training, which is a much more efficient use both economically and socially. And the task of relieving towns and villages from the harms caused by transit traffic can also be implemented in other ways at much smaller costs and with much less damage to the environment. Such methods include improvement of railway transportation and public transport services, traffic calming in inner urban areas, better traffic management, appropriate settlement development policies and construction of relatively short by-pass road sections to avoid towns and villages. (In connection with this subject see also Appendices Nos. 5 and 7.)

2.7.4. Protection of air quality

Half of the population in Hungary live in areas where the air is polluted to some extent. Air quality needs to be improved considerably by implementing the proposals mentioned earlier in this document and through various other measures.

Having an air quality measurement network of adequate density and standard in place is not a substitution for the required actions, but it is a precondition for such

Figure II.2.7.3.9.: Additional charges to be imposed on users of motor vehicles, as proposed by the European Conference of Ministers of Transport



*Based on the National Bank of Hungary exchange rate on 29th March 2002
Source: ECMT, 1998

steps, therefore the needed budgetary resources should be allocated for this purpose. It would be advisable to look into the possibility to get Hungarian manufacturing industries better involved in the production of measuring apparatuses (at present, supply of spare parts for the existing instruments poses a major problem).

2.7.5. Protection against noise and vibration

Over the last decades noise has become one of the most severe environmental harms affecting the population. Besides other measures proposed in the present study to combat noise pollution, in some cases direct state support is needed (to establish natural or artificial noise barriers, for instance).

2.7.6. Organizing integrated waste management

Nearly 104 million tons of waste is produced in Hungary a year. On the one hand, this causes severe environmental pollution, and on the other shows how wastefully raw materials are being used. It is an urgent task to

reduce the amount of waste produced, to introduce selective waste collection, as well as to make reusing and recycling generally pursued practices. The new Act on Waste Management and the National Waste Management Plan (which is expected to be approved by the Hungarian Parliament soon) will contribute to alleviating the situation, but they are far from being sufficient to solve all the existing problems in this area. Hulladék Munkaszövetség (HUMUSZ) Hungarian environmental NGO has elaborated detailed proposals to address the issue of waste management, and we fully support the implementation of this concept.

2.7.7. Water and soil protection

The last few decades have seen a significant deterioration of water quality both in terms of underground and surface waters. Only 57 per cent of all Hungarian inhabitants have sewers installed, which is an important source of pollution, whereas nearly 97 per cent of the population has access to public utility water supply. The situation is further aggravated because a large part of the sewage is not or not adequately treated. Budapest and some major provincial towns are particularly lagging behind as far as waste water treatment is concerned. Soil quality has also become poorer in many areas. To improve this situation, the state budget should provide substantial direct financial support.

2.7.8. Support of the National Agrarian Environmental Protection Programme

Agricultural methods widely used in the past few decades are largely responsible for reduced biodiversity, degradation of soils, less varied and attractive landscapes, as well as for chemicals entering the food chain, often causing damage to health. The most important task today is to form a state-of-the-art, environmentally sound agrarian economy.

As a result of the anti-smoking campaigns and the ban on tobacco advertising, this destructive habit will hopefully lose ground among the population. With a view to rearranging the jobs of those now working in the tobacco industry and tobacco-growing, too, increased support should be given to organic agricultural production (e.g. in the Nyírség region in eastern Hungary).

We propose that HUF 35 billion extra support should be allocated for the National Agrarian Environmental Protection Programme. Out of this amount, HUF 20 billion should be ensured by rearranging funds available for the Ministry of Agriculture and Rural Development, and HUF 15 billion should be granted as additional funding from the state budget.

Positive results of the programme would include thousands of new jobs and increasing volumes of surplus products, most of which would be sold in foreign markets. In this manner Hungary could also have access to substantial EU funds for this purpose. Extra support to the programme would lead to adding 100 thousand hectares to environmentally sound farming, with a surplus production worth some HUF 100 billion. This value is mostly made up of wages, so the state budget may increase its revenues by some HUF 30 to 40 billion.

In connection with this issue see also *Appendices Nos. 2 and 3, titled Proposals for the chapters related to agriculture in the state budget bill, and Proposals for the chapters related to agriculture in the 2004 state budget of Hungary, respectively.*

2.7.9. Nature conservation; protection, improvement and extension of Hungary's forest-lands and the green areas of its settlements

It is essential to fulfil the tasks listed in the National Nature Conservation Primary Plan, which was prepared on the basis of Act LIII of 1996 on Nature protection. One of the most urgent tasks is to increase the total area of forest-lands to 20 per cent of Hungary's territory, and to 25 per cent in the long run. Protected natural areas should cover 12 per cent of the country's whole area. State budget contribution is indispensable to achieve the goals set in the Plan.

Green areas in towns and villages should primarily be protected and improved through indirect economic implements and appropriate legal regulations, but direct state support is also needed.

Considering the annual reports of state forest management companies, the aggregate annual profit from business activities of all Hungarian forest companies may be estimated at HUF 2 billion. Consequently, over and above the current subsidies, it would be enough to devote an additional HUF 2 billion to avoid the negative environmental impacts caused by profit-oriented activities of state forest management companies. Better enforcement of the ecological, protective and public welfare functions of state-owned forests may contribute to raising the living standard of local population, boosting tourism and related services, and reducing healthcare expenditures at the level of the society as a whole.

For the efficient management of socially-owned forests, it is essential to elaborate and operate an appropriate system of targets and implements. Nature protection requirements and expectations of the Hungarian society can only be fully met if these forest-lands

are kept under state control and are managed along the lines of the above objectives. Financial basis for such operation can be secured partly from the sales revenues of timbering and partly from budgetary sources, as allocation for a state assignment. The latter part of the funds, estimated at about HUF 6 billion, should be allotted to forest management entities through contracts of administration, which are specified and controlled in detail. This task financing system will ensure equal operation for functions and services that cannot be placed on a market basis.

To achieve efficient operation of Hungarian forest management companies, they should be transformed into public service companies, and they should be provided with a contractual subsidy of HUF 8 billion per year, allocated from the state budget.

Privatization of even more state-owned forests cannot be a solution for the above problems, so we cannot support such policies. Today's practice unfortunately shows a rather short-term approach on the part of owners of private forests, who often manage their property aiming at a quick return on their invested capital. This has led to a growing share of forest plantations made up of trees which are not indigenous species in the given area, but grow fast and can be timbered after a relatively short period of time. In addition to that, under these management practices, the cutting age of the native tree species (e.g. Turkey oak) has also been lowered. One of the necessary preconditions of sustainable use is that short-term economic interests of owners should not clash with long-term objectives. Therefore we have taken the view that forest areas to be incorporated into the National Land Fund in the future, as well as land areas potentially suited to become afforested should also be taken under administration by the state or by non-profit organizations.

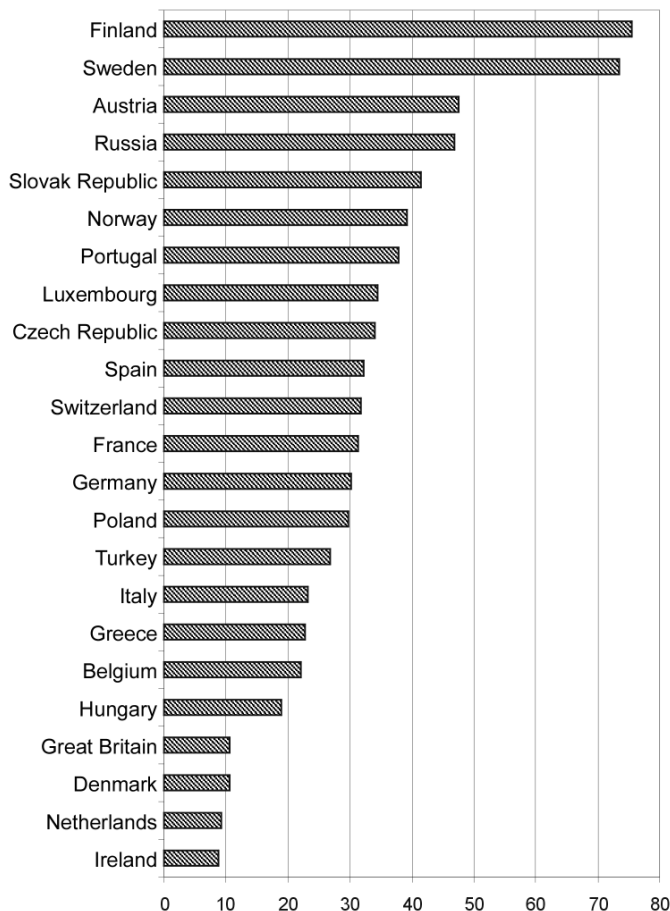
As regards the proportion of forest-lands within the total national area, Hungary is in the last position among European countries (see Table II.2.7.9.). This is another reason for changing the current situation as soon as possible.

(This section has been compiled by using the materials prepared by WWF Hungary.)

2.7.10. Removal of long-term environmental damage and rehabilitation of contaminated areas

In conformity with the National Environmental Rehabilitation Programme, budgetary sources should provide most of the funding for removing long-term environmental damage and for rehabilitating contaminated areas, which belong to the scope of responsibility of the Hungarian state.

Figure II.2.7.9.: Area of forest lands in selected European countries as a percentage of the total area



Source: International Statistical Yearbook of the Central Statistical Office of Hungary

2.8. Increased support to small and medium-sized enterprises

We think that it is vital to enhance the competitiveness of Hungarian small and medium-sized enterprises (SMEs). Importance of this economic sector is proved by the fact that it makes a 50 per cent contribution to Hungary's GDP and provides two-third part of the jobs.

In Chapter 9 of the present document we will demonstrate that large foreign companies are granted huge subsidies in Hungary. Considering that, we cannot approve of the current subsidization policy concerning small and medium-sized enterprises and the amounts of funds they are allotted. Hungarian SMEs can also be supported by cutting back the unnecessary subsidies given to foreign-owned companies. (See the Hungarian State Audit Office's Report on the Economic Development Target Programme.) Profits are chiefly realized at business entities selling the end product. This is why it is a false concept that Hungarian SMEs should only work as subcontractors engaged in supplying products to large foreign companies.

The subcontractor programme outlined in the Széchenyi Plan (National Economic Development Plan) is also very much questionable. As a matter of fact, this programme provides hidden subsidies to multinational corporations, which is again a factor which distorts market conditions. What is more, several of these companies carry out activities that are environmentally unsustainable, or contribute to expanding such activities (car manufacturing companies, for instance). On the other hand, it involves excessive risks economically if Hungarian entrepreneurs depend too much on the operation of foreign companies in Hungary. In case some of these firms decide to relocate their activities into another country, it may have very severe adverse impacts on the Hungarian economy.

In its country report on Hungary for 1999, the European Union, too, disapproved of the heavy tax burdens imposed upon, and the discrimination against, small and medium-sized enterprises. (The report criticized, for instance, that for SMEs the average payable corporate tax level is 17 per cent, whereas for multinational companies it is only 8 per cent – as a consequence of the preferences.) Nevertheless, we think that it would be a completely wrong policy to base the support of SMEs largely upon granting them individual subsidies. Such subsidization is contrary to the principles of market economy, violates the rules of fair economic competition, brings down the general level of economic efficiency and provides also opportunities for corruption. In our opinion, only normative subsidies can be acceptable tools if Hungary wishes to avoid the above adverse impacts. Furthermore, if more funds are spent on education, culture and healthcare, it will primarily assist SMEs: on the one hand, because many SMEs work also in these sectors, and on the other, because this will create additional demand for products and services supplied by SMEs operating in other branches of the national economy.

Reduction of the payable social security contribution from its rate of 39 per cent in 1998 to 33 per cent in 1999 had a particularly favourable effect on the activities of SMEs, for these companies employ relatively more live labour. Our calculations show that as compared to 1998 and using 2000 prices, this measure cut down wage costs by HUF 210 billion in 2000. Therefore, the continued reduction of wage costs should remain a major “normative” measure to support SMEs in Hungary also in the future. At present an average HUF 1.14 state budget burden is imposed on HUF 1 net wage. As of 1st January 2001, the rate of social security contribution came down to 30 per cent, and as of 1st January 2002 it was further cut down to 29 per cent. The current Hungarian Government has plans to reduce further the social security burdens.

Release of taxes on the minimum wage in 2002 also lessened the wage burdens of enterprises.

It would be more advisable to make some of the SMEs rather the subcontractors of the Hungarian-owned, so-called regional multinational companies, because in this manner they would form an integral part of the national economy, reinforcing thereby its cohesion. It would also be important to lay much more emphasis on developing the Hungarian environmental protection industry.

In the state budget of 2003 we propose to devote additional sources in the value of HUF 20 billion to the support of small and medium-sized enterprises. In our opinion this can be achieved in the following way. In public procurement tenders, Hungarian products take precedence even if they are at most by 10 per cent more expensive than the imported product. As a consequence, Hungarian customers placing orders are in practice counter-interested in purchasing domestic goods. Taking into account that state budget burdens (social security contribution, personal income tax, etc.) represent about 50 per cent in the value of most of the characteristic Hungarian products, it would be in the interest of the national economy to give domestic goods priority over foreign merchandise even if they cost twice as much. This contradiction can be resolved if the state budget disburses the mentioned 10 per cent to the customer placing the order. Thus the additional HUF 20 billion Hungarian support would result in domestic orders worth HUF 200 billion, which in turn would increase state revenues by some HUF 100 billion. In terms of employment, this would secure approximately 100 thousand jobs. This outflow of resources would improve the external economic balance as well, because on the one hand it would partly squeeze out imported foreign products, and on the other it would bring about an expansion of exports. From 2004, resulting gross revenues of the state budget would amount to at least HUF 50 billion (personal income tax, social security contribution, corporate tax and local tax revenues).

In addition, such measures would ease the setback resulting from the economic recession. We would like to point out that these economic impacts of the Széchenyi Plan have been favourably evaluated by the Council of Finance Ministers of the European Union. The narrow-minded restrictive monetary approach, now prevailing in Hungary, should be abandoned in this sector as well.

In contrast to Hungarian practice, in the EU nearly 400 different normative support schemes are involved in assisting SMEs at community level, with funds totalling over EUR 10 billion a year. Over and above these programmes, individual member countries operate extensive subsidization systems at national level, too.

As far as the Hungarian system of supporting research and development activities is concerned, there is a particularly strong discrimination against SMEs, because such extraordinary state subsidies are only granted to large foreign corporations.

The Hungarian Ministry of Finance recommends that SMEs should be supported by granting them interest subsidies on bank loans taken up for development projects, but only up to a limit of HUF 5 million. This support scheme in practice means subsidization of the lending banks, because SME subsidies are not coupled with appropriate credit conditions. Since banks are in a dominant economic position, it is predictable that they will be the beneficiaries of this situation. In the case of companies in majority foreign ownership, subsidies are generally not tied to banks or bank loans, but are granted directly (e.g. the Hungarian Tax and Financial Auditing Office refunds the paid taxes).

Therefore we recommend that the system of providing state subsidies through bank loans should be abandoned and the funds so becoming available should be granted to SMEs in the form of tax allowances.

2.9. Promotion of environmentally sound tourism

Under the current system, the Hungarian state budget adds a contribution of HUF 2 to each HUF 1 of tourism tax (local resort tax) collected on the basis of the duration of holiday-makers' stay. Introduction of this system was at the time justified by the need to make local governments interested in imposing and collecting the tax. This system of incentives has become superfluous by now. For 2002 the state budget estimated subsidies worth HUF 5.8 billion for Hungarian local governments to complement the HUF 2.9 billion they collected as taxes in the above manner. We recommend that as of 2004 the tasks related to holiday resorts should be divided into two categories: eco-tourism and other tourism. Certain types of tourism and tourism in general above a certain extent cause severe environment pollution. Therefore making the tourism sector more decentralized and more ecological are tasks which definitely deserve state support.

State contribution to eco-tourism should be HUF 3 to complement each HUF 1 collected as tourism tax (except for taxes related to buildings), while in the category of other tourism a proportion of 1:1 should be enforced. In this way, state support would be rearranged from areas that are environmentally overloaded, partly by tourism, to environmentally less problemati-

cal areas. Such a measure would also enable underdeveloped Hungarian regions to have access to more EU funds (this additional support may amount to as much as HUF 1 billion). Before introducing this system, it is necessary to elaborate precisely the criteria and the preferred target areas of eco-tourism, so that the adverse environmental impacts ensuing from tourism can be prevented well in advance.

We were glad to see that in recent years substantial amounts have been devoted, and are even today being devoted, to developing medical tourism – in conformity with our earlier proposals. In our opinion the most important task now is to enhance the rate of utilization of existing capacities.

Implementation of this task could be promoted by concluding bilateral agreements between the social security systems of Hungary and of the EU countries (first Austria and Germany).

Hungary's competitive advantage is guaranteed by the average wage level of Hungarian medical doctors, which is around twenty times less than their counterparts' in the EU countries. The agreements would prevent Hungarian health service employees, who had been trained at very high costs, from being forced to seek employment individually abroad or finding themselves without any job opportunity in Hungary, increasing thereby the level of unemployment. This would also be beneficial for the EU countries because medical treatment in Hungary costs significantly less than it does in EU countries.

Social security systems are going through a crisis even in member states of the European Union as a result of the ever-increasing expenses. Being less expensive, medical service in Hungary could provide assistance for the EU. On the other hand, in Hungary this solution would ensure employment for doctors and medical personnel. Chances for such an arrangement are considerably increased by Hungary's accession to the EU in 2004.

As a result of the above favourable measures, eco-tourism and medical tourism are expected to show a significant growth – especially because this tendency is also gaining strength in the EU. Within the Central and Eastern European region Hungary may have a pioneering role in these new sectors. Particularly the eastern part of Hungary can experience a boom in this type of tourism. Our preliminary calculations show that the number of visitors a year may increase by as much as 100 thousand, which can bring about extra revenues worth at least HUF 10 billion in the first years. About half of that amount, i.e. HUF 5 billion, can be realized by the state budget as gross revenues.

B.) Elimination of subsidies granted to activities damaging the environment and human health

“Any forms of state subsidies which distort market competition or threaten to distort it through giving preference to some enterprises or products ... are incompatible with the common market.”

Section 87 of the Treaty of the European Communities

“The Community’s environmental policy is aimed at achieving a high-level protection, taking into consideration the differences which exist between the Community’s regions. The environment protection policy is based on the principles of precaution and prevention, on the «polluter pays» principle, as well as on the principle that environmental harms have to be eliminated at the place where they occurred, and the polluter has to pay for the damage caused.”

Paragraph 2 of Section 174 of the Treaty of the European Communities

We think that it is of crucial importance to eliminate as soon as possible the direct and indirect state subsidies that are at present being granted in Hungary to activities and products which seriously damage the environment and human health, use up non-renewable resources on a large scale and are sometimes closely connected to the black economy. Besides, related controls and penalties should also be made stricter. Currently in Hungary some environment-polluting activities gain extra profits by exploiting non-renewable natural resources, i.e. thereby they benefit from undeserved competitive advantages.

Implementation of an environmental state budget reform is made indispensable by the need to improve the general state of the environment, and to enforce economic rationality and social justice. Furthermore, it is required by Hungary’s international commitments, as well as by several official documents of the EU, such

as the Amsterdam Treaty of 1997. The OECD Council issued a guideline (No. C[72]128) as early as in 1972, which was followed by several documents and studies in later years. The guideline says:

“Natural resources are scarce as a rule, thus their use in production and consumption may lead to their deterioration. Unless the costs of that damage are incorporated into the prices, the market will not be able to reflect the scarcity of the resources either in a specific country or internationally. That is why measures are required to reduce pollution and allocate the resources in a more efficient manner by implementing product prices (which are connected to the quality and/or quantity of the resources used in their production) that reflect more precisely the relative scarcity of the resources, and to ensure that the economic participants concerned act accordingly. ...The «polluter pays» principle is an effective means of encouraging the more rational use of scarce natural resources and avoiding distortions in investment practices and in international trade. Therefore, it is a principle to apply when dividing the costs of preventing and controlling pollution. This principle means that the polluter must pay for all the costs incurred during the implementation of the above measures taken by authorities to restore the environment to a reasonable state. Or, in other words, the prices of goods and services, the production and/or consumption of which cause environmental damage, must cover the costs of rehabilitating the environment.”

We would like to emphasize that an environmental budget reform, if properly introduced, would not increase costs at the level of the national economy. It would only charge the already existing expenses to those who are responsible for those costs. As a result, it would enhance the overall efficiency of the Hungarian economy, which would bring about a lower aggregate cost level.

3. Transport

At present, prices of motor vehicle transport fail to cover all the costs involved, for instance, the costs of the environmental and health damage this sector produces. (For more details see Appendix 4.) External costs need to be incorporated into the prices by all means; economic rationality and social justice, as well as Hungary's commitment to European standards require it. The Green Paper titled "Towards Fair and Efficient Pricing in Transport" published in 1995, and the White Paper titled "Fair Payment for Infrastructure Use" released in 1998 strongly manifest EU policies on transport. The documents clearly reveal that in each member country of the EU, a significant part of the road freight and passenger transport costs is not borne by the actual users of transport, and that these costs should eventually be enforced in transport prices.

A resolution (CEMT/CS[98]5/FINAL) adopted by the Conference of European Ministers of Transport (CEMT) in Copenhagen in May 1998 states that a large part of the losses and damage generated by transport is still not paid by the users of transportation services, and it calls for member countries, among them also Hungary, to start fully incorporating external costs into the prices as soon as possible. Such restructuring can only be achieved through imposing increased taxes and charges in a way that will not add to the aggregate volume of taxes to be borne by the Hungarian society. The

resolution also underlines the responsibility of national governments to give sufficient information to the public enabling them to accept and support the incorporation of external costs into transport prices.

Our proposals are based on the theoretical and practical concept that the costs of environmental and other damage, up until now borne by the entire society (including, of course, the users), must be enforced in the prices.

Environmental damage caused by transport in Hungary is summarized in Table II.3. Values in proportion to the GDP come from the ministry responsible for transport; HUF values calculated from GDP figures at official current exchange rate and at purchasing-power parity have been derived from the official data of the Hungarian Central Statistical Office for 2000.

Table II.3. illustrates that environmental damage attributable to transport is three or four times bigger than state budget revenues coming from taxes and charges levied on motor vehicles only (excise duties of fuels, motor vehicle tax imposed by local governments, etc.). Other types of taxes which are imposed on every product and service, such as VAT, should not be taken into consideration here, since they are supposed to cover the general expenses of the society as a whole, and are (or should be) shared by all branches of the economy in proportion to their performance – without these ex-

Table II.3.: Environmental damage caused by transport calculated on the basis of GDP in 2002 (billion HUF)

Damage caused by transport	Costs as a percentage of GDP		Costs at current prices						Purchasing-power-based costs					
			Total		Road		Railway		Total		Road		Railway	
	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max
Accidents	1.5	2.0	255	340	226	301	29	39	576	767	510	680	66	87
Air pollution:														
local	1.0	1.3	170	221	162	210	8	10	384	499	366	475	18	23
other (outskirts of settlements)	0.3	0.5	51	85	45	74	6	11	115	192	101	168	14	24
Noise and vibration	0.8	1.0	136	170	110	138	26	32	307	384	249	311	58	73
Time lost	2.0	3.0	340	509	293	440	47	70	767	1151	662	994	105	158
Total:	5.6	7.8	951	1324	835	1163	116	162	2149	2993	1887	2628	262	366

Note: In 1999, Hungary's GDP as determined on a purchasing power basis was 2.26 times larger than the value calculated at the exchange rate.

In 2002, Hungary's GDP calculated at current prices was HUF 16,980 billion, while on a purchasing power basis it amounted to HUF 28,656.8 billion.

Source: Central Statistical Office of Hungary: International Statistical Yearbook 2003 and Hungarian Statistical Yearbook 2003

penditures it would not be possible to sustain motor vehicle transport either.

We have to underline that figures in the table are far from covering all the external costs of transport. Among others, the loss and damage attributable to climate change resulting from greenhouse gas emissions or to land occupation for transport purposes have not been taken into account when calculating the figures, although the costs of removing them are not paid by the users of transport only. Damage due to reduced biodiversity is not included either. Furthermore, there are harms that indirectly arise from transport because they are produced by activities without which motor vehicle transport would not be able to exist at all (road construction, motorcar manufacturing, crude oil exploration and production – just to mention a few). An instructive example for the latter type of damage is the case of the tanker “Prestige”, recently stranded near the Spanish coasts. The Ministry of Environment Protection in Austria has found that those indirectly involved industries consume 0.7 times as much energy as transportation itself. Assuming that environmental damage is proportional to energy consumption, figures of the environmental damage caused by transport should be multiplied by 1.7 to make them realistic.

Other calculations determine environmental harms and costs to be lower than the above values. However, even those estimates support the idea that environmental and other damage caused by transport well exceeds the amount of state revenues derived from this sector.

A study published by the Hungarian Institute for Transport Sciences reveals that total losses of the national economy resulting from road accidents amounted to HUF 55.2 billion in 1994, which is around HUF 165 billion at 2002 prices.

Objections are often raised that for example the taxes (and so the prices) of fuels should not (or cannot) be increased any further because wages in Hungary are lagging far behind those in Western Europe. By accepting those objections we would agree that the lives and health of Hungarians are worth much less than those of EU citizens. On the other hand, taxes on fuels need to be increased among other reasons just because in this way other tax-type burdens can be reduced, leaving room for raising the wages, and so making it possible to preserve or even improve the solvency of Hungarian citizens. Accordingly, extra revenues from fuel taxes should be entirely devoted to covering social security expenses.

Increasing fuel prices generate inflation, but only temporarily and very slightly. **Beneficial impacts of the increase may offset the inflationary effect already after six months. Fuel costs represent only 3 per cent in the prices of Hungarian products as a rule; therefore, the average price level is not expected to grow much. (Fuel**

costs constitute only about 8 per cent even in the service fees of taxis in Budapest. Consequently, a fuel price rise of 50 per cent would only justify raising these tariffs by approximately 6 per cent. However, we estimate that a drop in the overall volume of road traffic would by far offset the negative impacts of that increase. Less traffic would reduce the fuel consumption of cabs by shortening the time spent in traffic jams, and more people would travel by taxi.) The inflationary impact caused by increased fuel prices can also be averted by diverting traffic from roads to railways, because railway transportation’s (import-dependent) fuel costs are thirty times less for the same performance than those of road transportation.

Higher excise duties on fuels would discourage fuel consumption. Lower fuel consumption would contribute to protecting the environment, reducing the number of accidents, bettering the conditions of public and railway transport and also to improving the balance of foreign trade.

The situation of road freight transportation in Hungary is a copybook example of the consequences brought about by pampering an economic sector. Strong lobby interests of the sector are being enforced; as a result, freight transportation companies grow lazy, integrated logistical systems are not built up and the national economy’s transport-intensity ratio does not improve either.

Hungarian road freight transportation companies are wrong when they argue that domestic carriers are already overburdened with taxes. The following facts support just the opposite:

- Oversupply prevails in the Hungarian freight transportation market, while the national economy’s specific transport-intensity is higher than the EU average. In 1998, freight transportation performance per one unit of GDP in Hungary was 1,352 freight ton-kilometres/EUR calculated at exchange rate, and 0.598 freight ton-kilometres/EUR calculated at purchasing power parity, whereas in the European Union this ratio was 0.455. Available data show that the index of specific transportation performance has considerably improved in Hungary since 1991, but even so it is still lagging behind the EU value. Therefore, with a view to the modernization of the Hungarian economy, it is essential to reduce the need for transportation.
- In Hungary, the share of the black and grey economies is much higher than in the EU, and this is particularly true for the road transportation sector. In the black economy, the specific transport-intensity ratio is extremely high, because this is partly a way to cover up the traces. A survey produced by the Hungarian Central Statistical Office (KSH) has found that 53 per cent of the total value of freight transportation services used by Hungarian house-

holds is performed without issuing any invoices on the completed work. (Source: "Hidden Economy in Hungary", published by KSH, Budapest, 1998)

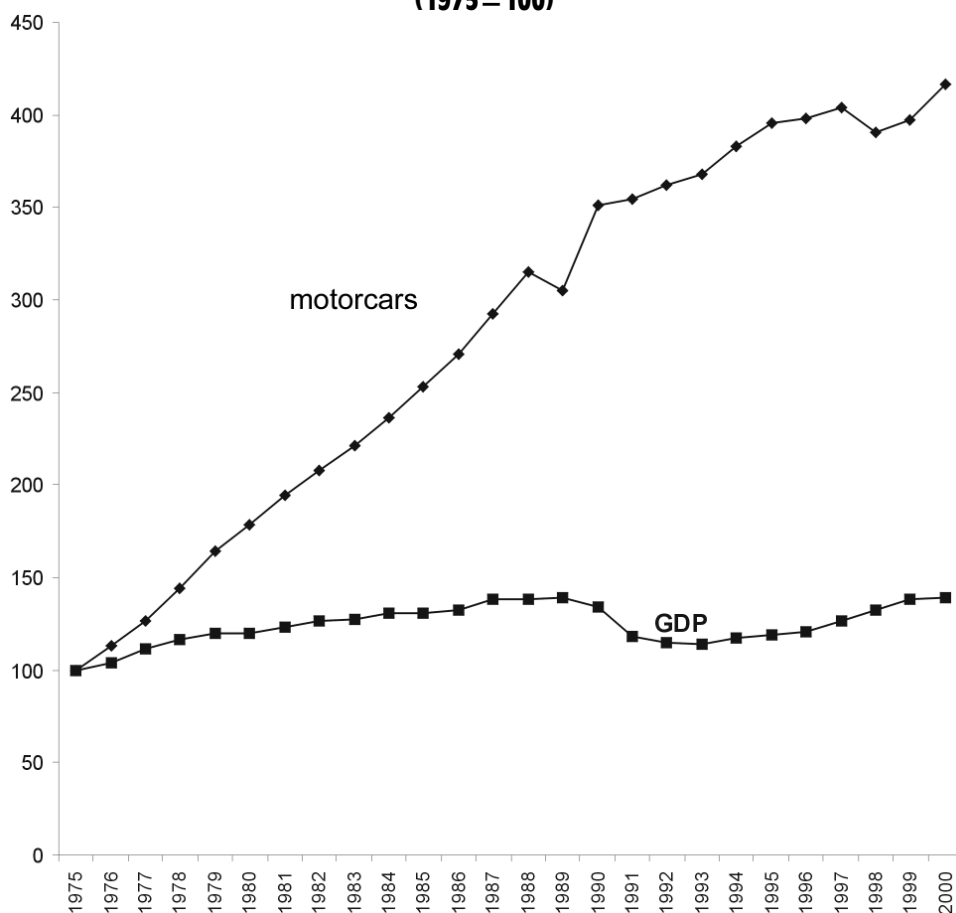
- The EU's Green Paper mentioned above and a recent publication by the European Conference of Ministers of Transport (ECMT) titled *Efficient Transport for Europe – Policies for Internalization of External Costs* both reveal that road freight transportation companies do not pay the bulk of the costs they cause. These documents also demonstrate a commitment to find ways to change this situation and have the participants of the transport sector pay for the real costs of their activities. (Public transport, which is a public service, could be exempted from that requirement.) A practice which is contrary to the above principle distorts market conditions, and unjustly discriminates against some participants while favouring others undeservedly. Unless the prices reflect real costs, economic efficiency will be lower than what would otherwise be possible. (Hungary has had the chance to learn from the bitter experience of the past decades and see the consequences of unrealistic prices.)
- More environmentally friendly freight transportation modes (railway, fluvial) have been losing ground, which resulted in higher specific environmental loads due to transportation, i.e. external costs have been growing steadily.
- Prices of fuels and also a large part of other energy sources are mostly determined by the high (and ever-growing) prices of imports. In addition, the volume and share of these imports are also rising, owing to the depletion of Hungarian hydrocarbon sources. On the other hand, the price of domestic labour depends on the performance level it is capable of attaining in the domestic and external markets; therefore, the burdens imposed on labour need to be cut by all means.

Another argument against our proposals is that higher taxes would "put an end to road transportation" and so they would bring about significant losses for the economy. We have to refute this argument. In Hungary the number of motor vehicles has surged over the past few decades. This trend has gained even more speed recently: imports of mo-

torcars increased by 31 per cent in 2001 compared to the previous year, amounting to 155 thousand. This number was further increased by 32 thousand Suzuki cars, assembled from imports for the domestic market. In 2002, the imports of motorcars, and within that particularly the imports of used motorcars, continued to rise rapidly, which was mainly prompted by the revaluation of the Hungarian currency and by the liberal regulation in force. However, the experience of recent years, as well as foreign analyses, evidence that rapidly growing numbers of motor vehicles do not necessarily mean that economic performance improves accordingly. Just the other way round; disproportionate growth of motor vehicle transport drains away resources from other areas that could more efficiently contribute to economic development. Figure II.3. compares GDP and the number of motorcars in Hungary. This comparison demonstrates that the country's development does not depend on the number of motor vehicles.

Unlike transportation companies, we think that the "real end" of transport will come if taxes remain the same as today. Firstly, because environmental and health problems caused by transport may increase (and

Figure II.3.: Gross domestic product and number of motorcars in Hungary between 1975 and 2000 (1975 = 100)



Source: Yearbooks of the Central Statistical Office of Hungary

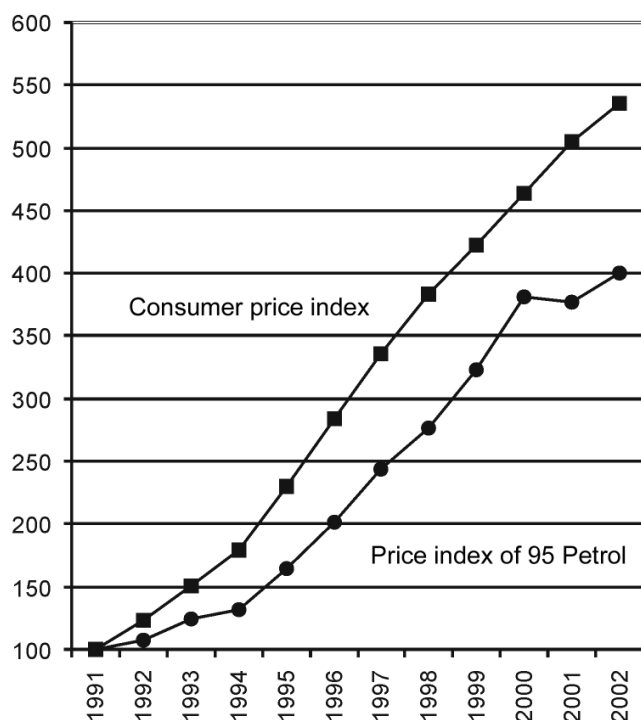
partly they have already increased) to a level that disables further economic development and seriously threatens even the normal functioning of the society as a whole. It is important to remember that damage may be increasing exponentially when traffic is growing. Secondly, the existing infrastructure is less and less sufficient to carry an ever-increasing number of motor vehicles. The capacity of the infrastructure, however, is very hard to be expanded for economic reasons (lack of, or insufficient, resources) and for physical ones (town and village settlement structures are not much flexible).

Another reason for increasing the taxes on motor vehicles (or at least adjusting them by the rate of inflation) is that it could open up ways to reduce taxes imposed on live labour, which has been a declared aim of the Government itself.

3.1. Valorization of excise duties on petrol

Petrol prices in Hungary have already almost reached the price level of relevant EU countries. During 2003, world market prices of hydrocarbons will presumably become stabilized at a lower level, which may bring about a drop in petrol prices. It would be justified to increase (or, to be more precise, to maintain the real value of)

Figure II.3.1.a.: Changes in the price of unleaded 95 Petrol and the consumer price index in Hungary 1991=100



Source: Central Statistical Office of Hungary, MOL Co.

excise duties by the rate of the price reduction. Another reason to support such action is that wages should not be the sole financial sources of social security; higher taxes (excise duties and the connected VAT) on fuels could in part provide the funds, since fuel use is responsible for a considerable part of all health damage.

Excise duties of fuels have fallen at a particularly high rate in real value between 1998 and 2003. Tables II.3.1.a. and II.3.1.b., as well as Figure II.3.1.a. illustrate that up until today, every successive Hungarian government pursued a practice in which consumption taxes (excise duties), and parallel with that petrol prices increased less than the average rate of inflation in each year. The governments, this way, were in fact granting regular allowances to a type of consumption which causes serious environmental pollution. This policy had an adverse impact on Hungary's balance of foreign trade, made economic restructuring more difficult to achieve, and contributed to the introduction of austerity measures which caused massive damage to the Hungarian society.

To facilitate comparison we have elaborated these data in the structure of the 1997 statistics. (In the tax we have not included the Road Fund contribution and the environmental product charge, because earlier these items did not form part of the consumption tax, but were used as earmarked funds, i.e. they offset some of the costs related to fuel use, for instance those of road construction and maintenance, as well as a fraction of the environmental damage.) Tables II.3.1.a. and II.3.1.b. show the changes in fuel prices and all their components, as well as their proportions between 1991 and 2003. Data in these tables demonstrate that the consumer price index was much higher than the rate of increase of petrol consumption taxes (excise duties). This allows a clear conclusion: the price of this environmentally harmful product has already come down in the last period due to the dropping real value of budgetary curtailments.

The outstandingly high world market price of petroleum and related other hydrocarbons in 2000 (Figure II.3.1.b.) was only a temporary phenomenon: 2001 saw already a significant price reduction, which continued in 2002 as well, and a presumably short-term new price increase only occurred at the end of the year – in connection with the crises of Venezuela and Iraq.

The expression “presumably short-term”, of course, only holds true for a time span of a couple of years. In the decades that follow we may anticipate a considerable price rise parallel with the depletion of resources and the aggravation of environment pollution. Several experts estimate that world petroleum production will peak around 2010, which means that from that time on, production will not keep pace with the exploration of new resources. Further problems are caused by the fact that production costs of the newly opened sources grow rapidly; and to

**Table II.3.1.a.: State budget revenues from consumption taxes
(excise duties), and consumer price index in Hungary**

Date	98 Petrol unleaded as from 1999		95 Petrol unleaded		Diesel fuel*		Consumer price index
	HUF/litre	%	HUF/litre	%	HUF/litre	%	%
1 Jan 1991	21.40		18.60		9.70		
1 Jan 1992	26.30		21.40		11.40		
1 Jan 1993	32.80	100.0	27.80	100.0	22.40	100.0	100.0
1 Jan 1994	36.90	112.5	28.00	100.7	23.00	102.7	118.8
1 Jan 1995	41.60	126.8	35.30	127.0	30.20	134.8	152.3
1 Jan 1996	47.60	145.1	41.30	148.6	34.70	154.9	188.2
1 Jan 1997	54.00	164.6	48.30	173.7	40.00	178.6	222.7
1 Jan 1998**	58.74	179.1	54.42	195.8	47.78	213.3	252.8
1 Jan 1999	61.42	187.3	61.42	220.9	53.25	237.7	278.0
1 Jan 2000	65.73	200.4	65.73	236.4	56.94	254.2	305.3
1 Jan 2001	65.73	200.4	65.73	236.4	56.94	254.2	331.8
1 Jan 2002	65.73	200.4	65.73	236.4	56.94	254.2	351.8
1 July 2002	72.45	220.9	72.45	260.6	62.76	280.2	351.8

*For diesel fuel we have made comparable the changed structure of consumption tax and VAT

**From 1998 on, in the case of excise duties only the part due to the state budget is shown among the data, i.e. in our calculations we have maintained 26.32 per cent as a part of the excise duties apportioned to the Road Fund and 3 per cent as a part apportioned to the Environmental Protection Fund. In the case of diesel fuel the Road Fund had a share of 26 per cent.

Source: Laws on consumption taxes and excise duties

Table II.3.1.b.: Price structure of fuels (HUF/litre)

Description	Production and distribution costs	Crude Oil and Petroleum Products Stockpiling Association fee	Road Fund	Consumption tax 1.)	Environment- al protection fee	Excise duty	VAT 2.)	Total (petrol station price)
98 Petrol (leaded up until 1998) - Super plus								
1 Jan 1991	22.60		3.20	21.40		24.60	11.80	59.00
1 Jan 1992	18.90		5.20	26.30		31.50	12.60	63.00
1 Jan 1993	19.90		6.00	32.80	0.50	39.30	14.80	74.00
1 Jan 1994	18.70		6.00	36.90	0.80	43.70	15.60	78.00
1 Jan 1995	24.84	0.94	9.50	41.60	1.20	52.30	19.52	97.60
1 Jan 1996	34.55	1.27	12.10	47.60	2.00	61.70	24.38	121.90
1 Jan 1997	43.58	1.82	15.40	54.00	2.00	71.40	29.20	146.00
1 Jan 1998	47.04	2.58	21.87	58.74	2.49	83.10	33.18	165.90
1 Jan 1999	47.89	3.53			2.61	86.90	34.58	172.90
31 Dec 1999*	82.29	3.53				86.90	43.18	215.90
1 Jan 2000*	82.39	3.73				93.00	44.78	223.90
31 Dec 2000*	86.39	3.73				93.00	45.78	228.90
1 Jan 2001*	86.39	3.73				93.00	45.78	228.90
31 Dec 2001*	63.99	3.73				93.00	40.18	200.90
1 Jan 2002	63.60	4.12				93.00	40.18	200.90
1 July 2002*	82.90	4.12				102.50	47.38	236.90
31 Dec 2002	84.98	4.12				102.50	47.90	239.50
1 Jan 2003	87.38	4.12				102.50	48.50	242.50
7 May 2003	78.58	4.12				102.50	46.30	231.50

Description	Production and distribution costs	Crude Oil and Petroleum Products Stockpiling Association fee	Road Fund	Consumption tax 1.)	Environmental protection fee	Excise duty	VAT 2.)	Total (petrol station price)
95 Petrol unleaded - Super								
1 Jan 1991	23.80		3.20	18.60		21.80	11.40	57.00
1 Jan 1992	22.20		5.20	21.40		26.60	12.20	61.00
1 Jan 1993	22.50		6.00	27.80	0.50	34.30	14.20	71.00
1 Jan 1994	25.20		6.00	28.00	0.80	34.80	15.00	75.00
1 Jan 1995	27.94	0.94	9.50	35.30	1.20	46.00	18.72	93.60
1 Jan 1996	35.25	1.27	12.10	41.30	2.00	55.40	22.98	114.90
1 Jan 1997	43.68	1.82	15.40	48.30	2.00	65.70	27.80	139.00
1 Jan 1998	46.42	2.58	20.27	54.42	2.31	77.00	31.50	157.50
1 Jan 1999	39.09	3.53			2.61	86.90	32.38	161.90
31 Dec 1999*	75.09	3.53				86.90	41.38	206.90
1 Jan 2000*	75.19	3.73				93.00	42.98	214.90
31 Dec 2000*	79.19	3.73				93.00	43.98	219.90
1 Jan 2001*	79.19	3.73				93.00	43.98	219.90
31 Dec 2001*	63.99	3.73				93.00	40.18	200.90
1 Jan 2002*	63.60	4.12				93.00	40.18	200.90
1 July 2002*	75.70	4.12				102.50	45.58	227.90
31 Dec 2002	77.78	4.12				102.50	46.10	230.50
1 Jan 2003	80.18	4.12				102.50	46.70	233.50
7 May 2003	70.58	4.12				102.50	44.30	221.50
Diesel fuel								
1 Jan 1991	14.40		0.70	9.70		10.40	6.20	31.00
1 Jan 1992	18.40		2.20	11.40		13.60	8.00	40.00
1 Jan 1993	19.10		6.00	22.40	0.50	28.90	12.00	60.00
1 Jan 1994	22.20		6.00	23.00	0.80	29.80	13.00	65.00
1 Jan 1995	22.61	0.97	9.50	30.20	1.20	40.90	16.12	80.60
1 Jan 1996	31.41	1.31	12.10	34.70	2.00	48.80	20.38	101.90
1 Jan 1997	43.94	1.86	15.40	40.00	2.00	57.40	25.80	129.00
1 Jan 1998	47.73	2.67	17.79	47.78	2.03	67.60	29.50	147.50
1 Jan 1999	39.67	3.65			2.25	75.00	29.58	147.90
31 Dec 1999*	78.87	3.65				75.00	39.38	196.90
1 Jan 2000*	79.07	3.85				80.20	40.78	203.90
31 Dec 2000*	95.07	3.85				80.20	44.78	223.90
1 Jan 2001*	95.07	3.85				80.20	44.78	223.90
31 Dec 2001*	71.07	3.85				80.20	38.78	193.90
1 Jan 2002*	70.71	4.21				80.20	38.78	193.90
1 July 2002*	70.71	4.21				85.00	39.98	199.90
31 Dec 2002	78.79	4.21				85.00	42.00	210.00
1 Jan 2003	80.39	4.21				85.00	42.40	212.00
7 May 2003	69.99	4.21				85.00	39.80	199.00

Notes:

1.) From 1998 on, excise duties include payments into the Road Fund and the Environmental Protection Fund (annual average).

2.) From 1993 on, VAT is separated; up until that time it formed part of the consumption tax. Only for diesel fuel: VAT is reclaimable.

*Data collection: on 30th December 1999, on 1st January 2000, on 31st December 2000 and on 1st January 2001, based on actual prices of petrol stations at MOL Co.

The excise duty of 2001 (98.6 HUF/litre and 85.0 HUF/litre) would only have entered into force above a price of 25 USD/barrel.

By virtue of Act LXXIV of 2001, the revalorized increase of excise duties only entered into force as from 1st July 2002.

Source: MOL Co.

make matters worse, in many parts of the world (e.g. in China) demand for hydrocarbons is expected to grow explosively, which will unsettle current market prices.

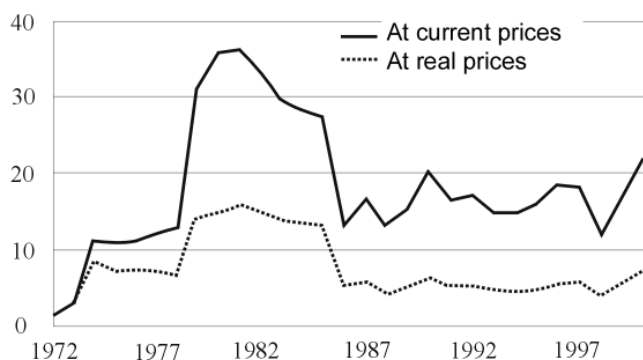
Authoritative estimates put the annual average price of crude oil at around 25 USD/barrel in 2003. The Hungarian purchase price was 22 USD/barrel in 2001, and 21.6 USD/barrel in the first 9 months of 2002.

It is worth highlighting that in the past 15 years, petroleum prices were stabilized at a relatively low level, particularly if calculated at the real value of USD (dotted line in the Figure). This is why we recommended earlier that the consumption taxes of fuels should be raised.

In our opinion, an increase of excise duties lower than the rate of inflation is against the Constitution and other relevant legislation, for it promotes activities damaging our health and the environment. Consequently, the essence of such measures is discordant with the principles of the European Union, too.

The Hungarian Ministry of Finance had plans to raise the excise duty on petrol by 6 per cent in 2001 and by 4 per cent in 2002. Inflation was higher than planned in 2001 (9.2 per cent), and the consumer price increase was expected to come down to 5.5 per cent in 2002. Combining the planned increase of excise duties for the years 2001 and 2002, this would have resulted in a rise of about 10 per cent for the two years in the aggregate, while the inflation rate was 16 per cent over the same period. Owing to the failure to valorize excise duties, the relative consumer price of fuels would have decreased by approximately 6 per cent. However, as a con-

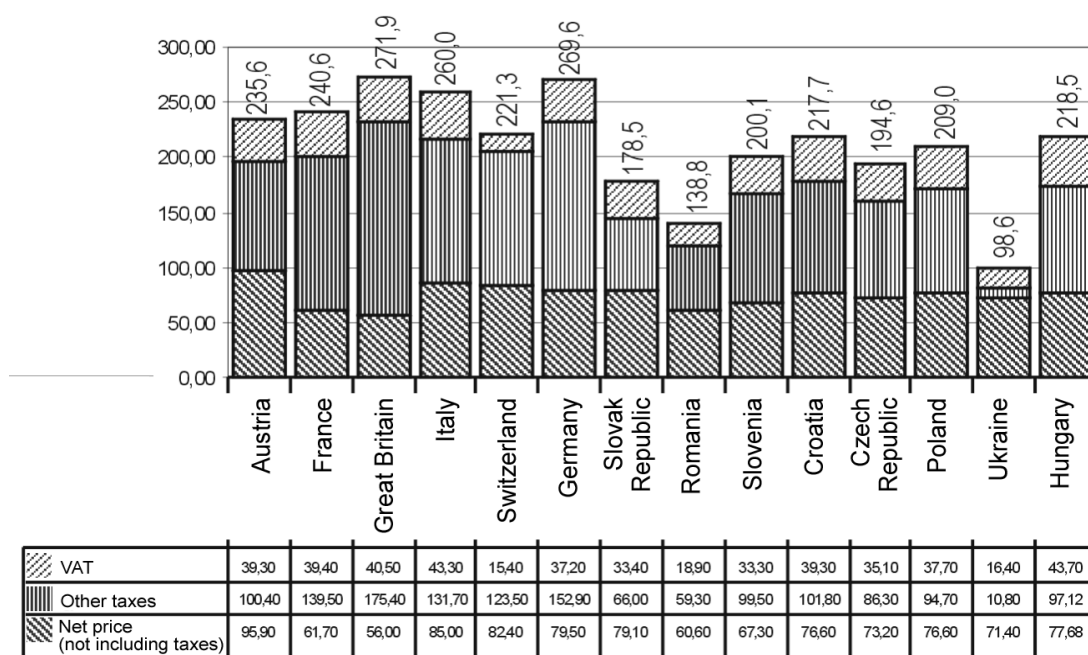
Figure II.3.1.b.: Changes in the world-market price of petroleum between 1972 and 2000 (USD/barrel)



Source: International Energy Agency, OECD

sequence of the threat by freight transportation interest groups, which is a serious violation of the Constitution and several laws, the Government did not raise the excise duties in 2001 despite the original provisions of the law. What is more, it even postponed the rise of 1st January 2002, also prescribed by the law, by six months, to 1st July 2002. Due to the threat, the arrearage in increasing the excise duties amounted to some 16 per cent as of 1st July 2002, which, indeed, would only have been a valorization. This also means that as a consequence of the lost tax revenues, funds available for healthcare, for instance, were reduced, whereas the ever-accelerating and wildly growing motorization is one of the main causes of health damage. According to our

Figure II.3.1.c.: Price structure of motor petrol in selected European countries in July 2002 (HUF/litre)



Source: MOL Co.

calculations, the amount of lost excise duty revenues due to the failure to valorize the excise duties under the pressure of the mentioned threats totalled nearly HUF 37 billion in 2001, and around HUF 63 billion in 2002 (also considering the shortfall in the rate). Therefore, all in all, lost excise duty revenues, calculated without interests, amounted to roughly HUF 100 billion. Excise duties have not been raised as of 1st January 2003 either, so the real value of this hidden subsidy increased even further (see Table II.3.2.). From this amount, a considerable part of the problems in the Hungarian healthcare sector could have been solved, and so many human lives could have been made longer or better.

Clean Air Action Group submitted a petition to the Hungarian Court of Constitution, appealing against the modification of the tax law under the pressure of the blackmailing of road freight transportation interest groups. It is important to note that in the aftermath of the events of 11th September 2001, such blackmailing action by a narrow pressure group of road freight carriers can already be qualified as a type of terrorism. (Appendix 5 contains the petition submitted to the Court of Constitution.) Our proposal is to increase excise duties on petrol in the years that follow in a manner that Hungarian prices are adjusted to those in Austria, calculated at the official exchange rate. It could enable Hungary to adapt to pertinent EU policies and also to fulfil the commitments undertaken in the CEMT (see Figure II.3.1.c.).

Owing to the revaluation of the Hungarian currency and the weakening USD (purchase of hydrocarbons is predominantly effected in USD), the Hungarian fuel price has practically reached the Austrian level; therefore under the present conditions we cannot propose a price rise. For that reason, other methods should be applied to incorporate the external costs of the now cheaper road transport into the prices. So it would be particularly opportune to take such measures now.

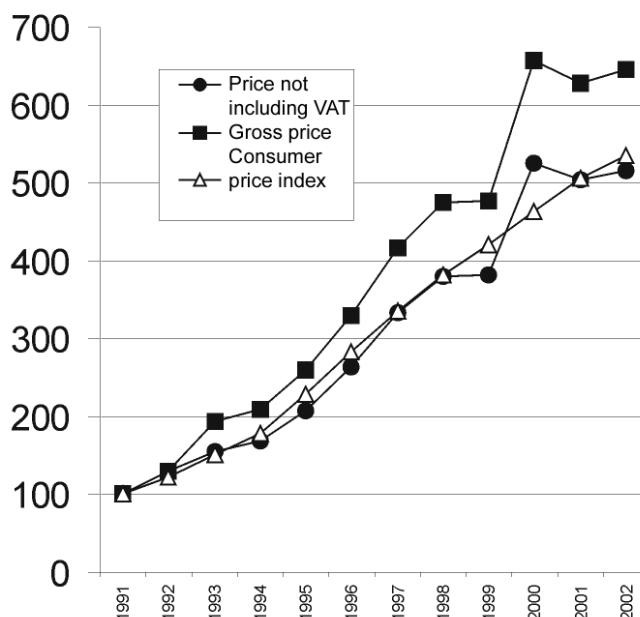
3.2. Increased excise duties on diesel fuel

In theory, excise duties on diesel fuel should be of the same level as those on petrol. There are no rational reasons whatsoever why diesel fuel excise duties should be set lower than the duties on petrol. Rationality would rather justify the opposite.

Figure II.3.2.a. illustrates the changes in the price of diesel fuel.

One of the most important reasons for abolishing the preferred status of diesel fuel is that latest research findings reveal that exhaust gases from diesel engines pose in general much more health and environmental hazards

Figure II.3.2.a.: Changes in the price of diesel fuel 1990=100



Source: MOL Co., Central Statistical Office of Hungary

than those from petrol-operated engines. (The UN World Health Organisation does not set air quality limit values for diesel exhaust gases because they have not found any concentration below which these emissions will surely not damage human health.) Another reason for adjusting the excise duty rates is that diesel fuel is mostly used by trucks and other heavy motor vehicles that damage the roads to a much higher extent than cars do. Consequently, at present there is a huge cross-financing in Hungary, at the expense of those using petrol-operated motor vehicles. This practice distorts market competition and increases environment pollution.

Transport companies can reclaim the VAT content of their invoices on diesel fuel, which is another preference for the use of diesel fuel. However, VAT can be reclaimed in the case of all kinds of products purchased for use in manufacturing or service industries and it is in line with EU practice as well, therefore we cannot propose the abolition of this possibility. Nevertheless, we think that the fact should be remembered. What is important to note is that the rate of VAT on fuels is higher in Hungary than generally in the EU countries (it is 20 per cent in Austria, for instance), therefore the reclaimable part is larger, which means a comparative preference. We do not propose that the 25 per cent Hungarian VAT rate be reduced – rather, it is presented as an argument in favour of increasing the excise duty on diesel fuel.

Excise duties introduced in 1998 included the contribution payable into the Road Fund and the environmental product charge. These two items had been set as percentage rates at the time. Accordingly, we calculated that

the rate of the Road Fund contribution amounted to 26.32 per cent of the excise duties paid on fuels after 1998. Environmental product charges represent 3 per cent of the applicable excise duties. So the absolute values of both the Road Fund contribution and the environmental product charge depended also on the type of the fuel. Although the Road Fund does not exist any more, all this proves again that the practice of applying different tax rates for petrol and diesel fuel is contrary to the principle of sharing proportionately the burden of taxation.

It is important to note that the proposed increase of the excise duty of diesel fuel would not affect agricultural activities, for the entire amount of the duties is refunded in this sector.

We are well aware that at present, bringing the excise duty rates of petrol and diesel fuel to a uniform level is not feasible in Hungary because of the expected political and economic consequences, and also because the current Hungarian diesel fuel price already surpasses the Austrian level (although the rate of the reclaimable VAT is higher in Hungary than in Austria). Achievement of a uniform excise duty rate for the two fuel types in the future, however, should also be promoted by raising the excise duty of diesel fuel at the same percentage rate as that of the petrol.

Based on the above reasons we recommended that as of 1st July 2002 the excise duty on diesel fuel should be increased at the same rate as the duty on petrol, i.e. by 16 per cent. In 2002 (only considering the impact of a six-month period) this could have brought extra revenues worth HUF 13 billion for the state budget as compared to the estimates (see Figure II.3.2.b.).

Despite the facts we have described above, the excise duty on diesel fuel was finally set – upon the Government's

proposal – at the rate of only 85.00 HUF/litre, i.e. the lower version, in contradiction of the law which was in force up until 1st July 2002. Originally the duty would have been raised to 88.40 HUF/litre from the current 80.20 HUF/litre. This decision was the result of the pressure from road freight transportation companies.

It is particularly noteworthy that in recent years, when adjustment to EU standards has been given more emphasis, the real value of excise duties on fuels has been decreasing considerably in Hungary. (See Table II.3.2.)

Data in Table II.3.2. clearly demonstrate that environmentally polluting activities are given ever-increasing subsidies through tax allowances. According to the estimate in the Act on the State Budget, revenues from excise duties on fuels will total HUF 384 billion in 2003. From this figure we may easily calculate that the real value loss of excise duties means additional subsidies (contributing to the deterioration of the Hungarian economic structure) of nearly HUF 50 billion for transport activities which pose serious loads on the environment. If the rate of the excise duty does not go up by a further 5 per cent (in line with the rate of inflation) in 2003, the amount of the mentioned subsidy will reach approximately HUF 67 billion. This is very problematical, considering that the healthcare sector is lacking these funds, when subsidies are just being granted to environment pollution which has detrimental effects on human health – so the adverse impact is doubled.

Despite all these weighty reasons we cannot propose that the excise duties of fuels be raised in 2004. It is because regarding such measures, Hungary should preferably follow the practice of the neighbouring EU member states (primarily that of Austria). Nevertheless, we keep strongly opposing to any reduction in fuel taxes.

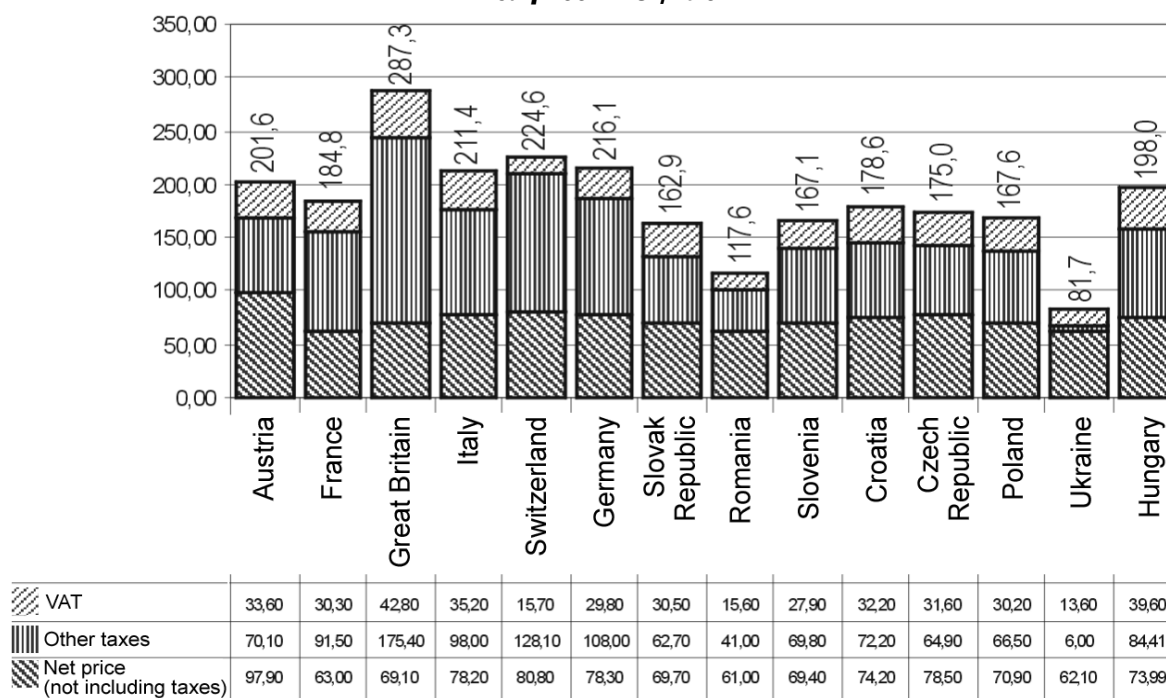
Table II.3.2.: Changes in excise duties imposed on fuels

	Petrol			Diesel fuel			Consumer price (%)	Ratio of petrol/diesel fuel prices
	HUF/litre	nominal price	real price	HUF/litre	nominal price	real price		
1 Jan 1998	83.10	100.00	1.00	67.60	100.00	1.00	100.0	1.229
1 Jan 1999	86.90	104.57	0.9507	75.00	110.95	1.0086	110.0	1.159
1 Jan 2000	93.00	111.91	0.9266	80.20	118.64	0.9823	109.8	1.160
1 Jan 2001	93.00	111.91	0.8485	80.20	118.64	0.8995	109.2	1.160
1 Jan 2002	93.00			80.20			106.0	1.160
1 July 2002	102.50			85.00				1.206
Average of the year 2002	97.75	117.63	0.8414	82.60	122.19	0.8740	106.0	
2002/1998	117.63%		84.14%	122.19%		87.40%	139.81	

1 Jan 1998 = 100

Source: MOL Co., Central Statistical Office of Hungary, excise duty laws

Figure II.3.2.b.: Price structure of diesel fuel in selected European countries in July 2002 (HUF/litre)



Source: MOL Rt.

3.3. Imposing excise duties and VAT on fuels entering Hungary in fuel tanks of motor vehicles

As demonstrated in Tables II.3.3., fuel prices are lower in neighbouring countries (except for Austria) than in Hungary. This difference is particularly large in the case of the Ukraine and Romania. Based on this price difference, fuel tourism and fuel smuggling have grown to huge proportions. This is confirmed by information received from Hungarian customs authorities and by relevant news releases regularly published in the press, although the actual dimension of those activities is difficult to assess. (Fuel smuggling is defined as an activity when fuels are brought illegally into the country, or are brought in legally, but resold illegally. By fuel tourism we mean that fuels are brought into the country legally and are used legally for own purposes, but the border-crossing trip is made primarily or largely with a view to purchasing fuels.)

We can estimate fairly precisely the quantity of fuel entering Hungary in the original factory-built fuel tanks of motorcars, trucks and buses. (Most of that quantity, of course, does not belong to the sphere of fuel tourism or fuel smuggling, because it is brought into the country as part of the customary motor vehicle traffic, but even so, this activity obviously represents a case of evading the constitutional obligation to share proportionately the

burdens of taxation.) We have found that in consequence of such fuel imports, annual incomes worth at least HUF 80 billion are generated illegally, while the Hungarian state budget loses revenues totalling HUF 180 billion. (See in Tables II.3.3.) Our iterative model calculations, based on official statistical data, show that Hungarian citizens import around 287 million litres of fuels, while foreigners bring into the country some 792 million litres every year from countries where fuel prices are lower than in Hungary. The Hungarian state budget loses HUF 40 billion on the former type of traffic, and HUF 106 billion on the latter. (We based our calculation on the number of border-crossings in 2000, and determined the HUF value at concurrent – therefore comparable – prices of 17th May 2001. In the calculations we only took into account 70 litres of fuel per entry for motorcars, and 600 litres for trucks and buses.)

We repeated the model calculation using traffic data of the National Board of Customs and Excise Guard for 2001, and arrived at similar results. Nearly 1.4 billion litres of fuels were brought into Hungary, lost revenues of the state budget totalled HUF 187 billion and illegal incomes amounted to HUF 84 billion. It is worth noting that two important factors have changed:

Firstly, fuel prices have been raised in Romania, therefore illegal incomes have dropped, and secondly, the embargo on Yugoslavia has been removed, so former fuel exports have been replaced by fuel imports.

In Tables II.3.3. we took into account not only the motor vehicles which enter the country specifically to

Table II.3.3.: Fuels imported in the tanks of motor vehicles in 2001
a) buses and trucks (diesel fuel)

Frontier section	Diesel fuel price (HUF/litre)	Difference compared to Hungarian fuel price (HUF/litre)	Total number of entries (in thousands)	Imported diesel fuel (million litres)**	Lost Hungarian revenues* (million HUF)
Hungarian-Ukrainian	105.00	108.00	69	42	5287
Hungarian-Romanian	125.40	87.60	434	261	33037
Hungarian-Croatian	193.00	20.00	224	134	17007
Hungarian-Slovenian	185.00	28.00	131	79	9971
Hungarian-Slovak	191.30	21.70	516	310	39270
Hungarian-Yugoslavian	130.00	83.00	139	84	10595
Hungarian-Austrian	215.00	-2.00	895		0
Total:			2409	908	115167

*Lost revenues: excise duties, stockpiling fees and VAT

**In the case of fuel tanks of 600 litres

b) motorcars (petrol)

Frontier section	Petrol price (HUF/litre)	Difference compared to Hungarian fuel price (HUF/litre)	Total number of entries (in thousands)	Imported petrol (million litres)**	Lost Hungarian revenues* (million HUF)
Hungarian-Ukrainian	113.00	136.50	1480	118	17386
Hungarian-Romanian	145.10	104.40	1719	138	20197
Hungarian-Croatian	253.40	-3.90	1099		
Hungarian-Slovenian	220.50	29.00	368	26	3782
Hungarian-Slovak	216.20	33.30	1973	138	20278
Hungarian-Yugoslavian	215.00	34.50	989	69	10168
Hungarian-Austrian	265.60	-16.10	4500		
Total:			12129	489	71811

Price level of 17th May 2001

*Lost revenues: excise duties, stockpiling fees and VAT

**In the case of fuel tanks of 70 litres

Source: Central Statistical Office of Hungary, MOL Co., tax laws

purchase fuel (fuel tourism), but all entering vehicles. Although we do not have data regarding the share of the former traffic category within the total number of entering vehicles, but on the basis of information obtained from the Hungarian customs authorities (which we compared with data of the Central Statistical Office) we may conclude that their number is definitely very large. On the other hand, even motor vehicles entering Hungary for other purposes fill up their fuel tanks before crossing the border – as a consequence, the state budget, once again, loses substantial revenues. Additional environment pollution resulting from such activities also increases the damage caused, partly because fuel quality in some neighbouring countries is inferior to fuels sold in Hungary. For non-standard

fuels, however, higher tax rates are in force, therefore upon these fuels higher excise duties should be imposed.

We have probably largely underestimated the quantity of imported fuels, for we calculated with an average of 70 litres of fuels for motorcars, and with 600 litres for trucks. Customs authorities, however, have reported that Mercedes cars with factory-mounted fuel tanks of 100 litres can often be seen in the eastern border section of Hungary, what is more, all-terrain “motorcars” with original fuel tanks of 400 litres appear there ever more frequently. As regards buses and heavy trucks, the originally mounted fuel tanks often have much larger capacities than 200 litres – there are even some vehicles with tanks holding more than 1000 litres of fuel.

We have been told that buses were found with additional "secret" 1000-litre fuel tanks built into the vehicles besides the original tanks to cross the border with this double fuel load. In addition to violating customs and excise laws, such practice seriously endangers the safety of passengers and the participants of transport, therefore much stricter controls and penalties (including also the immediate confiscation of the vehicle) should be applied.

With a view to cutting back fuel tourism and fuel smuggling we had proposed as an initial measure to have excise duties and VAT paid on the quantity of petrol or diesel fuel corresponding to the fuel tank capacity of the vehicle concerned in each case when the motor vehicle crosses the border more than once a day. We were glad to see that in 1999 the Government modified the implementation decree of the Customs Act to the effect that the same person is entitled to bring fuel into the country free of customs duties only once a day. We hope that this provision will in effect be enforced and the necessary monitoring system will be in place. It gives cause for alarm, however, that customs authorities can experience ever more frequently that the same vehicle – with different drivers – crosses the border several times a day.

Unfortunately, other adverse trends have also emerged recently. By virtue of Art. 105 of Act C of 1995 on Customs Legislation, Customs Procedures and Customs Authority, up until now at most 200 litres of fuels were allowed to be brought into Hungary free of customs duties even in the original factory-mounted fuel tanks of motor vehicles, without the right to sell those fuels. Sadly, authorities have not been able to adequately enforce this regulation. On the one hand, controls have been insufficient, and on the other, various bilateral road transport agreements granted exemptions from the 200-litre restriction to road freight transportation companies of ever more countries – as a result, by 2000 this regulation has become applicable virtually only for Hungarian transport companies. Act XXXII of 2000, however, annulled even this light restriction. Our calculations reveal that in consequence of that, the Hungarian state loses additional revenues of at least HUF 9 billion a year if traffic volumes remain unchanged (see Tables II.3.3.). But we have strong reasons to assume that in the new situation, also Hungarian road freight transportation companies will join this "business" on a larger scale, which will further increase the losses of the state budget. It is because there is an extremely strong motivation in the "fuel business": an out-and-home trip over the Ukrainian border with a fuel tank of 800 litres, for instance, allows earning HUF 120 thousand.

According to the agreement between Hungary and the EU, concluded in 2001, bringing fuels in the tanks

of motor vehicles into the territory of the other contracting party is exempted from payment of any customs duties, taxes and charges. This means that even those very light legal regulations (partly adopted in 2000) had to be repealed, by which the Hungarian state had attempted to restrict fuel smuggling.

One of those regulations was a modification of the Customs Act's implementation decree, adopted by the Government in December 2000, which says: "Fuels brought into the country in the original factory-built fuel tanks of motor vehicles may be cleared through the customs for domestic traffic free of duties the first time that a given vehicle crosses the border on a particular day. On the occasion of further entries on the same day, fuels may be cleared through the customs free of duties if those applying for customs clearance can certify by receipts or invoices that the fuel was purchased in Hungary."

Practical experience has shown that the modified decree was not successful in achieving its intended aim. On the one hand, the restriction is only applicable to persons and not to vehicles, so the same vehicle will cross the border several times a day with different drivers in the future, too. But even this scheme is becoming unnecessary. We have been informed by inhabitants living near the state border that today already children are employed to collect receipts and invoices at Hungarian petrol stations. The planned modification of the regulation means providing more favourable statutory conditions for smuggling, which is tantamount to granting open state support for organized criminal activities.

Besides its unfavourable economic impacts, fuel tourism causes further damage to the environment as well. The ensuing unnecessary extra motor vehicle traffic adds to the congestion on the roads, which in turn leads to more accidents, accelerates the deterioration of the roads and exacerbates environment pollution. Part of the fuels sold in the Eastern European countries does not meet Hungarian and EU standards, i.e. these are low quality fuels which cause increased environment pollution and health damage. These unfavourable environmental and economic impacts affect not only Hungary, but also the EU countries, because a considerable part of such illegally imported fuels is used by these motor vehicles in member states of the Community.

Consequently, what is needed here is to implement a comprehensive Europe-wide harmonization of the fuel prices. The European Union should make it clear for European countries and governments that it does not accept the practice of granting indirect support to road transportation in the form of low fuel taxes. Until this does not effectively happen, further restrictions are needed to prevent fuel tourism and fuel smuggling.

Tables II.3.3. also reveal that losses of the state budget on diesel fuel alone may exceed HUF 115 billion,

when calculating with an average fuel tank capacity of 600 litres for Hungarian and foreign trucks. Taking into account all motorcars and trucks, losses resulting from the “preferential” import of petrol and diesel fuel may surpass HUF 187 billion.

Gradual relaxation of the regulations restricting fuel smuggling indicates that organized crime has managed to find collaborating partners in the Hungarian public administration. We have been informed that at the time of modifying the relevant part of the Customs Act, some competent intermediate-level civil servants, in charge of public road and financial administration tasks, failed to inform decision-makers on the expected impacts of the planned modification, particularly as regards numerical data of the quantities involved. All this just accentuates the requirement that every official who participated in this disgraceful process should be removed immediately from the Hungarian public administration. We think that it would also be advisable to publish the names of these civil servants.

International fuel smuggling must be eliminated. New tendencies, started in the wake of the events of 11th September 2001, aiming at putting an end to money laundry activities, particularly underline the importance of this task. Therefore proper consideration should be given to the possibility of imposing taxes for the whole fuel tank capacity of all motor vehicles entering Hungary from any country where consumer prices of fuels are by more than 5 per cent lower than the Hungarian prices. The rate of these imposed taxes should equal the difference between fuel prices in Hungary and in the neighbouring country concerned. (It is to be appraised whether from a legal point of view this amount should be levied as a tax, customs duty, environmental fee, examination fee or a combination of these. Nevertheless, this would not change the essence of the measure.) Another option that should be looked into is that taxes should only be imposed (as environmental protection fees) in each case on motor vehicles entering Hungary from countries where fuel standards do not comply with Hungarian standards (i.e. fuels may be of lower grade than what is sold in Hungary). Such a measure would affect Romania, the Ukraine and Serbia, which are just the countries posing the largest problems in this respect. For other countries it might be sufficient to bring back the 200-litre restriction. This measure would probably meet with the recognition of the EU, because fuels carried from the East to the West in the tanks of motor vehicles place huge burdens (additional environmental damage, losses of state revenues, growing crime rate) on countries which are directly affected (primarily Austria and Germany).

Over and above these measures we recommend that the Hungarian Government should urge that in the neighbouring and nearby Central and Eastern European countries fuel prices be set at levels that take into consideration the interests of the EU countries. Hungary should advocate that this must be one of the criteria for awarding EU association and other preferences. No country should obtain any preferences, the government of which encourages environment pollution and smuggling through low fuel prices. To that end, upon the initiative and with the participation of the Clean Air Action Group Hungarian environmental NGO, the European Federation for Transport and Environment prepared a study on the subject (Road Fuel and Vehicles Taxation in Light of EU Enlargement), which was also sent to competent officials of the European Commission.

As of 1st January 2004, uniform energy taxes will be introduced upon the proposal of the European Council of Economic and Finance Ministers (ECOFIN), which will bring about a completely new situation. The core of the new system is that it becomes compulsory to apply at least a minimum level. Upon these grounds, as of 2004 Hungary may introduce energy taxes on fuels brought into the country in the original factory-mounted fuel tanks of motor vehicles arriving from non-accessing countries. The rate of this tax should equal the combined amount of the applicable Hungarian excise duty and VAT. Our preliminary calculations show that the state budget may realize extra revenues worth HUF 40 to 60 billion a year, even after deducting revenues of the Hungarian–Slovakian and Hungarian–Slovenian traffic, and after taking into account that fuel tourism will drop sharply as a result of the measures.

This tax should be collected even if the motor vehicles concerned are transported by rail into other EU member states.

3.4. Valorization, increase and better collection of motor vehicle taxes

Act LXXXII of 1991 says that motor vehicle taxes are meant “to ensure that public burdens related to motor vehicle use are shared in a more reasonable and fair manner, to increase the revenues of local governments (of Hungarian settlements and of the capital districts), as well as to provide more funds for maintaining and improving the country’s road network”. We can fully agree with the concept, but we also have to say

that motor vehicle taxes in Hungary are yet to meet the objectives described in the law, because:

- the rate of motor vehicle taxes is by far lower than the level necessary to accomplish the goals set in the law,
- motor vehicles registered outside Hungary make a disproportionately small contribution, as compared to domestic motor vehicles, towards attaining the mentioned objectives,
- lorries and trucks have an unreasonably small share of the burdens (as opposed to cars), and therefore fail to adequately contribute to meeting the objectives,
- thirty to forty per cent of all motor vehicle owners fail to pay their taxes.

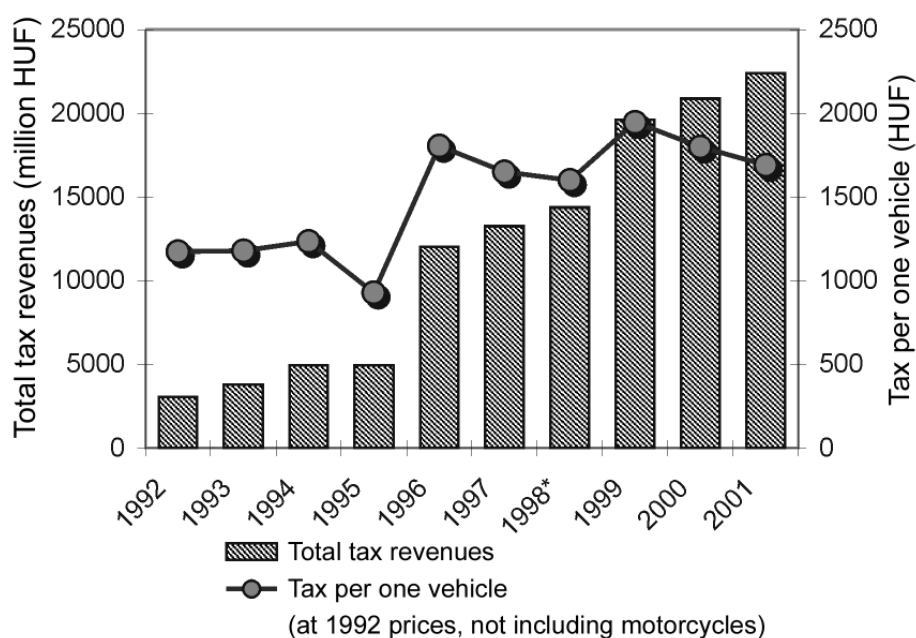
We think that in this field one of the most pressing tasks is to increase considerably the ratio of motor vehicle taxes effectively paid in by vehicle owners. It is unacceptable for economic, environmental and ethical reasons that around one third of Hungarian motor vehicle owners can evade paying these taxes practically without any sanctions or consequences. As a result, the state budget and the local governments lose revenues worth several billions of HUF every year. It is essential to elaborate efficient methods that enable local governments to improve the motor vehicle tax payment ratio significantly without adding to the costs of collecting the taxes. It is worth considering that the Hungarian Tax and Financial Auditing Office (APEH) should collect the motor vehicle taxes, too. The Tax and Financial Auditing Office would be able to collect these taxes by using the motor vehicle registry of the

Ministry of the Interior, and so, besides extra tax revenues, local governments could also save several billions of HUF in tax-collecting costs. (The Hungarian State Audit Office's report on tax revenues of local governments reveals that tax-collecting costs are extremely high as a rule, in some cases even surpassing the amount of the collected taxes.) The funds raised from collecting the motor vehicle taxes should be devoted to increasing the subsidies granted to local governments. This is justified and reasonable because motor vehicles, and particularly heavy motor vehicles, cause enormous damage to the infrastructure under local government management and to the stock of buildings.

The rate of motor vehicle taxes did not change between 1996 and 1998, whereas in the same period the inflation rate was 61 per cent in Hungary. In 1999, the lowest tax rate was raised by 50 per cent, and the highest rate by 67 per cent. On the other hand, no further increases have been implemented in either 2000, 2001 or 2002, despite the fact that the inflation rate was still 29 per cent. This provides further justification for a substantial increase of tax rates. (See Figure II.3.4.a.)

Motor vehicles damage the environment in various forms, not only when they are "on the move". Land occupation by vehicles poses ever-increasing problems, cleaning and maintenance cause severe pollution, not to mention the massive environmental load resulting from constructing and maintaining the related auxiliary industries and the required infrastructure. Therefore, taxes should not only be imposed with a view to

Figure II.3.4.a.: Changes in revenues from domestic motor vehicle taxes (million HUF)



*In 1998 a correction was made concerning the number of motor vehicles taken out of use earlier.

Source: Ministry of Finance, Central Statistical Office of Hungary

covering the variable costs of transport (such as fuel taxes), but also to covering the fixed costs (e.g. motor vehicle taxes).

Revenues and funds to cover the fixed costs of transport (including most of the costs of maintaining and improving the infrastructure) are currently lagging behind the necessary level. For instance, much more resources should have been spent in recent decades on the nation-wide road network of 30,000 kilometres. Secondary roads under local government management, having a total length of over 100,000 kilometres, have also accumulated a huge backlog of maintenance and development work.

Lorries and trucks damage and destroy the roads and other structures to a much greater extent than cars do. Specialists had already formulated their definite view on the subject some decades ago. In 1971, Dr. Ervin Nemesdy university professor, Academic Doctor of Technical Sciences, published in Budapest his work titled "Structure of Roads and Motorways", which, even today, is used by transport specialists as a standard work on the subject. In his book Dr. Nemesdy describes, among others, the results produced by comprehensive investigations carried out in the United States of America, which demonstrated that road damage is proportionate to the fifth power of the axle load. This led the author to the following conclusion: "...not only the interests of the road freight transportation companies should be taken into consideration, but also the state of the national road network and the unfavourable changes in the useful life of road surfaces, which may cause such amount of damage to the country's road network that is by an order of magnitude larger than the annual profits realized by transportation companies. (...) An axle of 10 Mp (...) is equivalent to the passage and useful life reducing impact of seven times as many 8 Mp axles. (...) All these reasons make it indispensable that heavy trucks with large axle weights should bear very high additional road charges and extra transportation taxes." Damage caused to roads is proportionate to the fifth power of the axle load; therefore, one heavy truck causes the same amount of damage to the roads as several hundred thousand motorcars. Lorries and trucks, therefore, should be taxed progressively. The current practice is contrary to both the Constitution and the Act against Unfair Market Competition, because motorcar owners and users of other motor vehicles are made to pay for the road damage caused by heavy trucks. This cross-financing arrangement should be abandoned.

We recommend that the rate of motor vehicle taxes should be modified as follows:

(1) We have maintained our proposal for a long time that motor vehicle taxes should be made uniform, i.e.

they should not have a lower and an upper limit rate. It is both unfair and unreasonable that motor vehicle owners pay this type of tax depending on the decision of a given local government. We welcome that the Government has accepted our proposal, and as of 2004 taxation is made accordingly.

(2) We think that it would be advisable to raise motor vehicle taxes levied on motor vehicles registered in Hungary to HUF 2,000 per every commenced 100 kg (as defined by Art. 6 of Act LXXXII of 1991) – instead of the current maximum, and the uniform HUF 1,000 projected for 2004.

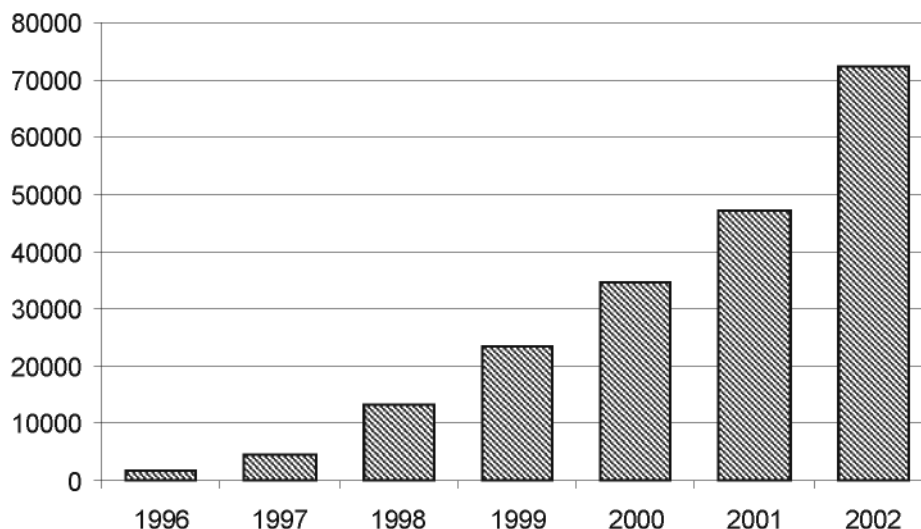
(3) Motorcycles, caravans, campers and tent-covered trailers should be taxed at a rate of HUF 15,000 per year instead of the current HUF 5,000 per year. Motorcycles have significantly higher levels of specific accident costs, air pollution and noise emission than motorcars. As regards caravans, campers and tent-covered trailers, these vehicles are generally used for luxury purposes, and this justifies a higher increase of their tax rates.

(4) In the case of passenger-carrying motor vehicles used with temporary licence documents, for every commenced month HUF 4,000 should be paid as tax instead of the current HUF 2,000 per month, while in the case of trucks, for every commenced month HUF 10,000 should be paid as tax instead of the current HUF 5,000 per month. Raising the taxes imposed on passenger-carrying motor vehicles and trucks used with temporary licence documents at a higher rate will be an incentive for owners to take out the definitive licence documents.

(5) For luxury and sports all-terrain vehicles, payable taxes should be four times the rate proposed in paragraph (2). Imports and use of such vehicles are not justified by any interests of the national economy, for they serve solely luxury purposes. At the same time they consume much more fuel than average motorcars do, and cause much more environment pollution as a result. Besides, they are especially prone to accidents due to their weight and construction, and their owners often misuse the "superior power" of these vehicles. Payable taxes until now have been far from offsetting the damage they cause. Therefore, motor vehicle taxes should be raised considerably in order to provide an incentive for reducing the number of these vehicles. This measure would meet with full support of the overwhelming majority of Hungarian citizens.

(6) For diesel-fuelled vehicles, 1.5 times the tax rate proposed in paragraph (2) should be applied up until the time when excise duties of diesel fuels are raised to the same level as those of petrol. Latest research findings have revealed that exhaust gases from diesel engines pose in general much more health and environmental

Figure II.3.4.b.: Hidden subsidies granted to imports of trucks as a consequence of the reduction of customs duties (including pertinent VAT) and the revaluation of the Hungarian currency (million HUF)



Source: Central Statistical Office of Hungary, Ministry of Finance, National Bank of Hungary

hazards than those from petrol-operated engines. The World Health Organisation does not set air quality limit values for diesel exhaust gases because they have not found any concentration below which these emissions are unquestionably harmless for human health. Another reason for adjusting the excise duty rates is that diesel fuel is mostly used by trucks and other heavy motor vehicles which damage the roads to a much greater extent than cars do. (For instance, one heavy truck causes the same amount of damage to the roads as several hundred thousand motorcars.) In its new transport policy adopted in 2001, the European Union declared that excise duties on diesel fuel should be raised to the level of duties on petrol; until this principle is not effectively implemented, it is justified that motor vehicle taxes on diesel-fuelled vehicles are raised at a higher rate than those on petrol-operated vehicles. We have set forth the detailed reasons for our proposal in Appendix 5 titled "Petition of the Clean Air Action Group to the Court of Constitution of Hungary regarding the Excise Duties on Diesel Fuels".

(7) Paragraph (2) of Art. 8 of the Act on Motor Vehicle Taxes (version effective up until the end of 2002) says: "articulated lorries and trucks meeting the requirements set by UN ECE 49.02/A on air pollution pay 75 per cent of the otherwise payable tax – in the case of articulated lorries 20 per cent thereof –, whereas articulated lorries and trucks meeting the requirements set by UN ECE 49.02/B on air pollution and UN ECE 51.02 on noise emission pay 50 per cent – in the case of articulated lorries 10 per cent – of the otherwise payable tax." We welcome that the current Hungarian Government has modified this regulation in the fol-

lowing manner (which already entered into force as of 1st January 2003):

"Art. 8, Para (1) A tax allowance of 20 per cent is due... (b) for trucks meeting the EURO 2 (UN ECE 49.02/B and UN ECE 51.02) requirements according to the works certificate – except for articulated lorries, which are entitled for a tax allowance of 30 per cent –, and for buses meeting the same requirement (environmental protection class marking: 4).

Para (2) A tax allowance of 30 per cent is due... (b) for trucks meeting at least the EURO 3 (UN ECE 49.03/A and UN ECE 51.02) requirements according to the works certificate – except for articulated lorries, which are entitled for a tax allowance of 50 per cent –, and for buses meeting the same requirement (environmental protection class marking: 7 or 8)."

We recommend that further steps should be taken along these lines, and the special preferential treatment of articulated lorries should be abolished altogether. We propose this because no reasonable argument can be found to explain the preferences granted to articulated lorries against other trucks. The law this way discourages the rational organization of freight transportation, and has needless unfavourable impacts on railway transport and combined freight transportation. (Even "the most environmentally friendly" trucks have a specific environment-polluting effect which is at least five times as high as that of railway transportation.)

It is to be noted that lorries and trucks worth USD 3,620 million have been imported into Hungary over the past eleven years. As a consequence of the reduction of customs duties between the EU and Hungary,

road freight transportation companies saved duties totalling HUF 122 billion between 1995 and 2001. In the same period, owing to the revaluation of the Hungarian currency, these companies paid by an additional HUF 136 billion less for their imports than what they would have paid if the exchange rate of 1995 had remained the same. (See Figure II.3.4.b.). Most of these motor vehicles were purchased second-hand, which caused and is still causing severe environment pollution. It is by all means necessary that lorries and trucks meet state-of-the-art environmental standards. However, achievement of this aim should not be promoted by granting tax allowances like the ones mentioned above, but through a practice of issuing licenses only for vehicles meeting strict environmental requirements. We believe that this is a much more efficient method environmentally, and at the same time it saves resources for the state budget. It is worth remembering that the current tax allowance is granted for meeting environmental requirements that are compulsory for any new motor vehicle to be put into service anyway.

Additional revenues from raising and fully collecting motor vehicle taxes would total some HUF 26 billion (taking into account the amounts realized through more efficient tax collection as well). The whole of these funds should be returned to local governments and be devoted to supporting public transport and other environmentally friendly ways of transport (see Section 2.7.3.).

3.5. Imposing infrastructure charges on heavy trucks in compliance with the principle of competition under equal terms

In its new transport policy adopted in 2001, the European Union underlined that heavy trucks cause serious damage to roads: *“Maintenance of motorways would cost six times less, if they were only used by cars. This advantage is not offset by any acceptable differentiation of pecuniary charges paid by trucks and cars respectively.”* Accordingly, the EU urges that user charges proportionate to road utilization should be elaborated and introduced.

Damage caused to roads is proportionate to the fifth power of the axle load. *“...not only the interests of the road freight transportation companies should be taken into consideration, but also the state of the national road network and the unfavourable changes in the useful life of road surfaces, which may cause such amount of damage to the*

country’s road network that is by an order of magnitude larger than the annual profits realized by transportation companies. (...) An axle of 10 Mp (...) is equivalent to the passage and useful life reducing impact of seven times as many 8 Mp axles. (...) All these reasons make it indispensable that heavy trucks with large axle weights should bear very high additional road charges and extra transportation taxes.” (Dr. Ervin Nemesdy university professor, Academic Doctor of Technical Sciences: “Structure of Roads and Motorways. Technology – Construction”. Műszaki Könyvkiadó, Budapest, 1971, p.55).

It is particularly urgent to revalorize the taxes imposed on foreign trucks. The European Union approved this step in writing, i.e. that the rate of this tax be maintained at its original value by adjusting it to changes in the HUF/EUR exchange rate. The tax rate was originally set in 1992 (at a value of 3 HUF/ton-kilometre), and has not been adjusted to the inflation rate since that time. Taking into account the average National Bank of Hungary exchange rate of the year 2001 (256.70 HUF = 1 EUR), the tax should be raised to the rate of 7.54 HUF per ton-kilometre. To make things even worse, as a consequence of various bilateral agreements, more than 90 per cent of foreign trucks are currently traversing Hungary without paying even the original tax of 3 HUF. At the same time these vehicles cause enormous damage to the environment, roads and human health: a study commissioned by the European Federation for Transport and Environment reveals that trucks cause damage worth over HUF 100 billion in Hungary every year, which is left unpaid. This calculation is proved to be correct by another study prepared by the European Conference of Ministers of Transport (Efficient Transport for Europe, OECD, 1998). Using data from this survey for reckoning up the value of the damage caused, we have arrived at an annual figure of HUF 140 billion at 2000 prices. Trucks registered outside Hungary cause damage to the environment and use the infrastructure financed from public funds in Hungary just like their Hungarian counterparts do. In fact, these vehicles are heavier on average than Hungarian trucks are; therefore they damage the Hungarian road network to a greater extent. Additionally, the negative impacts of the load they place on Hungarian roads are multiplied in certain periods when foreign trucks flow into the country in large numbers (e.g. early and late summer, during weekends, etc.). (In relation to the subject see also Clean Air Action Group’s view on motorway tolls in Section 2.7.3.9.)

In 2001, 1264.5 thousand foreign trucks entered Hungary, while in 2002 their number already increased to 1339.0 thousand. Calculating with an increment similar to that of 2002, the Hungarian state could collect taxes worth nearly HUF 98 billion in

Table II.3.5.: Motor vehicle tax (road charge) of foreign trucks entering Hungary

Year	Number of trucks (thousand)*	Tax** (HUF/ton--kilometre)	Exchange rate (HUF/ECU, HUF/EUR)	Payable tax	Paid tax***	Unpaid tax	Unpaid tax
				in billion HUF			(million EUR)
1989	363.1		65.07				
1990	441.0		80.48				
1991	588.0		92.70				
1992	773.2	3.00	102.10	23.2	2.0	21.2	208
1993	668.5	3.16	107.50	21.1	2.0	19.1	178
1994	778.7	3.67	124.78	28.6	2.0	26.6	213
1995	872.5	4.78	162.65	41.7	2.0	39.7	244
1996	947.8	5.62	191.15	53.2	2.0	51.2	268
1997	1098.4	6.20	210.93	68.1	2.0	66.1	313
1998	1180.6	7.08	240.98	83.6	2.0	81.6	339
1999	1056.2	7.43	252.80	78.5	2.7	75.8	300
2000	1128.2	7.64	260.04	86.2	3.1	83.1	320
2001	1264.5	7.54	256.70	95.4	3.1	92.3	359
2002	1339.0	7.14	242.97	95.6	3.1	92.5	381
2003	1417.9	6.91	235.01	97.9	2.5	95.4	406
Total	11107.6			773.0	28.5	744.5	3528

Notes:

*Number of trucks with foreign registration number entering Hungary, according to data contained in Yearbooks of the Central Statistical Office of Hungary

**In 1992: 3 HUF/ton-kilometre; afterwards revalorized by changing ECU and EUR exchange rates in accordance with Act LXXXII of 1991 and Act I of 1994

***For years 1993–1998: partly estimated on the basis of many years' average

Base for the calculation of the tax: 25 tons and 400 kilometres on average, and revalorized unit tax

2003, following the revalorization of the tax and the abolition of current allowances. In contrast, the State Budget Bill reckoned with unchanged annual revenues worth HUF 2.2 billion from this source between 2001 and 2002. As a result, foreign trucks are granted hidden subsidies in the annual value of nearly HUF 93 billion, which virtually equals the amount of the damage they cause. (In other words: if the tax originally set in 1992 was collected in full at real value, then the owners of the trucks concerned would in fact pay for the financially quantifiable damage they cause.) In the period between 1992 and 2001, the amount of uncollected road charges totalled EUR 2741 million, which is more than the aggregate value of all types of subsidies and aids that Hungary received from the EU. For details see Table II.3.5.

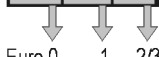
By virtue of the agreement concluded with the European Union, however, Hungary cannot impose any motor vehicle taxes on trucks registered in the EU. Nevertheless, the Union does not oppose (on the contrary, it

rather supports) that Hungary levies infrastructure charges on trucks. This was confirmed by the letter of the European Commission's Directorate-General of Transport and Energy written in reply to the European Federation for Transport and Environment. (This exchange of letters was initiated by Clean Air Action Group.) Consequently, Hungary has to impose the tax as an infrastructure charge. It is similarly an EU requirement that the charge should be imposed in a manner complying with the principle of competition under equal terms. This means that no carriers of any particular country or enterprise should be given preference over other carriers or be discriminated against. For that reason, the charge should be levied on Hungarian trucks as well.

In accordance with the above considerations, we propose that in 2003 an additional charge of 3 HUF per ton-kilometre as per the permitted total weight of the vehicle concerned should be levied on trucks of a permitted total weight of over 12 tons. We recommend that this charge should be increased by 2 HUF annu-

Figure II.3.5.: Outline of the Swiss road charge scheme

Rate*				Distance covered in Switzerland (km)		Allowed total weight of the vehicle		Charge in Swiss francs
1	2	3						
2,00			x	300	x		x 18 t	108,-
	1,68		x	300	x		x 30 t	151,-
	1,68		x	300	x		x 30 t	151,20
		1,42	x	300	x		x 34 t	144,84



*Multiplier depending on the pollutant emission by the engine of the vehicle concerned
Source: Monthly "Lélegzet", 2001/10

ally up until 2007, and afterwards its rate should be revalorized every year. Such measure would improve the position of the much more environmentally friendly railway freight transportation just in the sector where it is especially justified: in the transportation of large quantities of goods for long distances. It would mostly affect foreign freight transportation companies; thus creating a competitive advantage for Hungarian carriers in a fashion that is acceptable in the EU.

By introducing an infrastructure charge, Hungary would follow the example of Switzerland. A referendum held there in 1999 decided that a uniform road charge of a relatively high rate was to be imposed on trucks. The road charge scheme, also approved by the EU, was introduced in January 2001. The payable rate of the charge depends on the distance covered, on the permitted total weight of the vehicle concerned (which is an incentive to use the truck's capacity as efficiently as possible) and on the emission of air polluting substances (see Figure II.3.5.). An essential feature of the system is that the charges have to be paid on all types of roads, not just on motorways. Furthermore, the rate of this road charge is significantly higher than the currently applicable or planned road charges of the European Union.

Road charges payable by trucks are being introduced in an ever increasing number of countries. As of August 2003, vehicles above a permitted total weight of 12 tons have to pay 15 to 17 Euro cents (37 to 42 HUF) per kilometre on every motorway in Germany, and this charge is projected to be raised further from 2004 on. In Austria, as of 1st January 2004, a road charge of 15 to

20 Euro cents (37 to 49 HUF) per kilometre is planned to be levied on vehicles above a weight of 3.5 tons.

As a result of this measure, in 2003 the Hungarian state budget would realize revenues worth some HUF 30 billion from road charges levied on trucks registered in Hungary and HUF 35 billion from charges paid by foreign trucks.

3.6. Imposing highly progressive road charges on motor vehicles with axle loads above 10 tons

A decree of the Hungarian Ministry of Transport, Telecommunications and Water Management (No. 4/1999 [II.12.]) on Participation of Vehicles Surpassing Certain Total Weight, Axle Load and Dimensions in Public Road Traffic, on the Conditions of Road Administration and Public Authority Proceedings, as well as of Payment of Charges regulates the issue of payment of charges applicable to vehicles with an axle load exceeding 10 tons. These charges, however, are far from covering the damage and other costs caused by these vehicles, for revenues from this source totalled no more than HUF 900 million for instance in 2002. On the other hand, in compliance with the requirements of the European Union, an axle load of 11.5 tons is to be made possible on the main transport roads of Hungary instead of the currently allowed load

of 10 tons. Implementation costs of this so-called national road surface reinforcement programme amount to more than HUF 300 billion. Heavy vehicles with an axle load above 10 tons cause enormous damage even to Hungary's existing road network, as has been demonstrated in Section 3.5. of this study. Accordingly, the costs that these vehicles cause to the Hungarian society are a thousand times higher than the value of the charges they pay. Obviously, this practice cannot be pursued any longer.

Thus, the national road surface reinforcement programme should be implemented on account of the heavy trucks (and to a much smaller extent buses) that are categorized at present as overweight vehicles. But roads with an axle load bearing capacity of 11.5 tons are only needed by a few thousandths part of all motorists. Within the entire Hungarian road motor vehicle fleet, trucks and buses account for 12 per cent, and among these 10 per cent are overweight. From the total number of foreign vehicles entering Hungary, trucks and buses represent 13 per cent, and only 2 per cent of these are overweight (according to data obtained from the Hungarian Statistical Yearbook 2001, published by the Central Statistical Office of Hungary, and information supplied by the Technical and Information Services on National Roads /ÁKMI Kht./). It is a serious violation of the principles of social justice and free market competition – which are also included among the most important principles of the European Union – that substantial costs caused by an insignificant minority of all motorists are borne by the overwhelming majority of transport participants, or, indeed, by the entire society.

Owing to the above reasons it is inadmissible that the road surface reinforcement programme to ensure an axle load bearing capacity of 11.5 tons instead of the current 10 tons on national main roads be financed from public funds. These costs must be borne in full by the owners of heavy vehicles with axle loads exceeding 10 tons. The progressively increasing road charge, of an average rate of 1 HUF per gross ton-kilometre, aiming at offsetting the additional load placed on Hungary's infrastructure, would be imposed on both domestic and foreign carriers with vehicles of axle loads over 10 tons. Based on favourable experience gathered after the introduction of the charge, its rate can be gradually increased. Hungarian freight transportation companies falling into this category completed about 12 billion freight ton-kilometres in 2001. After introducing the above charge, their performance will come down to about 8 billion ton-kilometres, i.e. the state budget may anticipate revenues from Hungarian carriers in the value of approximately HUF 8 billion. On the other hand, pre-

liminary data show that freight transportation vehicles registered outside Hungary completed some 13 billion gross ton-kilometres in 2002. As a consequence of the imposed road charge, their performance will shrink to around 10 billion gross ton-kilometres; so the Hungarian state budget can reckon with HUF 10 billion as revenues collected from foreign carriers.

3.7. Uniform rates of daily travel allowances

In June 1997 a decree entered into force in Hungary which increased the amount of cost-deductible travel allowances to a daily USD 25 for international road freight and passenger transportation. For any other activities, including also railway transportation, the cost-deductible daily travel allowance is only USD 10. As a consequence of this measure, road transport (especially freight transportation) is granted subsidies in the following value:

At prices of the first six months of 2002, the daily allowance of USD 25 equalled HUF 6318. Assuming that Hungarians working in the road transportation sector cross the country border 800,000 times a year and stay abroad for three days on average, this makes up HUF 6318/day 800,000 3 = HUF 15.2 billion net wages, exempt from any payable public charges. At the railways, however, this amount is subject to a personal income tax and social security contribution payment obligation rate of 67.3 per cent; hence the conclusion that the value of subsidies granted totalled HUF 15.2 billion 0.673 = HUF 10.2 billion.

From the effective date of the decree, June 1997, till the end of 2002, the aggregate amount of subsidies reached approximately HUF 54 billion. This has several consequences:

State budget revenues lost due to the allowance have to be compensated by other economic sectors that are usually more environmentally friendly, at multiplied costs. (For instance, if heavy trucks are given HUF 1 billion as subsidies in the above manner, then, among others, also railway transport will need more subsidies, while railway revenues are diminishing. Furthermore, preventing or removing environmental and health damage also requires substantial funds.)

The mentioned decree gives unfair preference to international road freight transportation (primarily over railway transport). As a result, in many countries, including the EU member states

- the number of accidents and lives lost increases, and
- environmental pollution is also aggravated.

By granting a preference which badly distorts fair market conditions Hungary pursues a policy which is not acceptable by international standards and not used in any EU countries.

Considering that the majority of serious accidents are caused by heavy trucks and the fact that road accidents have a 33 times higher frequency rate than railway accidents, we can conclude that owing to the preference, the party causing the accidents does not even pay for the base costs of social security.

The preference, which violates both the EU regulations and the provisions of the Act on Unfair Market Practices, should be abolished immediately. Therefore, we recommend that daily travel allowances should be made uniform, i.e. cost-deductible daily allowances should in each case be limited to USD 10. Assuming a 50 per cent overall reduction in the payment of daily travel allowances, this measure will bring additional revenues from personal income tax and social security contribution worth approximately HUF 6 billion annually.

3.8. Stricter rules for accounting expenses of motorcar use

In Hungary the fuel expense accounting system currently in use for motorcars encourages motorists not to pay taxes and use their cars as much as possible, increasing thereby environment pollution as well. **To increase tax revenues, make transport more efficient and protect our environment, we propose that it should only be allowed to account motorcar use as expense if the fuel use pertaining to the accounted travel distance is attested by an invoice on the purchase of fuel. The invoice should also indicate the registration number of the motorcar concerned. In addition to that, it should also be made compulsory to keep a separate verifiable journal on fuel purchase.**

Another option worth considering is that motorcar use should be made a non-expense item. The following reasons support such a measure:

Motorcar use for private and business purposes cannot be separated in a well-controllable manner.

Severe environmental and health damage caused by the use of motor vehicles should also be alleviated through such measures.

An ever-increasing portion of motorcars are purchased by companies, which often means concealed remuneration by evading payment of taxes and social security contributions charged on wages. (What is more, companies can even reclaim VAT when purchasing motorcars!)

Some say that only a specified portion of fuel costs could be accounted as expenses, e.g. a fuel consumption of 7 litres per kilometre, or, for instance, not more than 80 per cent of the total costs of fuels. We do not agree with those proposals because motorists would find the easy way out and mark more kilometres on paper than actually covered.

Even if only part of the rules pertaining to accounting the expenses of motorcar use are made stricter, the resulting additional revenues may total roughly HUF 20 billion. (If the legal possibility of expense accounting was abolished altogether, the Hungarian state budget could realize extra revenues worth up to HUF 200 billion!) For the entire society, this would bring much more in reduced costs, not to mention the added benefits ensuing from less environment pollution, less frequent traffic congestions and fewer accidents. All these cost-reducing factors would contribute to lowering the rate of inflation as well.

We recommend that the mentioned extra revenues be devoted to supporting small enterprises, because this measure would partly affect them.

3.9. Increased taxes on company cars

“Company cars are granted for managers and owners of businesses as a fringe benefit. Surveys have shown that some 75 to 95 per cent of executives in fact obtain such benefits. The actual value of that «remuneration» may vary between HUF 100,000 and 1 million per year, depending on the car’s value and the extent of personal use. State budget revenues lost on account of the company car allotment (corporate tax and withholding tax or personal income tax) are generally offset by payment of the company car tax. However, the larger the income involved, the less tax is paid proportionally as compensation, given the tax rates stipulated in the currently effective Act on Personal Income Tax.” – says the justification provided for the amendment of company car tax regulations in 1999. We agree with the justification, as well as with the fact that as of 1st January 1999 taxes on company cars were increased at a several times higher rate than that of the inflation. Unfortunately, however, further tax increases have not been effected either in 2000, 2001 or 2002.

But even with the current higher tax rates, it has remained worthwhile for businesses to grant company cars to their executives, particularly if cars of higher value are involved. For example, in the case of the highest tax bracket (HUF 21,000 per month), HUF 252,000 was to

Table II.3.9.a: Company car tax rates in force

Purchase price of the motorcar (HUF)	Monthly tax (HUF)	
	in the year the car was purchased and in years 1 to 4 thereafter	in year 5 or later after the purchase year of the car
1–500 000	3 000	1 500
500 001–1 000 000	4 000	2 000
1 000 001–2 000 000	6 000	3 000
2 000 001–3 000 000	10 000	5 000
3 000 001–4 000 000	13 000	6 500
4 000 001–5 000 000	16 000	8 000
above 5 000 000	21 000	10 500

Source: Act on Personal Income Tax

be paid as company car tax in 2000. Together with the applicable 25 per cent healthcare contribution, the annual payable amount totalled HUF 252,000 + HUF 63,000 = HUF 315,000. For incomes above the limit of HUF 1 million, referred to in the justification provided for the amendment, and calculated with a tax rate of 40 per cent, we will find that tax worth HUF 85,000 per year is not collected by the state (HUF 400,000 – HUF 315,000). However, after taking into account other payable public charges as well (such as the social security contribution, etc.), the aggregate amount of unpaid taxes and contributions may exceed HUF 500,000 per year.

Under current regulations, the tax on company cars decreases if the value of the granted car increases, i.e. the tax has a degressive rate.

Another reason why we do not think that the currently effective regulation is appropriate is because it sets a lower tax rate starting from the fifth year following the purchase of the car. Older cars usually release

much more pollutants into the environment and pose much greater risk of accidents than new cars do.

Article 70 of the Act on Personal Income Tax in force provides as follows:

“(3) On account of the income mentioned in paragraph (1), the tax (hereinafter: company car tax) has the following monthly payable rate: [Table II.3.9.a.]

(4) In contrast to the provisions set forth in paragraph (3), if the tax payment liability under this Article had originated from a time prior to 1st January 1997, the company car tax has the following monthly payable rate:”

For the reasons detailed above we recommend that company car taxes should be modified in a manner that they be calculated with the base rates specified in Table II.3.9.c.

Using such tax rates, the monthly company car tax payable for a Suzuki car with a cubic capacity of 1.3 litres and a value of HUF 1.5 million would be HUF 8,100 + HUF 360 = HUF 8,460 (currently it is HUF

Table II.3.9.c: Proposed company car tax base rates

Purchase price of the motorcar (HUF)		Rate of the tax (HUF)	
Lower limit	Upper limit	Tax minimum	Percentage multiplier related to the HUF 6,000 base value for each HUF 100,000 purchase price increment (%)
1	1 000 000	6000	0
1 000 001	2 000 000	6000	7
2 000 001	3 000 000	10200	8
3 000 001	4 000 000	18360	9
4 000 001	5 000 000	23760	10
5 000 000	–	29760	13
The tax is to be calculated by the following method: (Value at purchase time – Lower limit) rounded off to hundred thousand / 100 000 = Multiplier Multiplier × Percentage multiplier × 6000 + Tax minimum = Calculated tax			

Source: Own calculations

Table II.3.9.d: Correction of the proposed company car tax rates according to cubic capacity

Cubic capacity limit (cm ³)		Tax correction impact of the increase of cubic capacity	
Lower limit	Upper limit	Tax minimum	Percentage multiplier related to the HUF 6,000 base value for each 100 cm ³ cubic capacity increment within the limits (%)
1001	2000	0	2
above 2000		1200	5
The tax is to be calculated by the following method: (Actual cubic capacity – Lower limit) rounded off to hundreds / 100 = Multiplier Multiplier × Percentage multiplier × 6000 + Tax minimum = Calculated tax			

Source: Own calculations

6,000), while the tax payable for a 3-litre luxury car worth HUF 40 million would amount to HUF 302,760 + HUF 4,200 = HUF 306,960 per month (currently it is HUF 21,000).

This example clearly illustrates that our proposal not only takes into consideration the impact on, and the damage caused to, the environment in the taxation, but also imposes these tax burdens in a much more proportionate manner upon the fringe benefit described in the introductory part of this chapter.

A further possibility is that the allotment of company cars can only be accounted as expenses up to a value limit of HUF 5 million and a cubic capacity limit of 2000 cm³, i.e. up to HUF 13,500 per month, and that the company concerned may only grant the remaining part of this benefit from its after-tax earnings. In *Table II.3.9.d.* we have made our proposal regarding these rates. We are well aware that such measures would also place additional burdens on the use of cars for non-private purposes, but the severe environmental and other damage caused by cars justifies such stringent approach. To some extent, these measures would even serve the actual company use by easing traffic congestion on the roads, which would result in shorter access times to travel destinations and reduced numbers of environmental pollution-related diseases. The latter one is particularly important for those travelling by car, since the concentration of air-pollutants inside the passenger compartment of cars is several times higher than the one measured either in public transport vehicles or on the sidewalks.

In Hungary, enterprises applying the so-called simplified venture tax, introduced in 2003, are not subject to payment of company car tax. As compared to the earlier situation, this is tantamount to granting substantial additional support to a seriously environment-polluting activity. The Hungarian Court of Constitution, however, has already confirmed in several resolutions that “the right of citizens to a healthy environment also includes the responsibility of the Republic of Hungary

that the state shall not reduce the standard of environment protection, secured by statutory provisions, except if that is inevitable for the enforcement of other fundamental rights or constitutional values. Even in that case the extent of reducing the protection standard shall not be disproportionate to the objective to be achieved.” The Treaty of the European Union lays down the “polluter pays” principle. This is another reason why the Hungarian regulation introduced in 2003 is contrary to the rules of law of the European Union.

At present, the tax payable on company cars primarily depends on the purchase price of the vehicle concerned. By ruling so, legislators intended to comply with the principle of proportionate sharing of public charges laid down in the Constitution of the Republic of Hungary. The partial abolition of company car taxes represents a serious violation of the pertinent Article in the Constitution. At the same time this is also contrary to the requirement of fair market competition, which constitutes a pivotal part of both the Hungarian and the EU legal corpus. This measure favours above all the owners of vehicles of higher value. Such cars are purchased through imports, just like the fuels which they consume in quantities far above the average consumption. On the other hand, these vehicles are mostly run to satisfy luxury consumption needs and not to contribute to value creation. Therefore, the planned tax allowance acts against the interests of the Hungarian national economy.

For the above reasons we strongly recommend that the company car tax payment obligation should remain applicable also to enterprises opting for simplified venture taxation. State budget revenues, not lost as a result of our proposal, might perhaps be used to cut down the rate of simplified venture tax.

Our preliminary estimates show that extra revenues of some HUF 20 billion could be realized from raising the tax on company cars.

3.10. Increase of consumption tax (registration fee) on motorcars

Recent years have seen a dynamic growth in imports of motorcars into Hungary: while in 1992 only around fifty thousand motorcars, predominantly from imports, were sold, in 2002 sales figures of imported motorcars, all-terrain vehicles and small trucks reached already some 215 thousand. Calculated in USD value and without private imports, by 2002 sales volumes increased to nearly three and a half times of that in 1996 (an increase of 240 per cent!), and amounted to USD 1121 million (see *Figure II.3.10.a.*). Measured in numbers of vehicles, the growth rate was 174 per cent, recording 155 thousand cars in 2001 (175 thousand including private imports), and more than 173 thousand in 2002 (215 thousand vehicles, as mentioned already, including private imports).

Data collected by the Hungarian Statistical Office demonstrate that in October 2002 the sales turnover of the motor vehicle and vehicle parts retail trade sector was by 17.6 per cent higher than similar data of the preceding year. The growth rate in the first 10 months of the year was even higher, reaching 24.0 per cent. In the same period, the motor vehicle fuel retail trade sector's sales volume increased by 8.9 per cent as compared to the same period of the preceding year.

Actual imports are greater than the above volume, because Suzuki cars, numbering around 35 thousand in 2002, assembled from imported parts and sold in the Hungarian market, should also be added to it. In 2002, this represented additional imports worth USD 175 million. Consequently, total direct imports amounted to a value of USD 1300 million. (Over and above this, spare parts and accessories represent a substantial extra value.)

The rapidly increasing imports significantly deteriorate Hungary's foreign trade balance and current balance of payments. Some data to illustrate the dimension of this impact: as compared to the value in 1997, imports of motorcars increased by USD 878 million (EUR 1030 million) by 2002, which accounted for more than the half of the deterioration in the sales turnover balance registered in 2002. This was mainly attributable to the gradual reduction of customs and duties. Customs duties on industrial products imported from the European Union and from countries associated to the EU have been gradually cut down by Hungary, and were completely abolished in 2001. As regards motorcars imported from the United States of America, applicable customs duties have been considerably lowered on the basis of a bilateral agreement. Statistical duties and customs clearance fees, representing 2 to 3 per cent in the aggregate, have also been abandoned in every trade direction. In comparison to

the total import value, the proportion of consumption tax has also decreased significantly, which was not caused by the modified tax rates, but rather by the improved import structure (namely by the increasing portion, reaching practically 100 per cent by now, of motorcars equipped with catalytic converters, which are subject to preferential taxation). As a consequence of all these factors, the growth rate of VAT revenues is also lagging behind the rate at which imports increase. *Figure II.3.10.b.* illustrates, aggregating all the above impacts, the hidden subsidies granted to motorcar imports. It is to be remembered that in recent years in Hungary even the most basic healthcare services in have been afflicted and impaired by a serious lack of funds, nevertheless the state has been granting, in covert forms, ever-increasing subsidies to motorization which greatly pollutes the environment and damages citizens' health. The huge amounts demonstrated in *Figure II.3.10.* clearly testify to this fact.

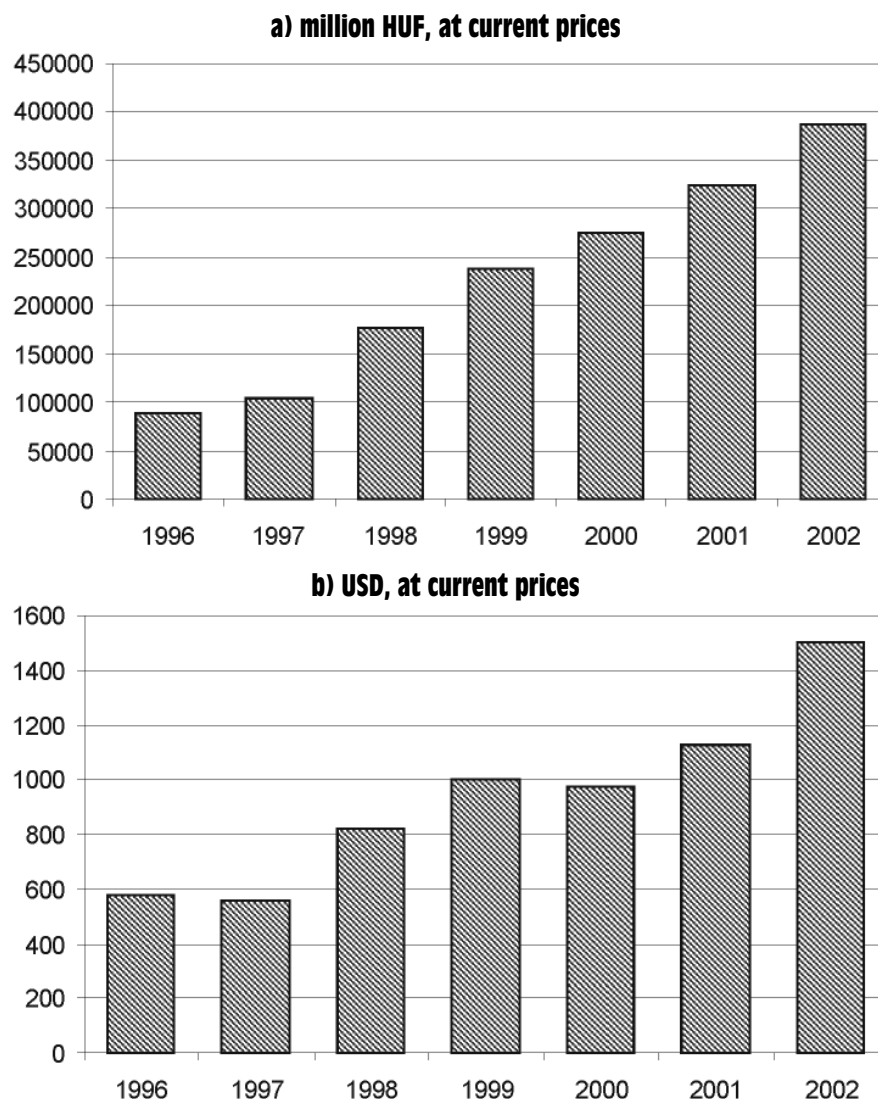
Raising once again the applicable customs duties would run counter to the agreement concluded between Hungary and the EU, would give rise to the disapproval of the World Trade Organization (WTO), would also have an adverse impact on the export-orientated foreign enterprises located in Hungary, and additionally might provoke further complications in the field of economic policy. These reasons leave no other option as a room for manoeuvre than to raise the rates of consumption taxes. By using the resulting extra state budget revenues – coupled with other similar measures – Hungary may replace the otherwise necessary restrictive measures which would set back either the standard of living or the economic growth, or even both of them. Inevitably, such measures always hit the most those social groups which have weaker interest-enforcement capabilities. Owing to the large-scale reduction of payable customs duties, the aggregate burden would even so be lower than it was a few years before.

Only about 40 per cent of the total impact resulting from the Hungarian currency's revaluation materialized in reduced consumer prices; the remaining 60 per cent mostly added to the profit of importers. We may presume that the effects of raised consumer taxes will have to be partly borne by importers due to market pressures brought about by the economic recession.

It is also advisable to raise consumer taxes because due to the large volume of turnover, even a small increase may result in substantial extra revenues: based on data of 2001, an increase of 1 percentage point may bring gross revenues worth approximately HUF 3.2 billion.

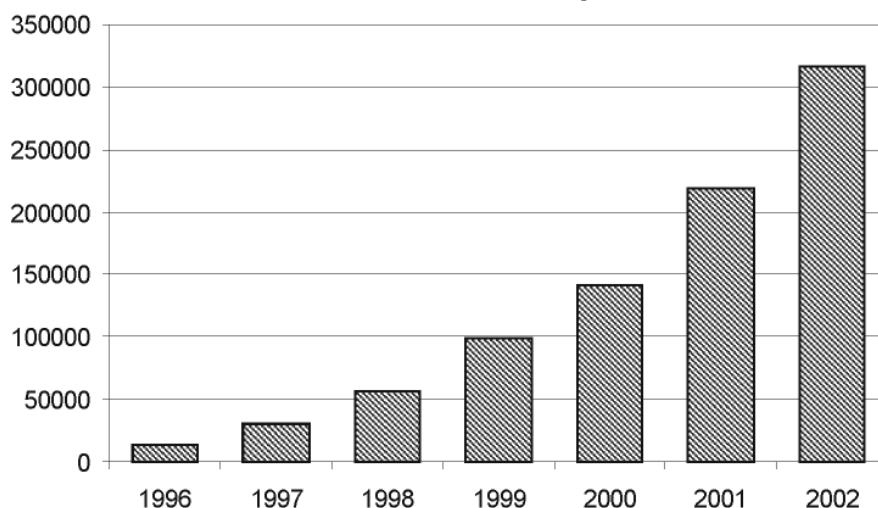
In the event that consumer taxes are raised, the question may, of course, rightly come up whether the price-increasing effect will not lead to such level of reduction in the turnover growth rate which can prevent that the projected revenues are in fact realized. Undoubtedly,

Figure II.3.10.a.: Changes in imports of motorcars and their spare parts (not including private imports)



Source: Foreign trade statistics by HS commodity classes (not including imported Suzuki cars)

Figure II.3.10.b.: Impact of the reduction of customs duties and the loss of related VAT on motorcars imported from the EU



Source: Own calculations based on the Foreign Trade Statistics, data of the National Bank of Hungary, as well as data pertaining to the reduction and abolition of customs duties between the EU and Hungary

such impact does exist, but we may presume that not even an increase of 12 percentage points would have such a price-increasing effect (taking into consideration the impact, accumulated up until now, from the reduction and abolition of customs duties and from the revaluation of the Hungarian currency, as well as the slower rate of revaluation in the future), which, with increasing domestic real income levels, would considerably slow down the growth of demand in Hungary. Another fact to support the assumption that this would certainly not happen, is that in contrast to the case of supplementary customs duties, formerly applicable in Hungary, when it was known well in advance that they would be partially reduced and eventually completely abandoned, now the raised consumption taxes will be incorporated into economic expectations in a long-lasting manner and so they do not motivate consumers to postpone purchases. As a consequence of the HUF revaluation and the customs duty abolition, purchase and operation of motorcars have become cheaper both in the absolute and the relative sense, and for this reason the tax-bearing capacity of motorcars has largely increased. Nevertheless, if the growth rate of motorcar imports does fall off despite what was said above, then state budget revenues will indeed not increase at the expected rate, but Hungary's foreign trade balance and current balance of payments will be improved.

Purchase of motorcars is also encouraged by the extremely sophisticated credit financing forms involved, which allow customers to purchase in advance. As a result, they become less price-sensitive, which could also be offset by the raised consumption tax rate.

Another factor to be taken into account is that environmental requirements will become stricter in the future, which means that the motorcars currently in use are in fact cheaper and more polluting than the cars expected to be used in the future. This is another reason to support the need to increase consumption taxes.

At present in Hungary, motorcars without catalytic converters are subject to a consumption tax of 22 per cent up to a cubic capacity of 1600 cm³, and a tax of 32 per cent above 1601 cm³. In the case of motorcars equipped with catalytic converters the applicable rates are 10 and 20 per cent. However, since cars without catalytic converters cannot be distributed any more in Hungary, this preference has become superfluous. Therefore we recommend that motorcar consumption tax rates should be set in a uniform manner at 22 per cent up to a cubic capacity of 1600 cm³, and at 32 per cent above 1601 cm³.

The proposed increase of consumption tax would have ensured extra revenues of around HUF 38 billion for the state budget in 2003.

We welcome the current Hungarian Government's decision to introduce as from 2003 a new customs tariff classification system under which several motor vehicle types will be removed from the truck categories and will be cleared through the customs as cars in the future, i.e. the applicable consumption tax will have to be paid on these vehicles, and the pertaining VAT cannot be refunded either. (Under the statistical system of the year 2002, this modification affects ten thousand motor vehicles.)

Motor vehicle importers have raised a proposal suggesting that the currently applied consumption tax should be replaced by a car registration fee. The European Commission, however, has just proposed to abolish this fee, for in the event of moving abroad the fee should be paid once again, which is qualified as undesirable double taxation (Hungarian economic daily "Világgazdaság", 9th September 2002). Consequently, it is not advisable to replace consumption tax by this fee in Hungary either. The difference between the two taxes can be summarized as follows:

- The consumption tax shall be paid upon importing the goods concerned, together with the applicable customs duty, and it constitutes a base for the VAT, increasing thereby the import purchase price and consequently the consumer price.
- The registration fee shall be paid upon putting the car into use. It shall be borne by the customer, so directly it does not form part of the consumer price. Decision has not yet been made about the rate of the fee and about the question whether VAT will be imposed on it or not. However, we have been informed that motor vehicle importers are urging that the fee should be exempt from VAT.

Therefore it is to be feared that by introducing the registration fee, motorcar prices could be further reduced, causing losses to the state budget and damage to the environment.

Accepting the scope of applicable tax types had been one of the preconditions of the EU accession. The negotiations, conducted jointly with other acceding states, had led to the final result that consumption tax was omitted from the list. In this state of affairs, the only feasible choice is to introduce the registration fee.

The minimum aim to be attained is that the payable amount reaches at least the combined level of the current consumption tax and VAT. However, several factors justify a much higher rate for the registration fee.

- Motorcar sales have been growing at an extremely rapid rate in recent years, and this process seems to be gaining further speed: in the first quarter of 2003,

the number of sold cars increased by some 25 per cent compared to the same period of 2002.

- The conditions for purchasing motorcars have greatly improved as a consequence of the reduction and abolition of customs duties and the revaluation of the Hungarian currency.

In the last two decades, the amounts spent on maintaining the existing national road network have steadily been only half of what would have been necessary just to keep up the state of the roads. The year 2003 brought further deterioration, because financial resources available for such purposes are by some HUF 25 billion less than in 2002. On the whole, this means that existing public roads are deteriorating at an ever accelerating rate. Therefore it is crucially important to raise additional funds for the maintenance and renovation of Hungarian roads. On the other hand, communicating this need towards car-owners will also make the significantly raised rate of payable fees more acceptable for them.

3.11. Increase and effective collection of consumption tax (registration fee) on used motorcars

Clean Air Action Group welcomed and fully approved the Hungarian Government's decision to forbid as of 1st January 2003 the imports of used motorcars into the country if they are more than 7 years old.

Share of used motorcars within total imports had been low for many years and in absolute terms their imports had dropped until 2000. Thus their proportion (measured in pieces of motorcars, including private imports) diminished from 36 per cent in 1996 to 11.7 per cent in 1999. 2001 brought a turn-about in imports of used motorcars, for their number surged from 13 thousand in 2000 to 36 thousand in 2001, then to 96 thousand (!) in 2002 (*Figure II.3.11.*). This rapid increase was triggered by the liberalization of used motorcar imports and by the abolition of customs duties on motorcars originating from the European Union.

Back in 1996, an age limit of 4 years had been set for imports of used motorcars. In 2000, however, this restriction was revoked, which resulted in a situation where Hungary started gradually turning into the scrapyard of Western Europe. Motorcar-owners in Western Europe were glad to get rid of their used vehicles (and the troubles and costs involved) even for a few hundred Euros. This process, however, contributed to deteriorating the environment pollution and impairing the traffic safety in Hungary.

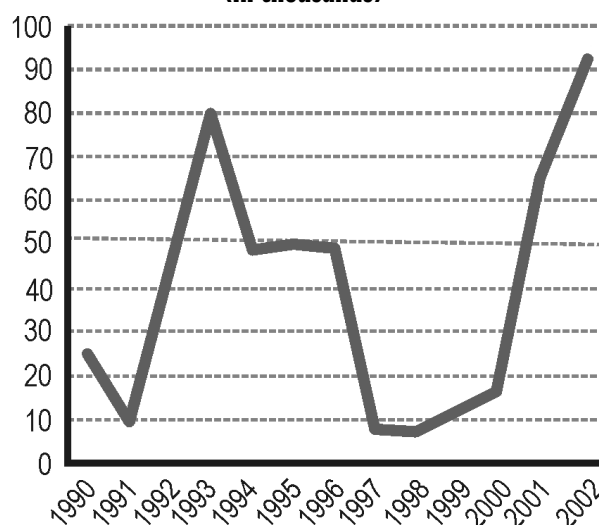
Imports of used motorcars are largely facilitated by customs procedures currently in force, which allow evasion of customs duties and taxes in mass proportions. And those concerned are in fact taking advantage of this possibility in many cases: they do not pay the consumption tax (and the connected VAT) according to the internationally accepted price catalogue, but on the basis of the presented bill, which is underinvoiced in most cases. To make things even worse, the real value of motorcars brought into Hungary as a private import is only checked if the value of the presented invoice is less than 50 per cent of the catalogue price (instead of the former 80 per cent). Such loosening in regulation has led to a practice when the invoiced value of motorcars imported in the above manner amounts to 51 per cent of the catalogue price as a rule...

That is the reason why Clean Air Action Group is urging that the customs value, and from the date of Hungary's accession to the EU, the registration fee, of used motorcars should be determined on the basis of the catalogue price.

Furthermore, in order to cut back the imports of used motorcars we propose that in case cars older than 3 years are put into use in Hungary, progressively increasing consumption taxes (or registration fees) should be levied at a rate which ensures that vehicles older than 4 years are not worth putting into use any more.

We recommend that the rate of the registration fee imposed on used motor vehicles should be at least 100 per cent on average. **Considering that regulations pertinent to importing and putting into use used motor vehicles will be liberalized as from the date of EU accession in 2004, and reckoning with a reduced**

Figure II.3.11.: Changes in imports of used motorcars (in thousands)



Source: Monthly "Lélegzet", 2003/2

import volume of 10,000 vehicles per year, we estimate that the Hungarian state budget may realize direct extra revenues worth nearly HUF 10 billion.

It is particularly justified to take the above measure because as from the date of accession, VAT on used motorcars imported from EU member states will remain in the country of origin, i.e. it cannot be collected in Hungary. Lost budget revenues from this source can be assessed at about HUF 20 to 30 billion, in case the measures we propose are not introduced.

A further important reason to support such steps is that from 2005 on, car manufacturers in the EU are obliged to take back for recycling the new motorcars they sell. This obligation, however, does not cover motorcars manufactured prior to 2005. As a consequence, Hungary itself has to raise the funds needed to cover the costs of handling those vehicles.

3.12. Raising funds for handling motor vehicle wrecks

Worn out and unserviceable motor vehicles (hereinafter we will use the term “wreck motorcars” in a sense including all types of motor vehicles) appear in ever growing numbers in parking lots, in out-of-the-way – or more central – parts of residential areas, vacant lots, or even in the woods and fields. We estimate that at least 130,000 cars are scrapped and become “wrecks” every year in Hungary. In most cases, handling of these wrecks places a growing burden upon local governments, and thereby indirectly (and in some respects, directly) also upon the state budget.

From 2005, EU regulations make it compulsory for motorcar manufacturing companies to take back and to recycle used motor vehicles. Hungary should formulate the domestic regulations in line with these EU rules.

Information supplied by the ERECO Eastern European Waste Recycling and Environment Protection Co. reveal that processing of, and recycling of the materials obtained from, these wreck motorcars in compliance with environmental protection provisions could be a remunerative activity, once a solution is found for the problem of collecting the wrecks and transporting them into car dismantling yards (preferably free of charge for the vehicle dismantlers). To achieve this, we do not recommend that a new tax should be imposed; we rather think that the solution would simply be to require vehicle-owners to continue paying the tax on motor vehicles and the compulsory liability insurance fees until they prove that they handed over the motor vehicle they

own to an officially licensed vehicle dismantling yard. Such measures are not expected to bring additional revenues for the state budget, because car-owners will hopefully be interested in handing over their wreck motorcars to dismantlers. For local government budgets (and thereby indirectly also for the state budget), however, the burden arising from the tasks and measures of handling wreck motorcars would be alleviated.

In order to provide further stimulation, i.e. to prevent for example that car-owners leave their vehicles in the depths of the woods or at the bottom of lakes declaring that the car has been stolen, it is worth considering that the state should bear the costs of transporting the wreck motorcars into vehicle dismantling yards. **Raising further the applicable rate of motor vehicle taxes could provide adequate funds for this purpose.**

We deem it necessary that EU regulations applicable to wreck motorcars should be entered into force without delay. The population, as well as interested enterprises and authorities should receive official comprehensive information about this as soon as possible.

3.13. Elimination of motorcar credits granted by withholding VAT unlawfully

When providing credits for the purchase of motorcars, special credit facilities have been used for many years in Hungary in which the applicable VAT was only to be paid up with the last instalment. This meant that in practice the state budget was made to grant interest-free credit for 20 per cent of the cars' value. As far as we know, it is not possible any more to use such schemes in mass proportions, but there are still some types of permitted transactions (some forms of leasing, for instance) where this method may be applied. Earlier transactions had been concluded for a period of 5 years, consequently they are still under way today.

We recommend that the Ministry of Finance should render a detailed account for the Hungarian Parliament about the annual amounts spent under the above scheme by the state budget to support motorcar purchases. The still existing loopholes must be closed. It is also necessary to look into the possibilities of collecting somehow the taxes pertaining to contracts that had been concluded earlier but are still valid today.

Interest costs arising from the delayed payment of taxes are borne by the state budget. We estimate that such interest costs may total HUF 2 to 3 billion a year.

3.14. Substantial reduction of subsidies to construct further high-speed roads

Available financial resources should be spent on maintaining and renovating the existing road network, on constructing short road sections to avoid towns and villages and on restoring the railway network, because these are much more economical and environment-friendly investments than the development of Hungary's high-speed road network. The only exception should be the eastern section of the M0 motorway (Budapest ring-road), which should only be built along the trace of the connection at Gödöllő. Detailed justification for our proposal can be found in Appendix 7 to this study, therefore we will only expound here our views on the northern section of the M0.

Among the items of the state budget, funds should in no way be estimated for the northern section of the M0 motorway (between national roads No. 2 and 11), because this giant investment, the total costs of which would exceed HUF 60 billion, is equally unjustified from the aspect of the national economy, transport and environmental protection.

The northern motorway section would cause serious pollution to the neighbouring area. Air pollution, noise, traffic congestion and the degradation of green surfaces would imperil the health of the affected population, and would also destroy several resort areas around Budapest, which have already been dangerously reduced in numbers.

The motorway would pass over the most important water reserve of the Hungarian capital. It is inadmissible to consider any investment which might jeopardize the main water base of a drinking water supply system serving the need of 3 million people.

The new road section will generate huge additional traffic, as has been clearly demonstrated by the southern section of the M0 as well.

Even if by some miracle the extra traffic was not generated, this section of the motorway would only improve Budapest's traffic situation by less than a single per cent. If we devote HUF 60 billion to achieve such improvement and if, in general, we wish to solve the traffic problem of the Hungarian capital by a similar method, then more than HUF 6000 billion should be spent in order to achieve the "comprehensive solution"! However, enhanced public transport services, extended parking regulation, generally used traffic calming measures, etc. are by several orders of magnitude more efficient ways of attaining the same goal.

Judging by the most optimistic forecasts (against which serious doubts can be raised), the northern

motorway section, in the event of being implemented, would only better the travel (driving) conditions of some 20 to 30 thousand people. However, if the funds devoted for the above investment (which equal the total annual budget of the Budapest Public Transport Company) were used to raise the standard of public transport services in the capital, travel conditions of 1.5 million people could be perceptibly improved.

Several local governments concerned have rejected the planned investment in official resolutions, and preliminary surveys show that the project is also opposed by the majority of the affected population.

The Hungarian Government wishes to spend around HUF 90 billion from the privatization revenues on the construction of new motorways and roads. In our opinion, road constructions and the fact that HUF 1400 billion have been drained away from the Hungarian railway infrastructure up until today are not compatible with either the environmental or the transport policy concept. This is particularly true if we take into consideration the requirements of the European Union. We recommend that the entire sum should be devoted to implementing some of the needed but unrealized developments of the railways. (This requirement is also justified by recent problems with motor trains.)

3.15. Abandonment of direct and indirect subsidies granted to the Formula-1 Hungarian Grand Prix

Holding Formula-1 races in Hungary and granting state subsidies for these events have been justified by the alleged extra tax revenues worth HUF 2 to 3 billion that the state budget is expected to realize from the spending of foreign tourists visiting Hungary at the time of this programme, and by the favourable publicity that the race is said to generate for the country. The calculations have been prepared solely by agencies interested in the Formula-1 Hungarian Grand Prix, and they have overestimated the supposed favourable impacts, and have made no mention of the disadvantages.

This event causes particularly great environmental load both at the site of the race and on the roads leading to it. Before the racing course was constructed, this valley near Mogyoród had been a green oasis adorned by a lake, while today it is a barren, smoke-filled, vast fiery concrete complex. All this involves very high costs. (Among other damages caused, it scares off traditional tourists who seek recreation and wish to do sports.)

Table II.3.15.: Main data of state subsidies granted to the Formula-1 Hungarian Grand Prix

Year	Number of spectators (in thousands)	Receipts from tickets sold (million HUF)	State subsidy (million HUF)	Licence fee		Exchange rate (HUF/USD)*
				million HUF	million USD	
1998	180	1476	450			
1999	200	2128	405			
2000	180	2446	400	1609.0		
2001	183	3058	400	1776.5	6.2	286.54
2002	160	2450	2500	2571.1	10.3	252.73
2003			3000	2877.8	11.3	254.00
2004				3178.1	12.5	255.00
2005				3509.6	13.7	256.00
2006**				3875.6	15.1	257.00

In 2002, the previous Hungarian Government undertook a guarantee to the extent of HUF 3 billion. In the event that the company makes use of this guarantee, the guarantee will be collected from the company, and then it will be wound up. To avoid this, the present Hungarian Government has granted a subsidy of HUF 2.5 billion.

*Calculating with the revaluation of the Hungarian currency.

**From 2006, EU regulations forbid the broadcasting of cigarette advertisements on television. Tobacco advertisements are prohibited in Hungary. The Formula-1 race has obtained exemption, which also constitutes a state subsidy, in an estimated value of HUF 3 to 4 billion. As a consequence, the aggregate value of state support given to the Formula-1 event – amounting to HUF 400 million in 2001 – increased to over HUF 5500 million by 2002.

“RTL Klub (Hungarian commercial TV channel) has closed an exceptionally successful year also in terms of its advertising revenues, which exceeded by nearly HUF 2 billion those of the previous year, even before the end of the year, not including the final earnings in December. The highest financial growth produced by the TV channel, however, took place in August (normally considered as part of the dead season): having acquired the exclusive Hungarian broadcasting rights of the best known sports event of the year, the Formula-1 race, it was capable of realizing by nearly HUF 400 million more advertising revenues than in August 2001, thanks to the F-1 Hungarian Grand Prix.” No information is available about the realized amount of foreign advertising revenues of the Formula-1, but these are probably several times higher than the domestic revenues. In the European Union, tobacco advertisement on television is only possible within the Formula-1 events; therefore the revenues may even come to HUF 10 billion!

Source: Hungaroring Sport Co., HVG Hungarian economic weekly, Ministry of Finance, budget laws

In reality, the Formula-1 race receives huge covert subsidies as well. Starting from this year, it is forbidden to advertise tobacco products in Hungary. Exemption from this prohibition has solely been given to the F-1 Hungarian Grand Prix, as a result of which it can realize considerable extra revenues – and the more so because in this respect it has acquired a monopolistic position and thereby has gained significant competitive advantage over rival events. The annual value of this status may be estimated at several billion HUF. (From 2006, even this type of tobacco advertisement will be banned in the European Union.) Because of the tobacco advertisement prohibition to be introduced in Austria from 2004, the last Austrian Grand Prix of the Formula-1 races is to be held in 2003, which also proves that with the exceptional permission to advertise tobacco products, it is unnecessary to grant any budget support.

The gravely environment-destroying Formula-1 race receives huge publicity, which impairs the effectiveness of the environmental protection awareness raising and educational work striving to make people think and behave in a manner meeting the requirements of our

age. This is illustrated by the fact that the European Car-Free Day, an event organized every year with the participation of already more than one thousand towns and cities all over the continent, receives only little and inadequate moral and financial support in Hungary. The social damage caused by providing such publicity to the F-1 motorcar race is immeasurable. It is odd and unaccountable that this event, which is opposed to the aims of true sports, damages the environment and demeans masses of people into passive circus spectators, is supported by just the Hungarian Ministry of the Youth, Children and Sports. We should remember that one of the “by-products” of this event is a brisk period for the prostitution business, with its associated scandals.

With full knowledge of the above facts, it was shocking that the Hungarian Government decided to increase more than sixfold the original subsidy of HUF 400 million, and in 2002 granted already HUF 2500 million to the Formula-1 race from public money. The raised state support of the year 2002, worth HUF 2500 million, also implies (owing to the 10 per cent annual increase of licence fees, stipulated in the contract) that similar or even

higher amounts of state subsidies are to be granted to this motorcar racing event also in the years to come (see Table II.3.15.). This is reflected by the Hungarian state budget for the year 2003 as well, where this subsidy is already raised to HUF 3 billion in the budgetary chapter of the Ministry of the Youth, Children and Sports.

Granting state support instead of the state guarantee, which has already been in place for years, is allegedly necessary because in the event of making use of the guarantee, Hungaroring Sport Co., the company organizing the F-1 race, should be wound up. It is also contrary to the principle of market economy that an enterprise, against which serious environmental objections can be raised, is intended to be kept in operation by means of such huge direct subsidies over and above the mentioned indirect support.

In recent years it has been a promising sign that the real value of state subsidies has been steadily decreasing year by year. Unfortunately this trend is now reversed.

Moreover, this subsidy violates the Hungarian Constitution and the Act on Environmental Protection.

The Constitution declares: "The Republic of Hungary recognizes and enforces the right of every citizen to a healthy environment." Accordingly, the Hungarian Court of Constitution has already confirmed in several resolutions that "the right of citizens to a healthy environment also includes the responsibility of the Republic of Hungary that the state shall not reduce the standard of environment protection, secured by statutory provisions, except if that is inevitable for the enforcement of other fundamental rights or constitutional values. Even in that case the extent of reducing the protection standard shall not be disproportionate to the objective to be achieved." In this case, however, the state is granting substantial additional support to a seriously environment-polluting activity in a manner that this is not needed at all in order to enforce any other fundamental rights.

Act LIII of 1995 on the General Rules of Environmental Protection declares:

"Art.6 (1) Utilization of the environment shall be organized and carried out in a manner that

- a) it causes the least possible degree of loading and stress to the environment;
- b) it prevents contamination of the environment
- c) it precludes the possibility of any damage to the environment.

(2) Utilization of the environment shall be carried out by taking into consideration the precautionary principle, by sparing and using economically the environmental elements, as well as by reducing the amount of waste produced, and making efforts to recycle and re-use natural and man-made materials."

Obviously, the subsidies granted to the Formula-1 motorcar race do not promote the saving and spar-

ing use of environmental elements, but rather the opposite.

The current increase in the value of state support is also unnecessary and superfluous from an economic aspect, considering the special profit, estimated at HUF 3 to 4 billion, gained from tobacco advertisements. It is incomprehensible that up until now no investigation has been conducted to find out what may have caused that this enterprise has not yet become self-sustaining economically.

It is an unacceptable argument that this event generates great international publicity for Hungary. In reality, Hungary will not be made particularly interesting for foreign visitors if they can experience in this country the very same that they have already got used to see in their home country. However, creating an environmentally friendly country which is developing in a sustainable manner could indeed better Hungary's standing and reputation in the world.

Another often heard but absurd argument is that granting state support is primarily necessary because it would result in more foreign tourists coming to Hungary, who would spend money here. In 2002, the Formula-1 race had some 160 thousand spectators, out of which the number of foreign visitors cannot be estimated at more than 60 thousand. Granting a state subsidy of HUF 3 billion is tantamount to giving, from public money, HUF 50 thousand as a gift to each foreign tourist. By taking into account also the hidden forms of support discussed above, this amount may even exceed HUF 100 thousand... (Anyway, it is not advisable to stimulate the inflow of foreign tourists right in the middle of the peak tourist season, in August.)

Accordingly, we recommend that the state subsidy of HUF 3 billion should be withdrawn and the entire sum should be devoted to financing anti-drug measures, because at present the funds available for this purpose are not sufficient.

3.16. Collecting VAT on foreign buses

We recommend that the VAT should be collected on passenger transport activities carried out in Hungary by buses registered in foreign countries. The tax base of the service fee is uniformly HUF 15 per passenger kilometre, and we recommend that upon that the 12 per cent VAT rate should be imposed, which is the rate applicable in Hungary to such activities.

At present, Austria, the Czech Republic and the Slovak Republic do collect VAT upon the passenger-

kilometre performance of foreign buses in their respective territories. In Hungary similar tax collection does not take place due to negligence. By collecting this tax, approximately HUF 5 billion extra revenues can be realized annually, and – to cap it all – from foreigners. Another favourable consequence would be the elimination of Hungary's unjustified disadvantageous position in this respect. Thereby the current discrimination against passenger transport services carried out by buses registered in Hungary, which is contrary to the principle of fair market competition, would also be removed.

This would also be favourable for Hungary because 161 thousand buses with foreign registration numbers entered the country's territory in 2001, while only 32 thousand Hungarian buses left the country. (Most of the entering buses arrive from the West. The Hungarian-Romanian border was only crossed by 28 thousand buses; consequently the Hungarian national minority traffic does not represent more than just a fraction of the total traffic.) Such a measure would have the additional benefit of easing the discrimination against the more environmentally friendly railway passenger transportation.

We have arrived at the mentioned HUF 5 billion as a result of the following calculation:

We have reckoned with 50 persons per bus and an average travel length of 400 km (diagonal distance across Hungary, or from the country border to Budapest and back). Taking as a basis the Austrian rate (EUR 0.05) at an exchange rate of 245.32 HUF/EUR, the base of the tax – rounded up – is 15.00 HUF/passenger-kilometre. The VAT rate applicable to passenger transportation is 12 per cent, i.e. 1.80 HUF/passenger-kilometre. $160,000 \text{ buses} \times 50 \text{ persons} \times 400 \text{ km} \times \text{HUF } 1.80 = \text{appr. HUF } 5.76 \text{ billion}$. By deducting the traffic-reducing impact arising from the introduction of this tax, extra revenues totalling HUF 5 billion can be ensured.

“As from 1st April 2002, value-added tax has been introduced for buses in Austria – On 1st April 2002, a value-added tax payment obligation enters into force; the payable amount depends on the number of passengers transported in vehicles, used for road passenger transportation services, crossing the country border, and on the travel distance covered in Austrian territory. The rate of the tax is 10 per cent of the ATS 0.60 (from 1st January 2002: approximately 5 cents) upon each passenger and upon each kilometre of the transport distance covered within Austria. $\text{Number of passengers} \times \text{kilometres covered} \times 0.60 = \text{average transportation fee} \times 10 \text{ per cent} = \text{VAT}$.

Example: 50 passengers, 300 kilometres: $50 \times 300 \times 0.60 = 9,000 \times 10 \text{ per cent} = \text{ATS } 900 \text{ payable VAT}$.

The tax, assessed by the customs authority on the basis of data contained in the tax return, falls due immediately, and so the tax is to be paid on the spot. Later on we will publish the VAT return form and will provide information on how to fill in the form. We draw the attention of our members that to avoid penal sanctions they should make preparations for filling in the form and for paying the tax.”

(from the homepage of the Union of Hungarian Road Carriers)

3.17. Introduction of urban road charges

We recommend that urban road charges should be introduced in Budapest and – if appropriate assessments prove that it is reasonable and justified – also in various other settlements of Hungary. This is a local government responsibility, but the state has to promote it through awareness raising, professional backing and by creating a suitable legal environment for this task.

Putting into practice our proposal would also improve the financial standing of the local governments concerned, which in turn would reduce the need for state resources. In addition, this measure would significantly better the environmental and traffic situation in Hungarian towns, and would enhance their potential to attract businesses.

According to data of the traffic count carried out in 2000, on working days 255 thousand motorcars and trucks cross the boundary of Budapest. Assuming that each time they enter the capital area, vehicles have to pay a road charge of HUF 1000 on average, and that this measure cuts down the number of entries to 160 thousand, annual revenues (calculating with 250 working days a year) would total HUF 40 billion. (In the first year these revenues would be smaller by a few billion HUF due to the costs of building up the system; but subsequently it could be operated at relatively low costs. What is more, the electronic system set up for this purpose could also be used in part for the benefit of public transport.) The generated extra revenues should be devoted to improving public transport services.

Over and above the mentioned HUF 40 billion, additional benefits worth tens of billion HUF are brought about by reduced environment pollution and damage to human health, by less traffic and fewer congestions on the roads and by Budapest's regained attractiveness. (Issue No. 2003/6 of the monthly “Lélegzet” published by Clean Air Action Group contains detailed studies on urban road charges.)

3.18. Compulsory introduction of parking fees

Hungary's most valuable asset – right after the people living here – is its land. And even within that asset, inner urban areas represent an outstandingly precious property. At present, this property is mostly used free of charge for the purpose of storing motor vehicles. This practice entails an extremely irrational area management and wasteful use of urban areas, which has led to a scarce economy in this sector. (An unfavourable by-effect is that it encourages purchasing ever more motorcars even in densely populated areas.)

For that reason we recommend that market economy should be introduced in this sector, too: demand and supply should find their equilibrium through adequate prices. The state should enact regulations making it mandatory for local governments to gradually introduce “equilibrium parking fees” in their areas. This means that parking fees should be set at such rates that even in peak hours at least 10 per cent unoccupied legal parking lots be available, and illegal parking be eliminated altogether.

International experience shows that similar measures have been successfully put into practice in many parts of the world. For instance, in several large cities of Japan and South-Korea, motorcars will only obtain registration numbers if their owners can prove that they are capable of storing these vehicles outside the town's public areas.

Another major problem with today's practice in Hungary is that the communities concerned hardly have a share at all in the revenues collected from parking fees. This should definitely be changed.

In the initial years of the new system, revenues worth some HUF 20 to 30 billion could be realized from this source annually, which should be devoted to improving public transport services and implementing traffic calming measures. On the whole, these measures would markedly enhance the liveability and traversability of Hungarian towns, and would also increase their competitiveness and tourist attraction potential (especially for European tourists, the main target group of this industry).

3.19. Postponement of the construction of Metro line 4 in Budapest

We welcomed that the previous Hungarian Government had accepted our proposal to postpone the construction of the planned 4th Metro line in Budapest

(no matter what its actual motivation for this choice had been). In our opinion this decision has saved the Hungarian capital for some time from the serious danger that insufficient financial resources and a marked increase of transport fares make Budapest's public transport system collapse, causing a complete transport breakdown and an environmental catastrophe. But now we are sad to see that the issue of Metro construction has once again been placed on the agenda, instead of using the available funds on the maintenance, renewal and improvement of the already existing public transport network of Budapest and its environs, and also allocating such resources for the development of environmentally friendly transport in the country outside the capital – particularly in Eastern Hungary –, as has been urged by Clean Air Action Group as well.

Appendix 8 to this study contains our key arguments to support the need to postpone the planned construction of Metro line 4, as well as our proposals regarding the improvement of Budapest's transport situation.

However, in the event that the construction of Metro 4 is started after all, we deem it necessary that substantial additional resources be provided for the other mentioned public transport purposes, too.

3.20. Increased taxes and duties on air transport

Air transport is granted huge hidden and open subsidies all over the world. Such subsidies may take diverse forms:

- Kerosene, the fuel of aeroplanes, is not subject to consumption taxes (excise duties).
- In international passenger traffic, VAT is not payable on air tickets.
- Air transport companies are often granted customs allowances for their acquisitions. (For instance, the Hungarian state has released payment of customs duties worth several billion HUF in recent years on the purchase of aeroplanes by the Hungarian Airlines /MALÉV/.)
- In the airports of most of the countries of the world duty-free (tax-free) shops are operated. The European Union has already banned such shops, because it considered that their operation seriously violated the principle of fair market competition.
- Airline companies and airports receive massive direct state subsidies (investment subsidies, etc.) all over the world. The influence of air transport companies is clearly exemplified by the fact that following the terrorist attack of 11th September 2001, the American Government granted non-refundable sub-

Table II.3.20.: Subsidies granted to air transport in the European Union in the middle of the 1990s

Type of subsidy	Value of the subsidies granted (billion EUR/year)
direct subsidies for operation and development	2.3
tax exemption of kerosene	18.4
VAT exemption of air-tickets	6.5
tax-free shops operating in airports*	1.4
unpaid environmental and other damage	16.4
Total subsidies	45.0

*amount of unpaid taxes as compared to purchasing the same goods in non-tax-free shops of the country concerned
Source: Yehudi David Demitri van de Pol: The Myths of Flying. Vereniging Milieudefensie, 1998 (www.milieudefensie.nl/airtravel)

sidies in the value of USD 15 billion to American airlines. (New York City, the hardest hit victim of the terrorist attack, only received a fragment of this sum as state support!) Under the same pretext, the United Kingdom, France and Germany also gave substantial subsidies to their respective airlines. Although certain circles of the European Commission and of the European Parliament expressed their doubts about the compatibility of these measures with free market competition, the power of the airline companies got the upper hand. And apart from a temporary setback, air traffic has been growing steadily ever since...

- In many countries of the world – including the EU member states – airlines do not have to pay VAT when purchasing aeroplanes. In any other transport sector the purchase of vehicles is subject to VAT payment.
- Construction and maintenance of roads and railway lines leading to airports are predominantly financed from public funds. (In Germany, for example, between 1993 and 1998 the state spent DEM 3 billion on building up new roads and railway lines to connect airports and the towns situated nearest to them.)
- All over the world uncounted billions have been spent (and are even today being spent) on the development of air transport from the budget of defence expenditures. Civil aviation has a considerable share in the benefits of such developments, but those concerned coyly leave this fact unmentioned.
- Border-guards and customs authorities stationed at airports are financed from public funds.
- Those operating private aeroplanes are allowed to account most of their incurred costs as expenses, i.e. their private flights are financed from money which is not subject to payment of personal income tax and social security contribution. This is an ille-

gal but common practice, and authorities do nothing to put an end to it. What it really means is that a seriously environment-destroying leisure activity of an extremely small group of well-to-do people is supported from public money.

- And last but not least, perhaps the largest among all types of support granted to air transport is that it does not pay for the environmental, health and other damage it causes.

As shown in Table II.3.20., in the middle of the 1990s, air transport in the European Union was granted state subsidies well in excess of EUR 45 billion. (For lack of data, the table does not contain all types of subsidies enumerated above.)

Subsidies granted to air transport are generally justified by its alleged favourable impacts on economic development in the region concerned. This statement is questionable even in itself, considering the astronomical sums spent on subsidizing this branch of the transport sector. It is hard to believe that granting similar subventions to other branches of the economy would not bring about equal or even better economic results in the affected regions. Nevertheless, several studies have been prepared on the subject with a view to clearing all doubts. These surveys have revealed that factors other than the availability of an airport in the area have much more influence on the development of a particular region. Numerous assessments arrived at the same conclusion; among them a survey carried out in England in which senior managers of large corporations were asked about the criteria they use when deciding about the location of their companies (Sharing Economic Prosperity – A Strategic Approach to Aviation. Policy Paper 5. APC, Surrey, UK, 1997). On behalf of Clean Air Action Group, the Hungarian Centre for Environmental Economics prepared an evaluation on the economic impacts of developing the Pécs-Pogány Airport (see Appendix 9). This study, too, has demonstrated the diseconomy, in the broader sense of the term, of such an investment.

We welcomed that in 1997 the Hungarian Government and the Parliament approved our proposal to cancel direct state subsidies granted to the Hungarian Air Traffic and Airport Directorate. By virtue of that decision, as from 1998 the Hungarian state budget has not provided any direct financial assistance to the Directorate. Unfortunately, air transport continues to receive huge state support in various other forms. Air travel is the most polluting means of transport, but environmental costs are not reflected at all in its prices. Air transport is being granted substantial allowances in Hungary and indeed in all other countries of the world: e.g. fuel for aeroplanes is not subject to consumption tax (excise duty). If the same rates of excise duty and connected VAT were payable on aircraft fuel than on other types of fuel, then pay-

ments by the Hungarian air transport sector would have totalled HUF 12 billion in 2000. This amount is in fact also an indirect subvention, granted by the Hungarian state to air transport. Hungarian inland air traffic is negligible, and the macro-economic issues of international air transport should be settled jointly with the European Union; therefore relevant changes should be implemented at a later date. When settling the economic standing of the Hungarian Airlines (MALÉV), this subsidy should be treated as a weighty factor.

In the past, MALÉV could purchase its fleet of aeroplanes free of customs duties and value-added tax.

Consequently, air transport receives massive covert subvention, which is unreasonable for economic and extremely unfair for social reasons. Imposing increased taxes on air transport is also justified by the fact that in recent years, Hungary saw a dramatic rise in the number of aeroplanes crossing its air space, which also entails substantial additional environment pollution. (Ferihegy Airport received 20 thousand aeroplanes in 1990, and more than 40 thousand in 2000.) It is to be noted that green movements all over the world are demanding that heavy taxes be imposed on air transport. Several scientific research institutes have already elaborated detailed proposals for the implementation.

3.20.1. Increased air tolls

Higher air tolls are one of the means of compelling airline companies to pay for at least a part of the external costs of air transport. Air tolls in Hungary are extremely low compared to other countries (see Table II.3.20.1.). In our opinion this is unacceptable, therefore air tolls should be raised to the level of the Austrian or German rate. Considering, however, that these air tolls are regulated by the so-called EUROCONTROL International Convention, to which Hungary is also a signatory, increasing the tolls requires time and effort. Consequently, all we can recommend at present is that the Hungarian Government should look into possible ways to somehow raise the tolls after all in conformity with the convention. If this international convention does not allow any increase in the near future, the Government should find other means to expand state revenues from air transport in conformity with EU regulations.

One of the main reasons to justify a substantial increase of air tolls can be the fact that the wages of Hungarian air traffic controllers are much lower than the wages of their counterparts in the EU, and that it is advisable to eliminate this difference on account of the EU accession.

It is worth mentioning as a guiding figure that in case Hungary manages to raise Hungarian air tolls to the

Table II.3.20.1.: Air tolls in European countries

Country	Toll* (ECU)
Belgium/Luxembourg	78.09
Germany	66.44
France	61.42
United Kingdom	80.69
Netherlands	45.38
Ireland	20.53
Switzerland	72.03
Portugal	39.31
Portugal (Santa Maria)	14.56
Austria	53.75
Spain (Europe)	47.50
Spain (Canaries)	45.62
Greece	24.04
Turkey	41.15
Malta	34.47
Italy	64.13
Cyprus	25.38
Hungary	21.80
Norway	46.46
Denmark	51.76
Slovenia	64.78
Romania	36.98
Czech Republic	46.87
Sweden	46.51
Slovak Republic	65.77
Croatia	46.11
Bulgaria	60.32

*for units approved by the European Commission
Source: Hungarian Ministry of Transport, Telecommunications and Water Management, 1998

Austrian rate, foreign exchange revenues of the state budget could grow – according to our preliminary estimate – by USD 40 million (HUF 9 billion), and the country's balance of payments would also improve by the same amount.

3.20.2. Introduction of airport utilization fees

Air space use should be treated as the utilization of a natural resource (e.g. noise pollution penalties, air load fees). It is necessary to consider the possibility of introducing such fees in air transport. There are airports in some countries that charge, for instance, noise pollution fees on aeroplanes exceeding a certain noise level. In Hungary airport utilization (environmental load) fees should be introduced. Environmental and health dam-

age caused by air transport are even more severe in and around airports because the emission of harmful substances by aeroplanes and the noise load are particularly high at the time of landings and take-offs. The amounts collected from such fees would also add to the revenues of the Hungarian state budget.

We recommend that the rate of the payable fee should be set in a manner to bring annual revenues worth at least HUF 1 billion.

3.20.3. Abolition of duty-free shops

Duty-free (tax-free) shops at airports violate the rules of fair market competition by favouring air transport and – among others – the sales of tobacco products and alcoholic beverages. Operating such shops also provides a supply system for smuggling. That is why the European Union adopted regulations to ban duty-free shops in 1999. Hungary should follow this example as soon as possible, and the more so since their operation does not bring any benefits for the national economy; what is more, duty-free shops have distinctly adverse impacts, being unfair competitors to tax-paying enterprises.

Existence of duty-free shops is particularly questionable today, when customs regulations have been made stricter, practically not allowing Hungarian citizens to bring into the country any cigarettes and hard liquors, for example. This measure should not be delayed until the date of Hungary's accession to the EU.

3.20.4. Other measures

We recommend that safety regulations should also be made stricter: e.g. Hungary's air space should only be used by airlines which have crews meeting up-to-date qualification requirements. Such measure would result in eliminating some rival airlines. This is another state-of-the-art method to protect domestic job opportunities.

3.20.5. Abandoning direct subsidization by the state and by local governments

Since air transport is the relatively most polluting means of transport, it should not receive any kind of support from the state or from local governments. Thus, all concepts and schemes should be rejected which aim at modernizing and renovating Hungarian airports by using state funds (or credits borrowed with state guarantees).

In the first quarter of 2003, the Hungarian Parliament debated the Bill on the National Territorial Planning Scheme. We think that it is unacceptable that a large number of regional and international airports are marked in the Annex to the Planning Scheme, without completed economic and social impact assessments. Even the development of the Airport of Bratislava is rather based on "national state considerations" than on economic grounds, just a year before the EU accession. Today's higher safety and environmental expectations could be met much more economically with one large regional airport (Vienna) and a high-speed railway network (Vienna, Bratislava, Győr, Brno). Hungarians, however, are dreaming about placing further airports in virtually every major town of the country.

According to data disclosed in the press, local governments concerned request from the state budget annual subsidies worth HUF 2–3 billion for provincial airports. Consequently, these expenditures can be saved directly, while indirect savings can be much larger than that.

3.20.6. Landing fee of non-public-service flights

In Hungary, the number and traffic of non-public-service small aircrafts have been dynamically growing in recent times. These vehicles cause considerable environment pollution (noise and air pollution, need to construct new airports and to extend the existing ones), and they increase exponentially the risk of accidents, which is demonstrated by recent catastrophes. At the same time this traffic receives similar preferences to those granted to public-service flights (they do not pay excise duties, consumption tax, weight tax, etc. either on the fuel they use or on the vehicle). This traffic serves predominantly luxury purposes. Such air transport is especially suited for terrorist actions as well. For all these reasons, we think that it is necessary to impose stricter control and higher taxes on non-public-service flights. To this end we propose that such aircrafts should pay at the time of each landing a fee of HUF 100 on every kilometre covered from the take-off, plus a landing fee of HUF 5000. These sums should be paid into the Environmental Protection Fund. Collected fees may not bring more than a few hundred million HUF as extra revenues; however, the goal is not to increase state revenues, but to protect nature and the environment and to safeguard peace and quiet for the population.

4. Energy

Hungary spent around HUF 1,200 billion on energy in 2001. The energy sector's direct and indirect contribution to increasing the country's foreign trade deficit totals nearly USD 3 billion. This amount equals almost 14 per cent of the value of all exports from the Hungarian customs area (see Figure II.4.).

Temporarily rising world-market petroleum prices have a significant impact on Hungary's economy: in 1998 they increased the volume of GDP growth by approximately 1 per cent, while in 2000 they reduced it by 2 per cent (see Table II.4.a.) In the years 2000 and 2001, the whole of the world-market price rise entered and influenced the Hungarian economy, and as a result, in 2001 Hungary's foreign exchange expenditures were by over USD 1 billion higher than in 1999. As compared to the year 2000, prices of petroleum and its derivatives slightly fell in 2001, which brought about an improvement worth USD 194.7 million. Owing to the delayed adjustment to natural gas prices, however, Hungary's expenditures rose, with incurred extra costs totalling USD 269 million. The combined effect of these two factors caused Hungary to spend by USD 74.3 million more on hydrocarbon imports. Table II.4.b. illustrates the impact of these expenditures.

Changes in Hungary's energy use and the sources thereof are shown in *Tables II.4.a. and d.*

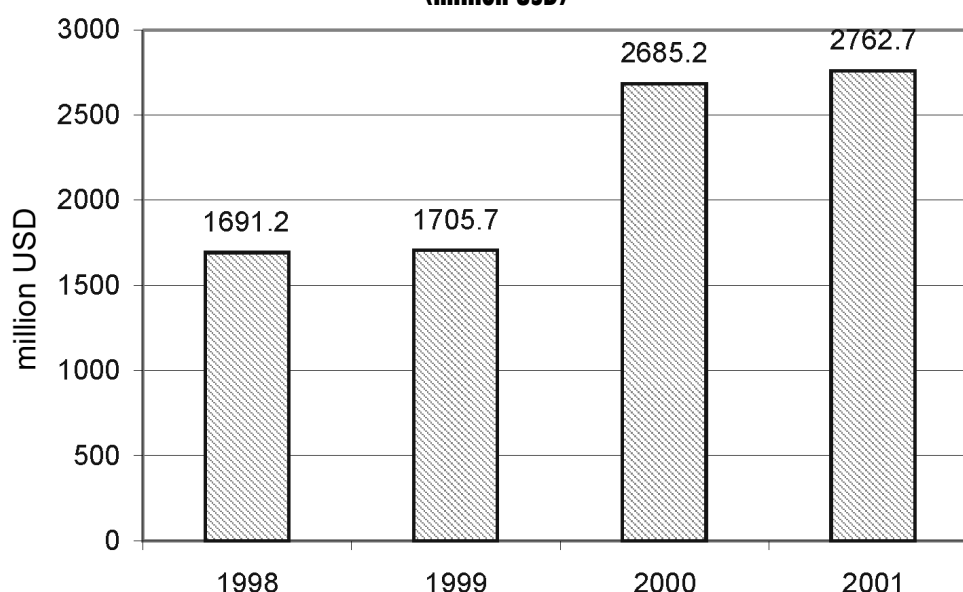
Roughly calculated, inflation of the USD currency has been counterbalanced by its revaluation against the Hungarian currency since 1990, therefore by ex-

pressing domestic energy prices in USD for that period, we will obtain the approximate real value of these prices. Gas fees of large consumers have increased by 22 per cent between 1st January 1990 and 1st January 2000, whereas household fees rose by nearly 70 per cent. Electricity prices went up by almost 21 per cent for large consumers and by around 160 per cent for household consumption.

Because of the delayed process of regulating the administrative prices of line energies, it proved to be economically worthwhile to export energy-intensive products – particularly as a consequence of high world-market prices at the end of 1999 and at the beginning of 2000. This was above all reflected by exports of the highly raw-material-intensive economic sectors. Consequently, it is advisable to regulate the administrative producer prices more rapidly and flexibly, as was for the most part in fact implemented in 2002.

Modernization of Hungary's economic structure is hindered by the large share of energy-intensive and raw material-intensive products in exports from the Hungarian customs area. **At the same time, labour-intensive products account for a relatively small part of exports from within the Hungarian customs borders.** As regards energy prices, large consumers should already pay world-market level prices for the energy today, for they also sell their products at prices that are essentially world-market prices. Energy prices need to be raised for household consump-

**Figure II.4.: Value of direct energy imports (HS 27 commodity class)
(million USD)**



Source: Foreign trade customs statistics, Ministry of the

Table II.4.a.: Interrelation between economic growth (GDP) and changing import energy prices

Description	1994	1995	1996	1997	1998	1999	2000	2001 estimate
Energy imports (PJ)	578.1	609.4	651.6	630.9	659.5	649.6	662.8	676.5
Energy imports (M USD)	1717	1801	2195	2051	1691	1706	2685	2763
Energy imports (Bn HUF)	181	226	335	379	361	407	760	792
HUF/USD exchange rate	105.5	125.5	152.4	184.7	213.7	238.5	283.0	286.8
Energy imports (M USD/PJ)	2.970	2.956	3.368	3.251	2.564	2.626	4.051	4.084
Energy imports (M HUF/PJ)	313	371	513	600	548	626	1147	1171
Annual impact of the price change of import energy (compared to previous year, -: decreasing, +: increasing)								
impact in M USD		-9.0	268.8	-74.0	-452.7	39.8	944.9	47.0
impact in M HUF		-1130	40973	-13671	-96723	9500	267425	13491
GDP (Bn HUF)		5614	6893.9	8540.7	10087.4	11393.5	13075.2	14770.0
Increase of GDP volume (%)		1.5	1.3	4.6	4.9	4.2	5.2	3.8
Impact of the price change of import energy (% of GDP)		-0.02	0.59	-0.16	-0.96	0.08	2.05	0.09
Increase of GDP without energy price impact (%)		1.48	1.89	4.44	3.94	4.28	7.25	3.89
Increase of GDP volume in the EU (%)		2.4	1.8	2.6	2.7	2.3	3.3	1.6
Annual growth deficit (%)*		3.32	1.71	0.76	1.46	0.32	-0.65	-0.69
Accumulated deficit coefficient		1.033	1.051	1.059	1.074	1.003	0.997	0.990
Accumulated arrearage at current prices (Bn HUF)		186	351	503	750			
Accumulated arrearage between 1999-2000 at current prices (Bn HUF)**						36	-43	-151
Increase of GDP at current prices		127.4	122.8	123.9	118.1	112.9	114.8	113.0
GDP deflator		125.5	121.2	118.4	112.6	108.4	109.1	109
Annual amount of the accumulated arrearage (Bn HUF, at 2000 prices)		356	553	669	887	40	-43	-138
Accumulated growth deficit in total (between 1995-98 , billion HUF)					-2465			
Accumulated growth surplus (between 1999-2001, billion HUF)								142

Notes:

*The growth deficit is the impact of the unrealized economic growth attributable to Hungary's misjudged adaptation: at the time of the EU economic boom austerity measures were introduced (the so-called Bokros package). Without such restrictions, Hungary's optimal GDP growth rate would have doubled the EU growth rate (+ sign: unrealized growth, - sign: surplus).

**The minus sign means growth surplus

Source: Yearbook of the Central Statistical Office of Hungary; OECD Economic Outlook No. 66, December 1999 and No. 68, 2000; 2001: preliminary data of the Central Statistical Office of Hungary

tion as well, but this should be accompanied by proper compensation, as required by the reduced wage and income level of the Hungarian population. On the expenditure side, prices should be raised in a manner that instead of allowing producers to realize larger profits, energy taxes (approved by the European Union on 20th March 2003) should make up the bulk of the increase. Larger profits of producers may have the adverse result of swelling the outflow of profits from Hungary, which in turn may have to be offset by higher interests on the state debt, with the ensuing extra budget expenditures. (As to the energy tax, appropriate justification and

improved acceptability can be ensured by imposing it as an environmental tax.)

At present, energy users do not pay for the bulk of the harm and costs they cause, because energy prices today fail to represent the true costs involved in the sector. Calculated at exchange rate, Hungarian household energy prices remain significantly under those of the EU countries. However, calculated at purchasing power parity, they roughly correspond to EU prices. Industrial user prices of line energies essentially match the EU price level (international competition prevails in this area, therefore foreign market prices, i.e. those calculated at foreign exchange prices, should be taken

Table II.4.b.: Impact of price changes of imported hydrocarbons (compared to previous year)

		1995	1996	1997	1998	1999	2000	2001
Crude oil	M USD	83.0	129.5	-73.9	-303.1	208.2	429.9	-170.4
	M HUF	22078	37172	10736	-39369	63556	151177	-46047
	M USD/PJ	0.3	0.6	-0.3	-1.1	0.9	1.8	-0.7
	HUF/ton	3760	6744	1838	-5843	11044	26173	-8254
Petroleum products	M USD	0.0	15.5	-0.8	-41.9	31.1	127.6	-24.3
	M HUF	0	14017	8147	-2455	11208	42956	-5100
	M USD/PJ	0.0	0.2	0.0	-0.7	0.6	2.8	-0.5
	HUF/ton	0	8531	5300	-1579	8681	39518	-3972
Natural gas	M USD	8.0	0.0	99.3	-154.7	-175.6	391.5	269.0
	M HUF	12853	22202	41897	-7665	-23946	139022	81173
	M USD/PJ	0.0	0.0	0.4	-0.5	-0.6	1.2	0.8
	HUF/thous- and m ³	1913	2347	5118	-870	-2586	14409	8641
Hydrocarbons in total	M USD	91.1	144.9	24.6	-499.7	63.7	948.9	74.3
	M HUF	34931	73390	60780	-49489	50817	333154	30026

Source: Foreign trade statistics, HS commodity classification

into account here). On the other hand, even in the EU countries, energy prices are considerably lower than the actual costs, owing to the following factors:

Prices do not include the costs of most of the measures which need to be taken in order to meet the ever stricter environmental protection requirements.

Present prices fail to reflect the growing scarcity of energy sources, i.e. the foreseeable trend that they will become ever more expensive to obtain in the future. (Both the European Union and Hungary are being forced to acquire an ever increasing part of their energy need through imports. In all probability, Hungary's imports of crude oil and natural gas may well exceed 90 per cent of the total consumption within ten years from now. This may cause Hungarian energy prices to surge on account of the increasing purchase costs.) Within the energy use of the EU15 group, imports accounted for 47.6 per cent in 1995. Their portion is estimated to reach 56.7 per cent in 2010, and 65.6 per cent in 2020.

Energy prices do not include a substantial part of the costs attributable to the environmental and other damage caused. Incorporating these costs would in some cases multiply the energy prices (*see Appendices Nos. 10 and 11*).

External costs may greatly vary with the type of energy and the technology used for production (as illustrated by data in *Table II.4.d.*); therefore the energy taxes (and the environmental load fees – *see Chapter 5*) to be introduced should also differ accordingly.

The rise of energy prices in the wake of imposing or raising energy taxes may be offset by a mechanism which

reduces wage costs. Thereby it stimulates energy saving and also creates new job opportunities, which in turn boosts family incomes. Regarding the Hungarian population's overall income position, even a substantial overcompensation can be achieved in this manner. Subsequent parts of the present study discuss this subject in detail.

Keeping energy prices low in comparison to real costs and EU prices is tantamount to defrauding entrepreneurs and the population. It makes them think that these prices are true ones, and can be sustained in the long run, which is obviously a nonsense. Therefore we think that it is indispensable to impose increased taxes on energy sources, both for industrial and household consumers, simultaneously with elaborating and introducing an appropriate compensation scheme (*see Chapter 2.7.2.*).

Although for various reasons energy prices today are not raised to the level corresponding to real costs, it is essential that in formulating the energy strategy the higher (real) prices should be used for the calculations. Calculating with incorrect cost data will necessarily lead to fundamentally erroneous conclusions and deeply mistaken decisions.

The reduction of labour costs and the increase of large consumer energy prices would mutually reinforce each other's impact. On the whole, these measures would shift the structure of the Hungarian economy and exports towards modernization, in a manner that in the meantime Hungary's comparative advantage (the available workforce and its improving competitiveness) would be enforced through economic constraint. This would act

**Table II.4.c.: Consolidated balance of energy sources
in PJ and in natural units (kt, million m³, GWh)**

Description	1989		1990		1991		1995		1996		1997		1998		1999		2000 fact		2001 preliminary	
	PJ	natural unit	PJ	natural unit	PJ	natural unit	PJ	natural unit	PJ	natural unit	PJ	natural unit	PJ	natural unit	PJ	natural unit	PJ	natural unit	PJ	natural unit
Domestic production																				
Coal	219.8	20325	188.1	17830	178.8	17135	130.1	14588	134.4	15190	138.1	15589	127.5	14650	125.7	14547	121.1	14033	118.9	13746
Crude oil	80.7	1966	78.5	1974	75.5	1893	68.4	1668	60.5	1477	55.8	1360	51.7	1260	51.0	1243	47.5	1136	43.7	1067
Gasoline	20.0	470	16.1	384	15.5	370	16.1	393	18	438	15.9	388	14.8	362	13.3	324	12.1	288	11.2	266
Natural gas (net)	199.2	6058	159.6	4874	161.2	4974	158.6	4886	150.7	4668	140.6	4369	124.1	3877	109.9	3401	103.6	3194	105.4	3214
Mineral liquefied gas	11.0	235	10.2	218	9.9	213	11.3	241	9.5	204	10.5	224	10.3	219	9.9	210	10.2	216	9.8	209
Hydroelectricity	1.6	158	1.8	178	1.9	194	1.6	164	2.1	207	2.2	216	1.5	155	1.8	181	1.8	178	1.9	186
Nuclear power plant	138.9	13889	137.3	13731	137.3	13726	140.3	14026	141.8	14180	139.7	13968	139.5	13949	141.0	14096	141.8	14180	141.3	14126
Firewood	13.8		11.7		13.4		15.9		14.5		14.7		13.6		13.6		14.9		15.3	
Other							11.6		5.2		6		6.1		5.9		5.6		6	
<i>Total</i>	<i>685.0</i>		<i>603.3</i>		<i>593.5</i>		<i>553.9</i>		<i>536.7</i>		<i>523.5</i>		<i>489.1</i>		<i>472.1</i>		<i>458.6</i>		<i>453.5</i>	
Imports																				
Coal and derivatives	99.7	3700	65.2	2929	90.6	4215	43.5	1782	45.9	1860	35.4	1586	31.7	1298	34.6	1411	35.1	1376	32.1	1231
Crude oil	258.0	6300	263.1	6418	216.7	5284	240.6	5869	215.0	5243	234.6	5723	251.7	6140	237.0	5780	242.4	5800	232.6	5619
Crude oil derivatives	61.0	1500	67.9	1624	31.1	747	69.6	1685	64.5	1575	65.2	1582	72.2	1722	61.0	1467	49.4	1170	54	1280
Natural gas	198.0	6000	217.3	6404	208.1	6121	231.6	6812	304.2	8946	274.2	8078	296.5	8728	306.4	9013	307.6	9047	325.9	9586
Electricity (balance)	111.0	11100	111.2	11147	73.6	7362	24.1	2405	22.0	2197	21.5	2149	7.4	740	10.6	1063	34.4	3440	31.9	3191
<i>Total</i>	<i>727.7</i>		<i>724.7</i>		<i>620.1</i>		<i>609.4</i>		<i>651.6</i>		<i>630.9</i>		<i>659.5</i>		<i>649.6</i>		<i>668.9</i>		<i>676.5</i>	
Total sources	1412.7		1328.0		1213.6		1163.3		1188.3		1154.4		1148.6		1121.7		1127.5		1130.0	
Exports (deduction)	85.3		70.8		47.1		87.6		80.2		78.3		74.3		79.7		77.4		88.0	
Change in stocks (deduction)	11.1		13.0		-13.1		8.6		27.9		23.1		28.4		-0.9		14.0		-23.0	
Domestic use	1316.3		1244.2		1179.6		1067.1		1080.2		1053.0		1045.9		1042.9		1036.1		1065.0	
GDP (Bn HUF)*		2936		2828		2498		2513		2546		2663		2793		2930		3082		3379
GDP per 1 PJ (Bn HUF)	2.230		2.273		2.112		2.355		2.357		2.529		2.671		2.810		2.975		3.173	
Import dependence**	55.28%		58.25%		52.57%		57.11%		60.32%		59.91%		63.06%		62.29%		64.56%		63.52%	
Renewable energy (%)	1.05%		0.94%		1.14%		1.49%		1.34%		1.40%		1.30%		1.30%		1.44%		1.44%	

Notes:

*At constant prices of 1991, multiplied by using volume indices

**Dependence on imported energy = imports / domestic use (%)

Source: Central Statistical Office of Hungary

Table II.4.d.: Purchase price of different fuel types and external costs involved in the use of fuels*
million HUF/PJ, at 2000 prices

Fuel type	Import purchase price**	External costs***		Total costs	
		low	high	low	high
solid	877.6	289.7	3466.1	1167.3	4343.7
liquid	1327.1	177.6	1681.2	1504.6	3008.3
natural gas	867.3	15.1	142.2	882.4	1009.5

*Not including nuclear energy and electricity imports

**Actual import prices, based on foreign trade statistics and energy balance

***Péter Kaderják: Economic Frameworks of the Integrated Energy-Environmental Policy (study No. KTM 1234/K, Ministry of Environment Protection and Regional Development)

Note: The above data reflect only air pollution and only the use of fuels

Source: Central Statistical Office of Hungary, Foreign Trade Statistics of the Ministry of the Economy

as a multiplier in Hungary's foreign trade, because net foreign exchange yields from more efficient products involving high-standard labour culture are positive; what is more, they are significantly higher than revenues from energy and material-intensive products, several of which even have a negative net foreign exchange yield.

The increase of energy taxes would generate inflation only in part and temporarily. On the one hand, energy costs would fall (or at least would grow slower) as a consequence of enhanced energy efficiency. On the other, increased employment (within a period of 10 years one million new job opportunities are to be established to attain the EU employment level) and improved economic structure would contribute to structurally easing the inflationary impact. This may be anticipated because as a consequence of the multiplier-type effects of growing efficiency and expanding employment, specific social costs would be reduced, which works against inflation. Instead of energy, highly manufactured social goods containing more added value would be used. Also, enhanced employment would contribute to lowering the current rate of unemployment and thereby would reduce the social costs of allowances and benefits which are ultimately charged on the society. At the same time, each new entrant in the labour market would also trim down the per capita level of other social costs.

A reduction in energy consumption would greatly improve the general state of the environment in Hungary and would help meet the requirements set in international agreements.

Prices of electricity in Hungary are much lower than in member states of the European Union. Tables II.4.e. and g. illustrate that electricity prices, for instance in Austria, are higher than in Hungary.

Independently from the decisions made by the EU, more and more member countries take steps to raise taxes on energy sources at an ever increasing rate. Examples are presented in Tables II.4.f. and h. (See also Appendix No. 6 titled "Environment protection taxes and charges in the European Union".) Due to rocketing world-market energy prices this process has temporarily slowed down, but has not come to an end.

It is to be noted that among all items, line energies are the farthest from meeting the requirements of tax harmonization with the EU countries.

On 17th July 1998, the European Parliament approved the so-called Olsson Report, which concluded that it would be beneficial for the EU to introduce new energy taxes. At the same time, a resolution was adopted (with a final vote of 417 in favour, 80 against and 17 abstentions) to introduce the proposed energy taxes as early as possible in the EU member states.

By taking this decision, members of the European Parliament have also expressed the wishes of their electors. An opinion poll carried out by Eurobarometer in 1995 found that 73 per cent of the population in EU member states were in favour of the environmental tax reform and also supported the rise of energy taxes as part of the reforms (See Table II.4.i.).

Hungary has also assumed an international obligation to increase energy taxes by signing the Energy Charter Convention. Among other provisions, the Charter says (Article 3 of Appendix 3):

"The Signatories ... shall elaborate proper legal and regulatory frameworks to promote (among other issues) the following:

a) efficient operation of market mechanisms, including market-oriented pricing and comprehensive reflection of environmental costs and benefits ..."

**Table II.4.e.: Electricity prices for industrial users
in OECD countries, USD/kWh**

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000
Australia	0.046	0.042	0.045	0.046	0.063	0.056			
Austria	0.070	0.071	0.072	0.081	0.081	0.081	0.078		
Belgium	0.064	0.060	0.059	0.068	0.065	0.055	0.052		
Canada	0.040	0.039	0.038						
Czech Republic	0.052	0.052	0.056	0.061	0.059	0.062	0.052	0.048	0.043
Denmark	0.067	0.070	0.063	0.069	0.073	0.064	0.068	0.066	0.058
Finland	0.055	0.046	0.050	0.060	0.062	0.052	0.050	0.046	0.039
France	0.057	0.055	0.053	0.060	0.057	0.049	0.047		
Germany	0.093	0.089	0.089	0.100	0.086	0.072	0.067	0.057	
Greece	0.070	0.059	0.055	0.062	0.059	0.054	0.050	0.049	
Hungary	0.060	0.053	0.046	0.045	0.048	0.054	0.056	0.055	0.049
Ireland	0.070	0.060	0.061	0.066	0.066	0.063	0.590	0.057	0.049
Italy	0.113	0.091	0.091	0.093	0.101	0.094	0.095	0.086	0.089
Japan	0.142	0.163	0.172	0.185	0.157	0.146	0.128	0.143	
Korea	0.068	0.067	0.069	0.074	0.074	0.070	0.048	0.056	0.062
Mexico	0.050	0.049	0.042	0.027	0.033	0.041	0.038	0.042	0.051
Netherlands	0.051	0.064	0.065	0.075	0.071	0.063	0.062	0.061	0.057
New Zealand	0.031	0.033	0.036	0.038	0.044	0.040	0.035	0.030	0.023
Poland	0.035	0.033	0.035	0.040	0.040	0.036	0.037	0.037	0.037
Portugal	0.133	0.118	0.112	0.118	0.108	0.094	0.090	0.078	0.067
Slovak Republic	0.052	0.047	0.045	0.049	0.049	0.049	0.049	0.041	0.042
Spain	0.105	0.085	0.078	0.081	0.080	0.064	0.059	0.056	
Sweden	0.055	0.035	0.036	0.039	0.045	0.034			
Switzerland	0.097	0.096	0.106	0.125	0.120	0.102	0.101	0.096	0.083
Turkey	0.092	0.095	0.077	0.076	0.085	0.077	0.075	0.079	0.082
United Kingdom	0.076	0.068	0.067	0.068	0.065	0.065	0.065	0.064	0.055
United States of America	0.049	0.049	0.047	0.047	0.046	0.044	0.040	0.039	0.040
OECD Europe	0.079	0.072	0.071	0.076	0.074	0.065	0.065		
Total OECD	0.072	0.072	0.073	0.079	0.074	0.068	0.063		

Source: International Energy Agency (Energy Prices & Taxes, 2nd Quarter 2001)

Table II.4.f.: Consumption taxes applicable to household use, based on the latest available data of each country, in respective national currencies

Ország	Ólmos benzin	Ólommentes benzin	Gázolaj	Könnyű gázolaj	Földgáz	Kazán-szén	Villamos energia
Ausztrália	0,405	0,381	0,381				
Ausztria		5,709	5,71	1047,2	560		0,204
Belgium	20,46	20,46	11,7	550			
Kanada		0,252					
Csehország		10,84	8,15				
Dánia		3,97	2,57	2050	2180	1689	0,6576
Finnország		3,325	1,808	401,9	113,2		0,0418
Franciaország	4,089	3,764	2,469	208,3			0,484
Németország		1,1	0,74	120			
Görögország	115	101	83	83000			
Magyarország*		102,5	85	85			
Írország	0,361	0,275	0,196	37,3			
Olaszország	1078	1007	739	697398			38,9
Japán			32,1				0,45
Luxemburg		15,01	10,2	210			
Mexikó			1,8985				
Hollandia		1,315	0,706	426	175,31		0,0492
Új-Zéland		0,3499	0,0036		19,46		
Norvégia	4,78	4,78	3,78	862			0,113
Lengyelország		1,346	1,002	123			
Portugália		58	49,3				
Szlovákia		11,78	12,31	786			0,024
Spanyolország	57,352	61,844	44,901	13097	1238		0,938
Svédország	5,16	4,5	3,04	2215			0,126
Svájc		0,746	0,77	13,6	3,5		
Törökország	283,7	277,4		212600			2,53164
Egyesült Királyság		0,495	0,478	31,3			

*Hungary: Excise duty applicable as from 1st July 2002

Source: International Energy Agency (Energy Prices & Taxes, 2nd Quarter 2001)

The Kyoto Protocol on Climate Change also requires all nations to work out and implement measures such as “*progressive reduction and elimination of market deficiencies, financial incentives, tax and customs exemptions, as well as subsidies in all economic sectors that generate greenhouse gases*”.

Environmental-type taxes should be raised instead of contributing to boosting profits that may be repatriated from the country – at the expense of Hungary’s environment. Opting for the tax raise is, obviously, not only a duty imposed on Hungary by international obligations, but a policy demanded by its very own

national interests. Citizens should be made aware of it, so that the Hungarian Government, supported by public opinion and by civil groups, may have a stronger position when negotiating with the affected producer interest groups, which have excessive power today.

Higher energy taxes along with other measures (that are discussed in later chapters of this study) contribute to enhanced energy efficiency and the widespread use of environmentally less harmful energy production methods (renewable resources of energy, cogeneration of energy, district heat services).

**Table II.4.g.: Electricity prices for household use in OECD countries,
USD/kWh**

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000
Australia	0.074	0.071	0.078	0.079	0.083	0.080			
Austria	0.171	0.163	0.166	0.192	0.194	0.169	0.168	0.134	0.121
Belgium	0.174	0.167	0.176	0.203	0.191	0.168	0.165		
Canada	0.064	0.063	0.060						
Czech Republic	0.029	0.029	0.032	0.037	0.038	0.037	0.050	0.051	0.054
Denmark	0.187	0.187	0.180	0.209	0.215	0.195	0.213	0.207	0.197
Finland	0.094	0.080	0.088	0.109	0.111	0.100	0.098	0.091	0.078
France	0.153	0.146	0.150	0.167	0.164	0.134	0.129		
Germany	0.172	0.169	0.178	0.203	0.180	0.159	0.159	0.152	
Greece	0.122	0.102	0.099	0.114	0.114	0.103	0.099	0.090	
Hungary	0.047	0.043	0.040	0.058	0.060	0.068	0.070	0.073	0.065
Ireland	0.140	0.121	0.123	0.132	0.135	0.131	0.123	0.117	0.101
Italy	0.182	0.146	0.164	0.169	0.178	0.159	0.159	0.147	0.135
Japan	0.203	0.230	0.250	0.269	0.230	0.207	0.187	0.213	
Korea	0.103	0.101	0.106	0.113	0.111	0.101	0.068	0.080	0.083
Luxembourg	0.123	0.115	0.120	0.146	0.142	0.124	0.123	0.118	0.099
Mexico	0.068	0.071	0.069	0.045	0.048	0.054	0.055	0.059	0.068
Netherlands	0.119	0.113	0.115	0.135	0.148	0.130	0.128	0.132	0.131
New Zealand	0.054	0.056	0.065	0.076	0.083	0.085	0.071	0.072	0.062
Norway	0.075	0.068	0.067	0.078	0.081	0.078	0.067	0.064	0.057
Poland	0.041	0.046	0.049	0.062	0.650	0.062	0.067	0.064	0.065
Portugal	0.184	0.164	0.163	0.181	0.176	0.156	0.154	0.141	0.120
Slovak Republic	0.030	0.030	0.029	0.031	0.031	0.029	0.028	0.035	0.050
Spain	0.211	0.177	0.176	0.195	0.190	0.163	0.154	0.143	
Sweden	0.105	0.082	0.085	0.094	0.110	0.101			
Switzerland	0.120	0.119	0.131	0.165	0.159	0.136	0.135	0.131	0.111
Turkey	0.091	0.098	0.076	0.076	0.087	0.080	0.079	0.084	0.086
United Kingdom	0.135	0.116	0.122	0.127	0.125	0.125	0.121	0.117	0.108
United States of America	0.083	0.083	0.084	0.084	0.084	0.084	0.083	0.082	0.082
OECD Europe	0.142	0.130	0.134	0.149	0.146	0.131	0.130		
Total OECD	0.113	0.111	0.116	0.127	0.121	0.113	0.109		

Source: International Energy Agency (Energy Prices & Taxes, 2nd Quarter 2001)

**Table II.4.h.: Percentage rate of VAT,
latest known data**

Country	Heavy gas oil	Light gas oil	Gas oil (Diesel)	Leaded petrol	Unleaded petrol	Natural gas	Boiler coal	Coking coal	Electricity
Australia			10.0	10.0	10.0				
Austria		20.0	20.0		20.0	20.0	20.0		
Belgium		21.0	21.0	21.0	21.0		12.0		
Canada	7.0	7.0	7.0		7.0	7.0	7.0		7.0
Czech Republic		22.0	22.0		22.0	22.0	22.0		22.0
Denmark		25.0	25.0		25.0	25.0	25.0		25.0
Finland		22.0	22.0		22.0	22.0			22.0
France		19.6	19.6	19.6	19.6	19.6	19.6		19.6
Germany		16.0	16.0		16.0	16.0	16.0		16.0
Greece		18.0	18.0	18.0	18.0	8.0			8.0
Hungary			25.0	25.0	25.0	12.0	12.0		12.0
Ireland		12.5	20.0	20.0	20.0	12.5	12.5		12.5
Italy		20.0	20.0	20.0	20.0				10.0
Japan	5.0	5.0	5.0		5.0	5.0	5.0	5.0	5.0
Korea									
Luxembourg		12.0	15.0		12.0	6.0	12.0		6.0
Mexico		15.0	15.0		15.0	15.0			15.0
Netherlands		19.0	19.0		19.0	17.5			17.5
New Zealand		12.5	12.5		12.5	12.5	12.5		12.5
Norway		24.0	24.0		24.0		24.0		24.0
Poland		22.0	22.0	22.0	22.0	22.0	22.0		22.0
Portugal			17.0		17.0				5.0
Slovak Republic		10.0	23.0		23.0	10.0	10.0		10.0
Spain		16.0	16.0	16.0	16.0	16.0			16.0
Sweden		25.0	25.0	25.0	25.0	25.0			25.0
Switzerland		7.6	7.6	7.6	7.6	7.6			7.6
Turkey	17.0	17.0	17.0	17.0	17.0	8.0	17.0	17.0	17.0
Great Britain		5.0	17.5	17.5	17.5	5.0	5.0		5.0
USA									

Source: International Energy Agency (Energy Prices & Taxes, 2nd Quarter 2001)

4.1. Harmonization of taxes on electricity, natural gas and coal

It cannot be explained by any rational economic reasons why natural gas, electricity and coal – all seriously harmful to the environment and chiefly using imported raw materials – are levied with the lower available VAT rate (12 per cent) in Hungary. (We are aware that among fossil energy sources, natural gas is the least environment-polluting option to use. Nevertheless, this does not mean that it is an environmentally friendly option, for using it in ever-increasing quantities substantially contributes, among others, to the greenhouse effect. Furthermore, natural gas is also a non-renewable energy source, which is another motivation for making increased efforts to save as much of it as possible.) In principle, the VAT rate applicable for natural gas, electricity and coal should be 25 per cent, similarly to other industrial products and fuels. However, latest research findings have demonstrated that this is not the most efficient possible method for the taxation of energy sources. (We would like to mention already at this point that simultaneously with the tax raise, we propose a rearrangement of tariffs to provide compensation for small household consumers without reducing the revenues of energy suppliers.)

Here is what the OECD stated in its country review about Hungary for the year 2000 (*OECD Economic Surveys, Hungary, Country Reviews, November 2000*) regarding Hungarian intentions to provide so-

Table II.4.i.: Public opinion in 15 EU countries on the environmental tax reform

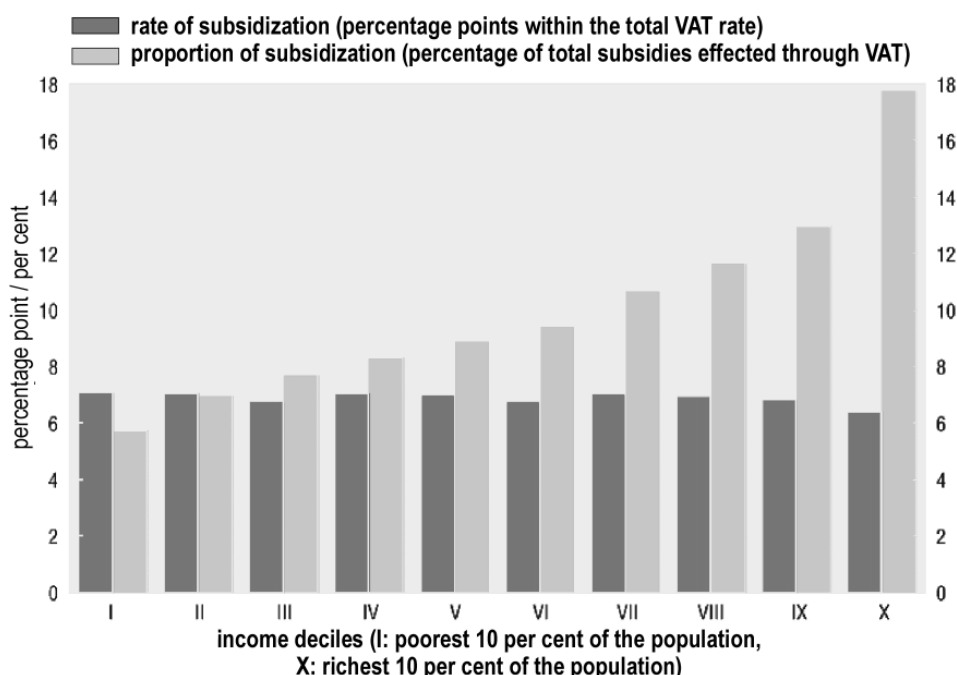
Opinion on the reform	Percentage share within the total
Strongly supports	35
Slightly supports	38
Slightly against	9
Strongly against	8
No opinion / No answer	10
Total	100

Source: Eurobarometer, 1995

cial welfare support through applying lower VAT rates for certain products:

“Authorities argue that they are focussing on «socially sensitive» products, and so the wide-spread use of the lower VAT rate contributes to achieving socially desirable redistribution. However, taking into account the huge sums passing through the value-added tax system, as well as the serious price distorting impact they cause, it is unclear whether VAT is in fact an efficient means for income redistribution. As a matter of fact, in most countries where different VAT rates are in use, it may happen that applying the lower VAT rate actually means granting more support for the well-to-do than for the poor. In Hungary this support means value-added taxes reduced by 9.7 percentage points on average for the lowest decile

Figure II.4.1.: Subsidies granted to different social strata (deciles) through value-added tax in Hungary in 1999



Source: OECD Economic Surveys, Hungary, 2000 (based on data of the Central Statistical Office of Hungary)

of the society, which is not significantly different from the 8.7 percentage points which are granted to the highest decile through this scheme. What is even more important than that, however, is that the richest 10 per cent of the population receives 16 per cent of the total support value, while the poorest 10 per cent only have a share of 5 per cent." (See Figure II.4.1.)

Consequently, the OECD stated the very same views as the ones asserted by Clean Air Action Group insistently and emphatically for many years: granting support through value-added taxes is pointless.

If the current lower rate (12 per cent) of VAT applicable to natural gas, electricity and coal was increased to the higher rate of 25 per cent, the Hungarian state budget could reckon with additional revenues worth about HUF 60 billion in 2004. It is worth considering that instead of the VAT rate reclassification, in the initial phase energy taxes should be imposed which allow realizing the same amount of aggregate extra revenues. Such taxes have the great advantage over value-added tax that their rates may vary for specific energy sources and energy uses depending on environmental and other factors.

District heat supply, cogeneration of energy and renewable energies would be exempted from payment of the tax. District heat supply is particularly advantageous in densely populated areas that are badly affected by air pollution.

As regards the details of introducing energy taxes, thorough professional analyses are needed. This work has already begun in Hungary, too (see, for example, the study titled *Ecological Tax Reform II* published in 2000 by the Hungarian Centre for Environmental Economics).

4.2. Current situation of natural gas and electricity prices for household use in Hungary and proposals for a solution

4.2.1. Environmentally harmful impacts of increasing the price of natural gas

Household consumption of natural gas has a major impact on the environment in Hungary, for natural gas is among the cleanest of all energy types. This aspect is of particular importance in areas like Budapest, where the air is highly contaminated. Within the full scope of natural gas consumption, using it in the cogeneration of energy (partly for district heating purposes) causes the lowest relative level of environment pollution.

We have to point out that environmental considerations were the principal reason why successive Hungarian governments have been strongly supporting the widespread use of natural gas in household consumption for decades.

Under current circumstances, however, significantly increased natural gas prices may bring about **serious additional environmental harms**. In many areas, where individual heating modes or boilers for mixed types of fuels are used, increased natural gas prices may stimulate the incineration of wastes. This practice is particularly noticeable in Hungarian households, being a possible way to cut down both their payable energy charges and their garbage removal costs. As a result, in many places it is not rare that wastes are incinerated in households or in the open field. However, when plastics and other wastes are burnt, extremely toxic compounds are released into the environment. Unfortunately, up until now authorities have not come up with any efficient scheme to prevent incineration of wastes in households. In addition to awareness raising, controls and fines, using financial incentives may also be an effective method to restrain such activities. In this respect, however, environment pollution has been stimulated by several factors recently, which may contribute to making the situation already unbearable:

- Household garbage removal fees have increased in many regions despite the fact that they had already been raised earlier at a rate surpassing the inflation. In Budapest, for instance, garbage removal fees went up by 10.5 per cent with effect from 1st January 2003.
- As regards natural gas fees for household use, the rate of increase is 12 per cent with effect from 15th May 2003, and further considerable price rises may be expected from 1st January 2004, especially if the Ministry of Economy and Trade wants to make the population pay for the capital costs as well, i.e. for the supplementary development costs of HUF 500–600 billion (by using a compensation mechanism up to the extent of a limited consumption quantity, for which no specific numerical parameters have been provided yet). Legality of the latter measure is highly questionable for a natural monopoly, because in that case ownership rights are due to consumers who pay for it.
- The proportion of plastics within wastes has significantly increased in recent times, and it is expected to grow even further. In Budapest, for example, plastics made up 4.6 per cent of all communal solid waste in 1990, while in 2001 their share reached already 15 per cent.

These processes have considerably exacerbated the already unacceptable air pollution situation in many Hungarian towns and villages (among them also in Budapest).

4.2.2. Past development, current situation and expected changes in factors influencing the price of natural gas

Within Hungarian natural gas consumption, imports represent an ever growing part due to the decline of domestic production, as demonstrated in *Table II.4.2.2.a.*

Similarly to the situation in the large majority of EU member states, prices in Hungary are above all determined by imports.

Concerning household prices we also have to point out that comparison with EU prices has been carried out by using the following methods:

- Comparison at customary exchange rates. This method is to be applied for calculations in the competitive sector, because the prices of these products are predominantly foreign market (competitive) prices. Consequently, any other method of comparison would violate the spirit of the rules and regulations of economic competition.
- Comparison at purchasing power parity. For Hungary this index (exchange rate calculated at purchasing power parity in comparison to the official exchange rate) was 2.26 in 1999; therefore Hungarian consumer price levels are to be compared after multiplying them by this coefficient. As calculated by

Table II.4.2.2.a.: Total use of natural gas and share of imports

Description	1990	1995	2001
Share of imports, %	57.7	59.1	75.9
Total use, billion m ³	11.3	11.7	12.8
Out of which: sales to households*, billion m ³	1.9	3.2	4.0

*without district heating

Source: Yearbooks of the Central Statistical Office of Hungary

OECD (Main Economic Indicators. September 2001: Comparative Price Levels, June 2001), Hungarian prices are to be divided by 0.48 to make them comparable with Austrian and German prices in terms of the population's purchasing power. Calculating with this coefficient, it becomes clear that natural gas prices for household use are already excessively high today.

Table II.4.2.2.b. contains data showing the trends of changing household natural gas prices and actual import purchase prices in recent years.

Changing prices of imports in 2002 are to be examined from various aspects:

- The annual average of household consumption prices increased in 2002 owing to the impacts moving over from 2001.

Table II.4.2.2.b.: Natural gas prices HUF/m³, annual average

Description	1994	1995	1996	1997	1998	1999	2000	2001*	2002*	Up until 14th May 2003**
Household	9.01	14.13	22.25	24.89	27.85	27.85	30.59	34.21	36.10	36.10
Imports	9.16	11.07	13.42	18.53	17.66	15.08	29.49	38.13	28.16	24.32
Discrepancy	-0.15	3.06	8.83	6.35	10.19	12.77	1.10	-3.92	7.94	11.78
Resale price	7.70	9.40	10.90	16.50	19.30	18.90	20.20	24.50	26.82	
Margin of MOL Co.	1.46	1.67	2.52	2.03	1.64	3.82	9.29	13.63	1.34	

*According to MOL Co.'s Annual Report, the annual average import price was 39.30 HUF/m³ in 2001 and 28.30 HUF/m³ in 2002, so they only slightly differed from the official foreign trade data.

**MOL Co.'s Report about the first quarter of 2003 reveals that: "Profits of the natural gas business have slightly improved in the first quarter of 2003, as a continuation of the tendency prevailing in 2002. The improvement is primarily attributable to the drop in import gas prices expressed in HUF, which was caused by the weak dollar. While the import gas price determined in USD was by 15 per cent higher in annual comparison, the import price expressed in HUF and weighted by quantity was by 8 per cent lower than in the first quarter of 2002. On the other hand, it is to be noted that the import price expressed in HUF has already increased in relation to the fourth quarter of 2002. This tendency is expected to continue during 2003, owing to the high oil product prices prevailing in the last quarter of 2002 and the first quarter of 2003. Changing consumption patterns caused the average wholesale price to fall to 25.9 HUF/m³ (by 1.0 per cent). As a consequence of the unusually cold winter in the first quarter of 2003, household consumption having a lower tariff increased, which neutralized the favourable impact of the 5.4 per cent rise in gas prices for some non-household consumers that had been introduced on 1st July 2002."

Source: Household prices: Hungarian Energy Office; import prices: Ministry of the Economy, foreign trade turnover of priority products on HS basis (Customs Statistics)

- Import prices converted into Hungarian currency declined because the prices fell in USD and the rate of exchange also decreased: from 275.92 HUF/USD in January 2002 it went down to 226.07 HUF/USD in January 2003.
- As stipulated in the contracts, purchases of natural gas are effected in USD, therefore Hungarian prices depend increasingly on the HUF/USD exchange rate as well. The declining trend of the USD rate, started in 2002, still continues today, in such proportions and with such resulting impacts that surpass anything that seemed to be conceivable up until now. Thus, the devaluation of the USD and the lasting revaluation of the Hungarian currency constitute a potential for further price reduction. Average exchange rate in the 1st Quarter of 2002 was 278.36 HUF/USD, which fell to 226.93 HUF/USD in the 1st Quarter of 2003. This was a decrease of 18.5 per cent, which meant that the price payable in Hungarian currency became lower by the same rate. This reduction may be best discussed by using data of the latest Central Statistical Office report for the first quarter of 2003, issued on 12th May 2003. During this period, Hungary's total imports of energy sources amounted to USD 837.1 million. These imports are predominantly made up by hydrocarbons, and so the recipient company is the MOL Co. (Hungarian Oil and Gas Industrial Co.). From the above-indicated exchange rates it can be calculated that the difference per 1 USD comes to HUF 52.30, and consequently the value of import purchases paid in Hungarian currency is by HUF 44 billion less than it was in the same period of 2002.
- At the beginning of May 2003 petroleum prices fell to a level around 23 USD/barrel, and the exchange rate (on 12th May 2003) declined to 211.26 HUF/USD. These trends may be quantified as follows: world-market prices decreased by 21.7 per cent and the USD rate came down by 10.5 per cent, so in the aggregate MOL Co.'s position improved by 34.5 per cent.
- At this point it is worth highlighting that the low USD exchange rate has become part of the official economic policy of the United States, as an instrument to stimulate exports and, as a consequence of that, economic growth and employment. Recent events covered in the press bear witness to the above statement: "John Snow, U.S. Finance Minister, holding his office for only three months now, has thrown away the eight-year-old «strong dollar policy» of the Washington Administration – reports Bloomberg News Agency, referring to investors and economists as sources for this information. A week ago Snow declared that American exports are promoted by the annual drop of 21 per cent in the USD exchange rate (compared to EUR). He has repeated this statement a couple of times, then at the end of the week, on Saturday after the Meeting of G7 Finance Ministers, he delivered the final blow on the American currency by pronouncing that the dollar has only lost a relatively tiny portion of its value up until that time." (The policy of strong dollar has come to an end. FigyelőNet, 19th May 2003) Until now, this factor has not been taken into account when setting the administrative prices of natural gas.
- We are, of course, well aware that import prices cannot be directly compared with the prices of household consumption, because natural gas has to be delivered to consumers, while a smaller part of it also has to be stored for six months in underground storage tanks, with the involved need to finance the costs of this stock, too. Logistical costs are incurred at two points: at MOL Co. and at the service providers. Consequently, household consumer prices are composed of three elements: gas costs, distribution fee and service provider's margin. Within the price payable by household consumers, MOL Co. is entitled to the first two price elements, while the third one is due to service providers. Thus, household consumer prices also contain the margin of service providers, so from the import figures MOL Co.'s position may be approximated by comparing the resale (wholesale) price approved by the Hungarian Energy Office (MEH) with the import prices (we speak about approximation here because resale prices should also reflect the costs of transportation and storage). For the latter, we can reckon with a value of 4 HUF/m³, so MOL Co.'s margin (the "discrepancy" indicating MOL Co.'s position) was 17.63 HUF/m³ in 2001. However, this is partly offset by the cost level of Hungarian natural gas production which is much lower than that of the world-market.
- In December 2002, the Venezuelan crisis and the Iraqi war preparations triggered another provisional rise in petroleum prices. This trend still prevailed at the beginning of 2003; what is more, it became even stronger when military operations were started. When major military actions ended, world-market prices of petroleum, along with those of natural gas, started to decline. This tendency is markedly reflected by the drop in Hungarian fuel prices on 7th May. However, the currently prevailing OPEC average price is 25 USD/barrel. Due to the lasting and substantial (of approximately 30 per cent) devaluation of the dollar, the amount payable in EUR for the OPEC average price differs from the sum payable in the first half of 2002. On the other hand, world-market prices of petroleum may even fall much under the 25 USD/barrel level if the restart of Iraqi production is not followed by adequate restraint of production.

4.2.3. Main data of the 2002 Flash Report of MOL Co.

In 2001, MOL Co. attained a net profit of HUF 1.2 billion, while in 2002 it already realized HUF 66.3 billion. Changing prices of natural gas, of course, greatly contributed to this result (see *Table II.4.2.3.a.*).

It is to be noted that the accuracy of the above data is questionable, because in 2001 and 2002 MOL Co. paid by HUF 2.1 billion more local taxes than the statutory requirement, and the company now reclaims this sum. Therefore, MOL Co.'s profits for 2001 are by this amount higher than the audited earnings – in fact almost twice as high!

To form a comprehensive picture of the situation, additional factors are also to be taken into consideration:

Incorporating the so-called base fee in the prices of foreign-owned gas service providers is unfounded because

Table II.4.2.3.a.: Natural gas prices affecting MOL Co.'s profits
HUF/m³

Description	2001	2002
Average import price	39.3	28.3
Average MOL sales price	25.9	28.0
Wholesale price for gas consumers	24.5	26.3
Wholesale price for industrial users and power stations	30.5	33.0

Source: Annual Flash Report of MOL Co.

there are no actually provided services behind it. The base fee is practically due to MOL Co., which performs the tasks of storing the natural gas and levelling out the peaks of procurement, production and consumption. The specific value of this fee is approximately 2 HUF/m³.

Table II.4.2.3.b.: Changes in imports of hydrocarbons and electricity

Product	Unit	1994	1995	1996	1997	1998*	1999*	2000*	2001*	2002*
Crude oil	thousand tons	5821	5872	5512	5480	6738	5755	5776	5579	5030
	PJ	239	241	226	225	276	236	237	229	206
	thousand USD	590624	678749	766637	688389	542925	671887	1103980	896017	834651
	million HUF	62311	84935	116902	126301	115914	162560	314338	257551	213385
	USD/ton	101.5	115.6	139.1	125.6	80.6	116.7	191.1	160.6	165.9
	million USD/PJ	2.47	2.82	3.39	3.06	1.96	2.85	4.66	3.92	4.05
	HUF/ton	10704	14464	21207	23046	17203	28247	54420	46166	42424
Petroleum products	thousand tons	2569	2569	1643	1537	1555	1291	1087	1284	2096
	PJ	105	105	67	63	64	53	45	53	86
	thousand USD	379433	379433	258320	240896	201868	198704	293553	322750	454203
	million HUF	40053	40053	39640	45234	43291	47161	82636	92544	117027
	USD/ton	147.7	147.7	157.2	156.7	129.8	153.9	270.1	251.4	216.7
	million USD/PJ	3.60	3.60	3.83	3.82	3.17	3.75	6.59	6.13	5.29
	HUF/ton	15591	15591	24122	29423	27844	36525	76043	72071	55839
Natural gas	million m ³	5640	6719	9460	8186	8815	9261	9648	9394	11096
	PJ	192	228	322	278	300	315	328	319	377
	thousand USD	490996	592958	834740	821800	730413	591825	1008097	1250863	1199755
	million HUF	51645	74377	126910	151726	155714	139642	284509	358190	312417
	USD/thousand m ³	87.05	88.25	88.24	100.39	82.86	63.91	104.49	133.15	108.13
	million USD/PJ	2.56	2.60	2.60	2.95	2.44	1.88	3.07	3.92	3.18
	HUF/thousand m ³	9156	11069	13416	18534	17665	15079	29488	38129	28157
Electricity	million kWh	2359	2781	3479	4171	3328	3334	4903	5236	4888
	PJ	24	28	35	42	33	33	49	52	49
	thousand USD	48961	61133	90249	104099	87432	106688	135399	152344	172291
	million HUF	5171	7749	13753	19088	18698	25110	37930	43627	44470
	USD/thousand kWh	20.75	21.98	25.94	24.96	26.27	32.00	27.61	29.10	35.25
	million USD/PJ	2.08	2.20	2.59	2.50	2.63	3.20	2.76	2.91	3.52
	HUF/kWh	2.19	2.79	3.95	4.58	5.62	7.53	7.74	8.33	9.10

*As from June 1998, the 5 % fee was abolished Data for 2002 are preliminary

Source: Foreign trade statistics as per HS classification of goods

Gas service providers committed a series of suspicious economic acts: they purchased a large part of the gas pipeline network in a manner that the actual proprietors did not waive their right to the networks, and therefore proceedings should be initiated against them for receiving of stolen goods. Consequently, not even initially should they have incorporated the network development contribution paid by consumers – in the value of over HUF 24 billion – in the price of natural gas.

Purchasing natural gas from the Baumgarten pipeline implies further price reserves (worth around HUF 10 billion annually), for the use of this pipeline means that Russian natural gas makes a round trip and finally arrives to Hungary at a significantly (by 20 to 30 per cent) higher cost. The contract concerning this transaction is false because it states that the purchase is an alternative source for natural gas procurement. However, if the Russian partner fails to deliver gas, then the Austrian party, who is a net importer, will not be capable to deliver to Hungary. Consequently, this contract should be terminated and the purchase be diverted into cheaper direct imports from Russia against Hungarian goods.

In its latest statements MOL Co. announced a need for additional development funds, worth HUF 500–600 billion, claiming that unrealized earlier developments endanger the fulfilment of its supply obligation. This sum seems to be exaggerated, particularly considering that other methods are also available for solving this problem. Growing demand for natural gas is primarily caused by the forced development of natural-gas-fuelled power stations, which have a lower specific investment financing need. Therefore, consequences of the particular needs of foreign investors should not be borne by the Hungarian population, but by the investors themselves. On the other hand, through the extension of Hungary's international relations it becomes feasible to establish new natural gas pipelines offering an additional capacity, so MOL Co. does not have to effect any specific investments. It is a well-known fact that the Russian partner had initiated the construction of a gas pipeline that would pass through the Slovak Republic and Hungary and go towards Italy. Following the construction of the pipeline, MOL Co. would realize considerable extra revenues from the transit. Negotiations concerning this project have been going on for a long time, and they are already in an advanced stage. It is a reasonable requirement that the Hungarian population gains some favours in exchange for licensing the transit, which entails some additional environmental risks. In connection with this project, the natural gas transportation capacity to serve domestic use may be extended

by using only relatively small funds. All this shows that MOL Co., similarly to other cases, follows here the principle “if we have the cake, let's have it all”, and wants to make the Hungarian population pay for everything – doubly, if possible.

It is to be highlighted that regarding natural gas prices, the Hungarian–Russian contract follows changing petroleum prices with a delay of 9 months, so the necessary information are available for the regulation of domestic prices.

Table II.4.2.3.b. contains a detailed presentation of import prices, compiled from data based on official customs documents which conform to EU requirements.

4.2.4. Further data on the standing of some domestic companies of the energy sector

At companies of the energy sector, which passed into foreign hands, workforce has been cut in huge proportions with the aim of reducing costs. Workers have actually been laid off in numbers well exceeding ten thousand, the maximum number estimated at the time of the privatization, which is illustrated in Table II.4.2.4.a.

Besides that, workforce has also been reduced at MOL Co., where the total number of employees fell from 20,466 in 1998 to 13,120 in 2002, i.e. decreased by 7346 persons. This trend of staff cuts has continued in the first quarter of 2003: “personal-type expenditures declined by 12 per cent in the first quarter, reflecting the workforce-reduction measures taken”, which implies HUF 2.1 billion and laying off nearly 1600 workers. As a result, more than 29 thousand employees lost their jobs in the above described area of the energy sector. This was not mentioned and agreed upon – and especially not with such proportions – at the time of transferring the companies into foreign ownership. In the future, Hungary should follow the example of Ireland, where privatization contracts contained an important stipulation requiring the maintenance of the existing level of employment: failing which the foreign investor concerned commits a breach of contract and automatically loses its ownership right.

After a workforce reduction of such dimensions the state cannot guarantee any more the 8 % rate of return on assets, because these companies have violated the tacit agreement. In our opinion, guaranteeing the 8 % rate of return on assets is, already in itself, contrary to market principles. On the other hand, upon construing the contract in terms of its market implications we may conclude that the mentioned profit rate was only to be guaranteed once, in the initial year. The tendency of dismissals, however, continues, with

**Table II.4.2.4.a.: Workforce changes at gas service providers and in the electricity sector
(annual average staff number, persons)**

	Gas service providers	Electricity sector	Total
1995	10276	43693	53969
2001	6314	27142	33456
Dismissed between 1995 and 2001	3962	16551	20513

Source: Time series comparison of data from annual reports of the Hungarian Energy Office

some energy service providers announcing further staff cuts.

Gas service providing companies, which passed into foreign ownership, have a solid financial standing, and the technical state of the pipelines is satisfactory. Hungarian consumers also pay a development contribution fee at the time of hooking up to the network, which adds to the wealth of foreign proprietors. The high levels of profits realized up until now also prove that resources are relatively abundant as compared to the extremely small development need, which is shown by data in *Table II.4.2.4.b.*

From the above facts it may be concluded that natural gas distribution companies, which are in foreign majority ownership, acquired profits and property worth HUF 71.6 billion in the period between 1996 and 2001 (and further HUF 15 billion may be estimated for 2002), while their subscribed capital only totals HUF 53 billion.

Under the law, it is the Government's prime duty to protect the interests of the Hungarian population, its voters. Therefore, it has to recover the above-mentioned HUF 24,128 million that the population was made to pay up only to unfairly increase the property of foreign investors. The Government must ensure that such funds are added to the wealth of Hungarian citizens who had paid them up.

We have to point out that from a compatibility aspect, the financing pattern of the Hungarian Energy Office is objectionable, because the largest part of its revenues come from payments by companies in foreign majority ownership, and so the Office's position may be biased in specific issues. This danger is illustrated by the following example: Under the previous Hungarian Government, the Ministry of Economy proposed, on the basis of a proposition submitted by the Hungarian Energy Office, a 40 % increase in natural gas prices. Fortunately, the Government overruled this proposal lacking proper foundation (for it only represented the interests of foreign companies). Later events have proved this decision right: MOL Co. has not gone bankrupt; the population and the environment, how-

ever, would have become ruined by a 40 % price rise. As one of their impacts, increased prices would have caused Hungarian inflation to shoot up by at least 2 per cent, which would have added around HUF 120 billion annually to the interest burden of the state budget – and the deficit would also be as much higher. World market prices, however, have fallen since then, and further decline is prognosticated for the second half of 2003. It is worth noting that even in its least successful year, in 2001, MOL Co. spent HUF 5.2 billion on counselling, and overpaid its local tax obligation by HUF 2.2 billion. On the other hand, in 2002 the company had by some HUF 3 billion less personal-type expenditures than in 2001, owing to the implemented workforce reduction.

Moreover, a characteristic feature of the year 2001 for MOL Co. is the appearance of the item "Increment of provisions formed to cover environmental protection liabilities" among titles decreasing its profit before taxation (See *Table II.4.2.4.c.*). Under these provisions MOL Co. kept substantial funds in reserve, with the aim to use them as another means to force a price rise.

**Table II.4.2.4.b.: Profit before tax of gas service providers and their revenues from network development contribution paid by consumers
million HUF**

Year	Profit before tax	Network development contribution paid by consumers
1995	-850	
1996	1864	3698
1997	6068	4463
1998	5494	3819
1999	10115	4684
2000	10842	5496
2001	13099	1968
Total	47482	24128

Source: 2001 Annual Report of the Hungarian Energy Office

Table II.4.2.4.c.: Increment of provisions accumulated to cover environmental protection obligations

Description	2000	2001
provisions, million HUF	4070.7	25375.7
number of companies*	153	122

Note: MOL Co. built up by far the largest provisions among all companies. Data on the specific sum are not available.
Source: Flash Report of the Hungarian Tax and Financial Audit Office, Volume I, page 32

4.2.5. Joint application of mining taxes and administrative prices

In the case of MOL Co., the current level and handling of mining taxes is not settled in a satisfactory manner. In 2000 and 2001, mining taxes had an extremely low applicable rate, in spite of high energy prices. The previous Hungarian Government, however, in practical terms added to this rate a price-type "mining tax" by applying low administrative prices, as another way to protect the interests of citizens. We can see now that this was indeed the right decision, even though at that time it came under severe criticism by the press and even resulted in the dismissal of a minister. Up until now, the current Hungarian Government has also continued with this practice of safeguarding the population's interests.

We do not think that MOL Co.'s mining taxes are properly accounted today. On the one hand, the favourable situation of Hungarian hydrocarbon mining should be taken into account when setting the

rate of payable mining tax, with particular emphasis on the fact that the country's mineral resources are being rapidly used up, and they are irreplaceable in the future. As we have mentioned, the Government had to offset low mining taxes by setting administrative prices to draw away incomes so as to comply, at least to a certain degree, with the principle of justice and economic rationality. Because it is just sheer absurdity that despite soaring prices of mining products, payments by MOL Co. remain virtually the same, while a huge burden is imposed on the population all at once.

Dependence of incomes from hydrocarbon mining on import prices is clearly illustrated by factual data in Table II.4.2.5.

It can be established from these statistics that total profits (mining of petroleum and natural gas together, for these two cannot be easily separated physically either) exceeded considerably the losses caused by administrative prices, and the company realized profits in each one of these years. We have to point out that up until now the press has always left unmentioned the profits realized on other products of petroleum mining; nevertheless, these factors, too, should be involved in price bargaining.

4.2.6. Proposal for the methodology of a solution

It is a practically feasible concept, and also the Government's proposal for a solution, that natural gas prices for household use should be financed from mining taxes that are based on realistic foundations and

**Table II.4.2.5.: Some financial data on petroleum and natural gas mining
million HUF**

Description	1997 fact	1998 fact	1999 fact	2000 fact	2001 fact	2002 expected	2003 plan
1.) Petroleum mining							
Value at import price	40295	27897	44291	79227	62820	36512	31562
Cost of Hungarian production	7045	7275	8866	9346	9918	7469	7327
Mining tax*	3872	1783	2951	5263	4303	4148	4334
Extra profit	29378	18839	32475	64618	48599	24895	19900
2.) Natural gas mining							
Value at import price	82368	69828	53131	101519	126836	100106	86539
Cost of Hungarian production	14847	14703	16519	18324	20103	24354	23894
Mining tax*	11299	8697	7110	6585	7764	9407	9453
Extra profit	56221	46428	29503	76611	98969	66346	53192
Extra profit, gross	85599	65267	61977	141229	147568	91241	73092
Less: price loss of natural gas		-23640	63219	103461	37178	3456	
Total extra profit, net			85618	78010	44107	54064	69636

*According to the breakdown specified in the mining tax calculation of the Ministry of Finance
Source: Ministry of Finance, Central Statistical Office of Hungary, foreign trade statistics

are higher than up until now. This method would also make it possible to moderate extraordinarily high import prices that may prevail in certain years, because with higher import prices more taxes are accumulated for compensation purposes. As a consequence, price rises for household consumption could remain relatively small in 2003, and could be mostly offset – in accordance with the Government's concept.

We have to emphasize that in Hungary 2899 thousand households were connected to the natural gas network in 2001, and among them 2363 thousand households used natural gas also for direct heating purposes. In addition, most of the flats supplied by district heating are similarly dependent on natural gas. Thus, the majority of the Hungarian population is interested in settling this issue in a fair manner.

Hungary's natural gas resources are being used up, therefore price subsidies can only be provisional and of a steadily diminishing rate. What seems to be feasible is a solution to provide support only for a specified quantity and up to a limit set for one household. This arrangement would be similar to block tariffs, used for electricity up until 2000, and should be modified by a multiplier which depends on the size of the family concerned. Prices of quantities consumed above the block tariff would progressively come near to import prices and to other related costs (seasonal storage and transportation).

*According to the version announced by the Government, as from 15th May 2003, natural gas prices will be raised by 12 per cent for household consumers (and by 15 per cent for other consumers). In the heating season starting in the autumn of 2003, prices will be raised by 6 per cent up to a consumed quantity of 1500 m³, by 8 per cent for a quantity between 1501 and 3000 m³, and by 12 per cent above 3000 m³. In our opinion, this should be complemented by providing adequate support for large families. **Budgetary consequences of this measure may be estimated at around HUF 30 billion in 2004.***

This quantity should be decreased each year proportionately to the depletion of workable natural gas resources. At the same time, adequate funds should be allocated for energy efficiency programmes so that families can use this possibility to partly replace the forced reduction in their gas consumption. Additionally, this solution would also improve the structure of the Hungarian national economy and would create new job opportunities, so the resulting economic development and higher income levels would make it practically feasible to gradually introduce natural gas prices for Hungarian household consumption that are close to world-market prices. This process would also be accelerated by the introduction of energy taxes in the European Union.

4.2.7. On electricity prices

On the purchase side, **electricity** prices also depend on the prices of energy sources, therefore the revaluation of the Hungarian currency and the weakening rate of the USD may bring about huge cost reductions also in this sector in 2003, compared to cost levels in 2001 and 2002. (On the other hand, it is true that changing hydrocarbon prices only have a partial effect on the price of electricity. Electricity generation costs represent around half of the total final costs of electricity, and the remaining part is made up by transportation and distribution costs. In the Hungarian electricity industry, approximately 20 to 22 per cent of the total fuel heat volume is produced by using natural gas, another 40 per cent in the nuclear power station, while the remaining part is generated in coal-fuelled power stations and by using oil. About 3/4 part of the total fuel heat volume is used for electricity generation purposes, and fuel costs represent 2/3 part of all production costs. Accordingly, for example a 10 % rise in natural gas prices would have the following impact on the price of electricity: $10 \cdot 0.22 \cdot 0.75 \cdot 0.66 \cdot 0.5 = 0.55 \%$.)

At present, Hungarian Electricity Works (MVM) Co. has a huge accumulated loss, totalling about HUF 80 billion. (Already in previous years, the Government had granted budgetary subsidies worth ten billions of HUF to counterbalance these losses.) Current losses of MVM Co. have been settled in the following manner:

- by increasing prices at an average rate of 10 per cent with effect from 1st February 2003, consumers are made to pay HUF 55 billion,
- and losses of HUF 30.8 billion are written down in a manner deferred over 5 years.

It is to be noted that the current production loss in the Paks Nuclear Power Station, caused by a serious breakdown, will have further cost impacts over and above the mentioned values.

Losses are largely attributable to the low prices at which MVM Co. has to sell electricity to service providers – which they will then resell at much higher prices. Because “an 8 % rate of return on assets” is guaranteed to foreign-owned companies at all costs. In short, the reason why Hungarian Electricity Works Co. makes a loss is that it has to generate the funds ensuring extra profits for power stations transferred into the hands of foreign owners. This conclusion is underpinned by data of the (consolidated) pre-tax profits of companies of the electricity industry (See Table II.4.2.7.a.).

These net figures are obtained by adding the loss of the Hungarian Electricity Works and the profits of foreign-owned companies. This calculation reveals that price rises are primarily required so that the profits of foreign-owned companies can be increased.

**Table II.4.2.7.a.: Pre-tax profits of electricity companies
billion HUF**

Year	1995	1996	1997	1998	1999	2000	2001
Amount	-73.8	-42.4	18.4	54.8	75.0	75.3	64.9

Source: 2001 Annual Report of the Hungarian Energy Office

We can come to a noteworthy conclusion by highlighting the amount of pre-tax profits of electricity service providers within the above statistics (*Table II.4.2.7.b.*).

A substantial part of the pre-tax profits are artificially regrouped for electricity service providers.

The Horn Government provided justification for selling Hungary's electricity sector and for the conditions that were decidedly harmful for the country by stating that "the power stations are dilapidated" and that huge funds were required for the necessary investments.

The following facts have been confirmed since that time:

- The power stations were not dilapidated.
- Most of the power stations are still in operation; only regular maintenance was needed, and simultaneously with that, reconstruction work was performed and is still being performed. Reconstruction, obviously, comprised some minor development projects as well (at power stations, a much higher depreciation reserve is accrued than in other sectors, which allows even major developments), above all to meet environmental protection requirements.
- A large part of the power stations in Hungary switched over to natural-gas-fuelled operation, which has the lowest relative development need. At the beginning of the 1990s, the Hungarian State did not allow its own power stations to effect this technological switch-over, claiming "excessive dependence" as the reason.

The situation has changed since then, so such developments have become considerably cheaper.

- In the meantime, Hungary's electricity need has only increased at a much lower rate than prognosticated; therefore the existing capacities (which are being extended through modernization) can satisfy the demand despite the fact that current electricity imports make up only about 50 per cent of the 1990 import volume. It is to be noted that even in 2001, Hungarian electricity consumption was lower (32.2 billion kWh) than in 1990 (33 billion kWh).
- Privatization of MVM Co. in 2003 would cause serious damage to the country because the funds drained away from here are used to secure extra profits for electricity companies already owned by foreign proprietors, and so it can be sold under its true value. Low profit levels of the Paks Nuclear Power Station bear witness to the above: in 2002, profits realized by Paks only amounted to HUF 2.8 billion, which also entails serious safety risks for Hungary and its environment. On the other hand, extra profits realized by foreign-owned electricity service providers reach record levels: for instance, pre-tax profits of DÉDÁSZ increased from HUF 1.5 billion in 2001 to HUF 3.2 billion in 2002, i.e. more than doubled. We have been informed that the Hungarian Energy Office set energy service provider companies at a profit level of 9.3 per cent for the period 2001–2003, which is higher than the initially guaranteed 8 % profit rate.
- Business activities of ELMŰ, in German majority ownership, can be a deterrent example. In 2002, the company realized a pre-tax profit of HUF 11,688 million. As regards workforce reduction, a veritable slaughter is going on at the company: in the period from 1997 to the end of 2002, the number of workers employed by ELMŰ decreased by more than 50

**Table II.4.2.7.b.: Pre-tax profits of electricity service providers
million HUF**

Company	1997	1998	1999	2000	2001	2002
ElmŰ	3566	7811	9753	8469.3	7804.0	11668.0
Édász	4332	8527	9285	7453.7	5564.0	5171.0
Dédász	1193	1971	1664	2361.9	1471.5	3217.8
Émász	-1169	1572	1971	3030.5	411.6	1239.3
Démász	3395	5334	6092	5452.2	2548.0	5096.0
Titász	351	1841	4170	4481.9	990.0	2632.0
Total	11668	27056	32935	31249.5	18789.1	29024.1

Source: Hungarian Energy Office and flash reports

per cent. Direct staff cuts meant that 2068 persons were laid off. At the same time, the company has also eliminated a considerable number of jobs indirectly, by abusing its proprietary rights:

- a) ELMŰ dictates the imports of German-made light sources (OSRAM), forcing back Hungarian products.
- b) Hungarian-made electricity meters are systematically replaced by German-made metres, although those are not superior to the Hungarian ones either in terms of costs or their technical standard.
- c) The company specifies the materials needed for its investment projects in a manner that they are almost always of German origin. ELMŰ manages to achieve this by the trick of involving and attaching enterprises to itself, i.e. it extends its activities and dictates the terms (this means that orders are only placed with contractors who comply with all requirements). In short, ELMŰ builds up vertically an absolute monopoly.
- d) The company keeps its accounts with the German-owned Külkereskedelmi Bank Co.
- By using the above-described methods, ELMŰ has eliminated some 10 thousand Hungarian jobs at a national level within a short period of time. On the other hand, it keeps expanding German job opportunities. Among other reasons, this is also unjustifiable because (in 2000) the employment rate in Hungary was only 59.1 per cent, as against the 74.8 per cent rate in Germany.

Consequently, on the costs side, price rises can hardly be justified. However, in order to provide stronger incentives for the sparing use of electricity, it is advisable to initiate, also in this area, the re-introduction of tariffs similar to former block prices.

4.2.8. Opening up the market and market competition

When considering natural monopolies, the issue of competition is given particular attention today. In our opinion, what we can see in the Hungarian market of electricity and natural gas is not a competition, but rather a situation in which foreign companies, well supplied with capital, try to acquire as large a share in this market as possible. To achieve a true opening of the market and a true competition, several real factors are to be in place:

- 1.) At present, in order to transit the delivered natural gas into other countries, it is necessary to obtain the approval of natural gas suppliers (in this case the approval of the Russian partner). This requirement cannot be easily circumvented because the composition of natural gas is characteristic of the place of

origin. This constitutes the proprietary right of the country selling and delivering the gas and cannot be limited unilaterally. Obtaining such approval entails some extra financial consequences.

According to EU prognostications prepared for the period up until 2020, within total energy use, the share of natural gas will grow from 23.6 per cent in 2000 to 26.7 per cent in 2020 in Europe. Internal resources are being used up; therefore natural gas production will fall from 204 million toe (petroleum-tonne equivalent) in 2000 to 141 million toe in 2020. On the other hand, imports will increase from 133 million toe in 2000 to 290 million toe in 2020. (These data were calculated for the current 15 member states of the EU, so imports will grow by more than that after the enlargement.)

An ever larger part of imports are planned to be purchased from Russia. As a consequence, on the demand side we may reckon with a strengthening monopolistic position of the supplier.

- 2.) With more emphasis on environmental aspects, increasingly expanding needs may be anticipated for the use of natural gas.
- 3.) In Hungary natural gas has an even stronger monopolistic position owing to the imposition of excise duties on substitute products (primarily on household fuel oil). Thus, in terms of substitute products, too, market competition is a mere theoretical hypothesis. In practice this is a major limitation to competition.
- 4.) Comparatively much lower Hungarian household income levels constitute a further limiting factor to the evolvement of market competition.

4.2.9. Expected impacts of introducing a uniform European energy tax

On 20th March 2003, ECOFIN (the European Union's Council of Economic and Finance Ministers) adopted a decision setting the minimum rate of energy taxes to be imposed on energy products. (Detailed review of this measure can be found in the May/2003 issue of "Lélegzet", environmental monthly published by Clean Air Action Group.)

By assessing the impact of the European energy tax on the structure and volume of Hungarian energy use we may draw the following conclusions:

- 1.) As regards fuels, the currently applicable Hungarian excise duty rates exceed the minimum rate set by the EU by 17.1 per cent for petrol and by 15.4 per cent for Diesel oil.
- 2.) At present, no energy taxes are paid upon energy use for commercial and industrial purposes in Hungary, therefore in this area, users will have to pay

the entire minimum tax rate. According to our calculations, altogether they would pay taxes amounting to some HUF 8 billion as a result. This would mean an impact of HUF 6.5 billion on the petrochemical industry and HUF 1.5 billion on the production of nitrogenous fertilizers. (EU regulations, however, make it possible to release these taxes.)

- 3.) If the minimum tax rates are introduced, in theory taxes worth some HUF 20 billion may be imposed in 2004 on the use of electricity and energy for heating purposes (calculating with the quantity of actual energy use in 2001). In these calculations we have only reckoned with end use taxation, i.e. we have imposed taxes on the energy sources used for electricity generation only in the last phase.

Despite the problems surrounding the issue, adoption of the directive on uniform energy taxes may be considered as a favourable step, because as a result energy taxes can be gradually introduced and their rates raised, concurrently with the reduction of taxes and contributions charged on wages.

4.3. Extension of the energy efficiency programme

In section II.2.7.2. of the present study we have already provided justification for the need to support energy efficiency enhancement. Here we are going to set forth some further arguments in favour of such measures. Today already a more robust energy efficiency programme should be implemented, and the more so as higher energy prices have considerably shortened the payback period of such investments. Energy efficiency programmes would have exceptionally favourable impacts also because energy (mostly imported into Hungary) may be replaced by (predominantly domestic) live labour. In this context we make reference to a model elaborated by Austrian and Slovak researchers, which demonstrates that by settling energy prices, applying appropriate energy taxes and launching a state-supported energy efficiency programme Slovakia could open up 350 thousand new job opportunities (The Transformation of Slovakia).

We recommend that the inflationary effect caused by changed VAT rates applicable to energy sources and by imposed energy taxes should be partly neutralized by ensuring full VAT refund on energy efficiency and energy saving developments. Practical experience shows that the average sum invested into an energy rationalization project equals the value of energy used during 5 years. As a consequence, with a one-off energy rationalization investment, the state budget realizes in

one sum such VAT revenues as would from energy use during a period of 5 years. When replacing electricity, natural gas or district heat, this difference is much greater, for such items the applicable VAT rate is 12 per cent, whereas investment projects are subject to a 25 per cent rate. Therefore, the state budget will certainly not lose any money as a result of such measures; just on the contrary, it will gain extra revenues overall.

If the value-added tax is refunded immediately, energy rationalization investment projects become much cheaper. Already in the year of implementation, this will cause inflation to diminish at a greater rate than it is made to grow by rising energy prices. On the other hand, the inflation rate is also cut back (and in a lasting manner to cap it all) by lower energy costs brought about by the investment. Less environment pollution is an additional cost-reducing factor.

This programme would help develop the Hungarian environment protection industry, as well as enhance its competitive and export capabilities. Employment in Hungary would also greatly benefit from the impact of such programmes.

The proposed energy rationalization programme would fit in very well with the housing programme and the renovation of flats in Hungary. What is more, it would multiply the favourable impacts and promote a more comprehensive implementation as a result.

We do not propose that energy efficiency fees should be imposed on renewable energy sources and on cogeneration of energy.

4.4. Proportionate refilling of the Central Nuclear Fund

We have already emphasized earlier that by applying maximized administrative electricity prices, resources are drained away from the Paks Nuclear Power Station, jeopardizing financially its safe operation. In spite of that, production was stepped up in the power station to attain extra revenues. This has also contributed to the occurrence of a serious breakdown in April 2003, which has not only imposed substantial additional costs on the company but has also caused it to lose considerable revenues. At the same time, funds have to be secured for covering the implementation costs of the power station's enhanced operational safety as well. Therefore it is now reasonable to provide the needed sum from the Central Nuclear Fund, but it will have to be refilled later.

Another reason why the current situation is untenable is because "cheap" electricity generated in the Paks

Nuclear Power Station is used to finance the 8 % rate of return on assets of foreign-owned electric power stations (as electricity produced there has a higher prime cost). Delivery price of the electricity generated in Paks should be regulated in a manner that it covers all the costs of safe operation (including the necessary investments, too) and provide for the sums to be paid into the Central Nuclear Fund. Afterwards, an additional **annual sum of HUF 6 billion** should also be incorporated into the prices. Paks Nuclear Power Plant should pay this amount every year into the state budget for the next 15 years, since it has failed to pay not only the interests of the initial state grant for the power station investment project, but, owing to the accelerated inflation, also the amount of the original capital.

4.5. Investment policy changes in the energy sector

In the wake of ownership changes in the Hungarian energy sector, the guaranteed 8 % rate of return on assets has made it theoretically possible to expand capital investments. New proprietors are interested in accounting the largest possible amounts for “development” purposes, i.e. as expenditures of implementing new plants (such as power stations). These investments, however, are rarely justified at a national economy level, and their costs are practically impossible to verify. Both economic and environmental considerations require that energy efficiency enhancement be preferred to the establishment of new power stations.

Nevertheless, if new power plants do become necessary, investments involving the least costs and environmental load should be given preference. In this respect, cogeneration of energy (power stations that are capable of producing heat and electricity at the same time) should receive priority support. It should

be set as a prerequisite for authorizing such investment projects that they have a Hungarian main contractor and a high (more than 50 per cent) share of subcontractors.

In our opinion, projects such as the one to establish a primary power station using the lignite mined near Bükkábrány in North-Eastern Hungary should be rejected. This investment would not only cost hundreds of billions of forints, but would also bring about massive environment pollution, a large increase of external costs and it would run counter to the international environment protection obligations that Hungary had assumed. If this power station is not constructed, energy prices could grow at a lower pace, which, in turn, could hold back the rate of inflation. (Fortunately, this project has already been removed from the list of high priority plans.)

If capital investment practices in the Hungarian energy sector are properly controlled by state regulations, they may contribute to easing the pressure on the central budget and may set free substantial resources for other purposes.

4.6. Purchase of natural gas through barter transactions

It is worth considering that Hungarian natural gas imports from Austria and France, which belong to the “walking gas” category (see *Table II.4.6.*), should be countermanded, for the contract is not based on true facts. This contract had been concluded for safety reasons with the explanation that if Russia fails to supply, natural gas would be delivered to Hungary from the West. The European Union’s energy balances reveal that at present more than the half of the EU’s natural gas imports come from Russia, and this portion is steadily increasing. Consequently, in practice natural gas may only be delivered to Hungary from the West if the gas is

Table II.4.6.: Hungarian natural gas imports broken down by main countries of origin

Description	1997			1998			1999			2000			2001		
	M m³	M HUF	HUF/m³	M m³	M HUF	HUF/m³	M m³	M HUF	HUF/m³	M m³	M HUF	HUF/m³	M m³	M HUF	HUF/m³
Total:	7526	151726	20.16	8815	155714	17.66	9261	140446	15.17	9648	284509	29.49	9394	358190	38.13
<i>out of which:</i>															
Russia	6246	117048	18.74	6735	123152	18.29	8002	105781	13.22	7906	234834	29.70	8131	302027	37.14
Ukraine*	766	15120	19.75				465	11443	24.62	489	9399	19.23			
Austria	225	8693	38.64	355	14358	40.44	506	15044	29.72	830	27664	33.33	878	38870	44.26
France				266	10467	39.41	287	8178	28.46	423	12612	29.83	385	17292	44.97

*Ukraine: calculated data for 1999 and 2000

Source: Foreign Trade Yearbooks of the Central Statistical Office of Hungary, 1997, 1998, 1999 and 2000

transported across the Slovak Republic, for example, and then brought into Hungary from Austria – which entails significant added costs and further environment pollution. Therefore the contract's fundamental conditions are in practice impossible to meet, which is a sufficient reason for terminating it. Having done so, Hungary could purchase the natural gas cheaper from Russia against Hungarian barter goods. Of course, it is advisable to offer for Austria a utilization of the existing natural gas pipeline in which the direction of delivery would be reversed, and Hungary would transport Russian natural gas into Austria either for safety or for business purposes, because this is the shortest available transport route.

Hungary also purchases large quantities of natural gas from the Ukraine, but this gas is of controversial origin. Russia claims that it comes from tapping the transit pipeline illegally. It would be advisable to effect this purchase, too, as part of the Hungarian–Russian barter transaction.

The above two deals together could ensure for Hungary further 30 thousand job opportunities, and additional state budget revenues totalling some HUF 30 billion.

4.7. Raising to 25 per cent the VAT rate applicable to artificial fertilizers and some other products

Producing artificial fertilizers is an extremely energy-intensive process. (See details in our study *Why is an Energy Price Increase Unavoidable and How can This Increase Be Implemented?*)

More rational energy utilization can also be encouraged by not giving preferences to products manufactured by using particularly high quantities of energy. To that end and for the interests of the environment, it is vital to review Attachment No. 1 (Products and Services Subject to the 12 per cent VAT Rate) of Act LXXIV of 1992 on Value Added Tax. To ensure better transparency, we have listed in *Table II.4.7.* below all products that should be reclassified from the 12 per cent into the 25 per cent VAT rate category. It is a wrong policy to stimulate the use of artificial fertilizers that place a serious load on the environment in Hungary. Application of increasing quantities of nitrogen fertilizers can serve as a warning sign: from 263 thousand tons in 1999 it went up to 275 thousand tons in 2001, while the amount of manure used diminished from 3920 thousand tons to 2869 thousand tons in the same period.

We think that applying the lower (12 per cent) VAT rate to artificial fertilizers, insecticides and herbicides is tantamount to **granting unjustified preferences; what is more, the current practice is definitely harmful from the aspect of environment protection and energy management.**

One of Hungary's most important interests is to **carry out agricultural production in a sustainable and environmentally friendly manner in the long run.** A crucial precondition for such agriculture is to **cut back on the use of materials and products which cause harm to the soil, plants and animals, as well as to human health.** In Hungary the use of chemicals radically dropped during the transition period, in the early 1990s. Unfortunately, recent years have seen a change in this trend and a slight increase again. Further expansion of chemical use could be partly prevented if the rate of the VAT applicable to these products was increased to 25 per cent. The VAT rate reclassification would hardly affect large-

Table II.4.7.: Products proposed to be reclassified from preferential to normal VAT rate

Description	Customs tariff number
Mineral products (calcium-phosphate-based artificial fertilizers)	ex 2510 20
Mineral fuels	from 2701 to 2705, 2709, 2711 21, 2711 12 11, 2711 12 19
(for heating)	ex 2711 12 94, 2711 12 97
(for heating)	ex 2711 13 91, 2711 13 97
(for heating)	2711 29
Electricity	2716
Mineral or chemical fertilizers (formed as artificial fertilizers)	ex 3102, ex 3103, ex 3104, 3105
Insecticides, fungicides, disinfectants for external use, herbicides, etc.	3808
Diaper fillings (disposable)	ex 4818 40

Note: We recommend that cotton washable diapers have a 0 % VAT rate.

scale farming since they can reclaim VAT regardless of its rate; but the increase would promote a change in the farming methods of small-holders who find it difficult to comply with the professional requirements of up-to-date chemical use anyway, but are best suited to implement more environment-conscious cultivation forms.

The mentioned VAT rate reclassification is also justified because in the European Union the concept of using fewer chemicals in agriculture has been gradually gaining ground recently. Land used for growing organic ("bio") products in Austria increased tenfold during the past five years. In Denmark, Finland and Sweden, a special ecological tax is imposed on the use of pesticides. Already today, the only Hungarian agricultural products that are allowed to enter EU member states without any restriction are those that are grown without the use of chemicals.

The majority of chemicals used in agriculture, as well as the raw materials for producing those chemicals in Hungary come from imports. Their reduced use could improve Hungary's foreign trade balance and enhance the competitiveness of domestic labour force.

At the same time we propose that **extra revenues resulting from the increased VAT rate applicable to artificial fertilizers and pesticides be entirely allotted to supporting organic farming in Hungary.** This can be financially implemented by taking into account in the subsidization system, and deducting the amount of, the VAT reclaimed when using artificial fertilizers. The funds so generated should be added to the financial assistance granted to organic products. Our calculations have revealed that the VAT rate reclassification of artificial fertilizers and pesticides from 12 to 25 per cent represents an aggregate extra burden of some HUF 20 billion. However, considering the regressive impact of the tax, **additional revenues**

worth HUF 15 billion can realistically be anticipated; and these should be entirely devoted to supporting organic farming.

These measures would contribute to reducing the rate of rural unemployment, too, for it is well known that organic farming requires much more live labour than ordinary agricultural production which uses chemicals.

All the above is also substantiated by studies and assessments under the title "Environmental Protection and Integration" carried out recently by the Hungarian Academy of Sciences in its Strategy Research Programme.

Disposable and non-reusable products, which have come into general use in the last decade, will cause a "waste catastrophe" within a few decades. As regards disposable baby diapers (customs tariff number: 4818 40), even their production is seriously harmful to the environment and rather energy-intensive. Not being reusable, they end up in waste tips. A single child "produces" a ton or so of disposable diapers until their clean habits are established. Awareness raising would also be necessary to cut back considerably on the use of such products. The absorbing layer of the disposable diaper is made from cellulose which could be a useful raw material for other purposes. Additionally, most of the diapers come from imports, deteriorating thereby Hungary's balance of payments, too. As a result of the VAT rate increase, state budget revenues worth HUF 1 billion can be anticipated from this item. We recommend that by using these funds, **parents of Hungarian babies should be granted vouchers which entitle them to acquire Hungarian-made cotton (not disposable!) diapers free of charge.** (Calculating with 100 thousand babies born annually and with 50 pieces of diapers per child, the mentioned HUF 1 billion would ensure abundant funds for this purpose.)

5. Environmental load fees, environmental product charges and mining taxes

Various types of environmental taxes and charges have become ever more widely used all over Europe – both in the EU and in the former Eastern Bloc countries (see Appendix 6). Experience gathered up until now indicates that the use of such instruments is beneficial both from an economic and an environmental protection aspect. We recommend that environmental load fees (ELF) should be introduced as soon as possible as a means to distribute revenues in a more fair and reasonable manner. **The current unfortunate practice of permitting activities that damage the environment enables some companies to increase their profits** at the expense of their competitors – which is unjustified and contrary to the principle of competition under equal terms. The introduction of ELFs attempts to change that practice, and make sure that environmentally harmful activities are not preferred to those using more labour and containing more added intellectual value; therefore, Hungary's economy could move ahead at a faster rate.

Both scientific research and practical experience have demonstrated that the later it is done, the more it costs to remove the damage caused by environment pollution. So, the prices of environmental elements (air, water and soil) need to be involved in economic planning by applying the “polluter pays” principle. Environmental load fees are efficient means of controlling economic processes through encouraging the user of environmental elements to reduce and prevent pollution, and providing them with financial assistance to achieve this goal from the generated revenues. If ELFs perform well, the society may benefit from an improved state of the environment and human health. Competitiveness of the Hungarian economy would also be enhanced once technology is transformed and developed to become more environmentally friendly, which is indispensable for further progress anyhow.

The system of ELFs is designed to serve sustainable development through a quality-oriented improvement of economic activities.

If they are introduced comprehensively, the impact of ELFs on the annual inflation rate – calculating with direct effects only – is not expected to exceed 0.3 per cent with the lower fee rates proposed by the Ministry of Environment Protection, and 0.5 per cent with the higher rates. ELFs are planned to be introduced gradually, which means that in the first year this value will

only be 0.01 per cent and 0.15 per cent respectively. However, considering indirect impacts as well, on the whole the introduction of ELFs may not increase the rate of inflation at all. Rather the opposite is true because by reducing environmental harm and health problems, and by providing support for restructuring the economy, they reduce costs at the level of the society as a whole, that is, they have an anti-inflationary effect.

We think that the professional work carried out in the Ministry of Environment Protection to elaborate ELF schemes meets general expectations and complies with the requirements of Act LIII of 1995 on the General Rules of Environmental Protection, even though this preparatory work is not yet completed and additional investigations are also needed. This subject is only discussed in brief in this document, starting from the situation in 1999. At that time it was assumed that environmental load fees would be introduced in 1999, and we have kept the calculations prepared in that year, and will present them below. These figures, of course, should be adjusted according to the actual date of the introduction.

We recommend that ELFs should be introduced in a manner that the revenues generated by them are principally used for local improvements.

Since funds for environmental purposes are extremely scarce in Hungary, it is advisable to give preference to similar structural solutions (i.e. means that reduce pollution through their indirect economic stimulation impact). These should be presented to the European Union as own resources, i.e. as Hungary's pecuniary contribution to the protection of the environment, and they should form the basis for requesting financial support from the EU. This solution is in compliance with the principles of market economy as well.

The Hungarian Ministry of Environment Protection has elaborated two versions for the environmental load fees: Version A with lower rates and Version B with higher rates. Expected annual revenues generated by each version of ELFs are summarized in *Table II.5*.

It is to be noted that even the higher rates proposed by the Ministry are incapable of covering the costs of damage that environmentally harmful activities cause. Therefore, it is essential that ELFs are introduced as soon as possible, with the higher fee rates. On the other hand, it is to be assessed whether this is in fact an efficient economic instrument under current circumstances to cut back environment pollution. Environmental load fees

**Table II.5.: Expected revenues from environmental load fees
billion HUF**

Lower rate calculations (Version "A")

	1999	2000	2001	2002	2003	Total
Air load fee	2.6	5.22	7.8	10.44	13.051	39.153
Water load fee	2.48	4.96	7.44	9.92	12.4	37.2
Soil load fee	1.74	3.48	5.22	6.96	8.7	26.1
Total	7.7	15.4	23	30.8	38.46	115.4

Higher rate calculations (Version "B")

	1999	2000	2001	2002	2003	Total
Air load fee	3.9	7.8	11.7	15.6	19.51	58.54
Water load fee	4.3	8.6	12.9	17.2	21.56	64.68
Soil load fee	4.3	8.6	12.8	17.1	21.42	64.26
Total	12.5	25	37.5	50	62.5	187.5

Source: Ministry of Environment Protection

would entail considerable extra administrative work (and expenses), whereas they would generate much less revenues than several other tax types. As we have already pointed out, it would be possible to substantially raise state budget revenues by raising the applicable rate of certain existing tax types, practically at no extra administrative costs.

5.1. Introduction of air load fee

Air quality in Hungary has improved in the last decade; however, in absolute terms in many places it is often still worse than the approved health limit values. On the whole, "polluted" areas are decreasing in size but the combined total area that is "polluted" or "slightly

polluted" is steadily expanding. The latter two categories comprise over the half of Hungary's population.

The payable rate of air load fee (ALF) would be calculated by the quantity and the level of hazard of polluting substances emitted into the air annually.

The Ministry of Environment Protection has published a study titled *Impact Assessment of the Concept of Environmental Load Fees*, presenting their estimates. Supposing the higher fee rates are introduced (concerning the proposed rates see Table II.5.1.) and the air load fee will not change in real terms, the emission of sulphur dioxide and nitrogen oxides are expected to drop by 72 and 2.1 thousand tons respectively. The consequent environmental benefit will be higher than the costs of reducing pollution. Furthermore, payers of ALF will be offered a portion of the fee to finance their capital invest-

Table II.5.1.: Proposed rates of air load fee on various pollutants

Air polluting substances	Unit rate (Version „A”) HUF/kg	Unit rate (Version „B”) HUF/kg
Sulphur dioxide	15	30
Nitrogen oxides	30	60
Carbon monoxide	15	15
Solid substances (non-toxic)	15	15
Substances belonging to Hazard Category I	750	750
Substances belonging to Hazard Category II	75	75

Source: Ministry of Environment Protection

ments needed for reducing the emission, which constitutes an additional stimulation. It is also expected that new penalties and limit value regulations will be introduced and the system of financial assistance will be modified, which – along with the above-mentioned factors – may reinforce the efforts. Even if the lower rates are imposed, environmental pollution levels may fall as a result. Significant improvement, however, can only be expected after the first five years of the gradual implementation of ALF at the highest achievable rate. Most of the revenues from ALF would come from the electricity sector, but also mining, the production of non-metallic goods, as well as metallurgy and metal processing could take a significant share.

5.2. Introduction of water load fee

Although water quality has also improved in recent years, it is not entirely satisfactory for various uses and life in and around natural waters of Hungary. It is vital to prevent pollution and contamination of surface waters to protect human health and to preserve or even enhance the ecological value of waters. Hungary is required by international obligations and by the EU membership to take measures – among others to establish economic incentives – aiming at achieving those goals. The entire impact of the water load fee (WLF) can only

be evaluated as part the system of all relevant regulations; consequently, it should be defined and calculated in line with other regulatory elements.

The payable rate of WLF is calculated by the total quantity of polluting substances discharged into waters annually. The rate may vary with the hazard that the individual pollutant represents and with the specific features of the affected area (*see Tables II.5.2.a. and b.*).

It is estimated that direct discharge of polluting substances into waters will go down by 3.14 per cent if the lower rates are introduced. Some bigger towns in the country may already be encouraged by this rate of payable fee to implement some capital investments with a view to improving water quality. If the higher rates are introduced, the resulting decrease of discharge will be 36 per cent or so (expressed in units of toxicity exposure), which will affect first of all Budapest and its surroundings with the Danube as its main water stream. Capital investments related to the 36 per cent reduction of environmental load would entirely be implemented in communal sewage disposal.

5.3. Introduction of soil load fee

Urban development, industry and military activities have done significant damage to the soil and the underground water reserves in Hungary. The numbers of po-

Table II.5.2.a.: Proposed rates of water load fee

Description of component	Unit rate HUF/kg		
	A	B	C
1.a Chemical oxygen need	30	44	160
1.b Biological oxygen need	50	73.3	267
2. Extracts from organic solvents	600	880	3200
3. Phosphor	500	733.3	2667
4. Nitrogen	60	88	320
5. Heavy metals			
5a. Mercury	75 thousand	110 thousand	400 thousand
5b. Cadmium	15 thousand	22 thousand	80 thousand
5c. Chrome	3000	4400	16 thousand
5d. Nickel	3000	4400	16 thousand
5e. Lead	3000	4400	16 thousand
5f. Copper	1500	2200	8000
6. Total salts	1.5	2.2	8
7. Toxicity	0.5 HUF/m ³	0.7 HUF/m ³	2.7 Ft/m ³
8. Heat pollution	0	0	0

Source: Ministry of Environment Protection

Table II.5.2.b.: Expected revenues from water load fees**(Version "A" in 2003 at 1996 prices)**

Sector	Water load fee (billion HUF)		Water load fee per unit (HUF/m ³)	
	1	2	1	2
Industrial plants connected to public sewer systems	8.3	2.9	82.5	28.3
Households connected to public sewer systems	2.9	6.7	12	28.3
Other sectors	0.8	2.4	9	28.3
Country total	12	12	28.3	28.3

(Version "B" in 2003 at 1996 prices)

Sector	Water load fee (billion HUF)		Water load fee per unit (HUF/m ³)	
	1	2	1	2
Industrial plants connected to public sewer systems	12.2	4.2	121	41.6
Households connected to public sewer systems	4.3	9.8	17.6	41.6
Other sectors	1.2	3.4	13.2	41.6
Country total	17.7	17.7	41.6	41.6

Source: Ministry of Environment Protection

tential pollution sources and actual contamination occurrences have been steadily growing over recent decades.

Soil load fee (SLF) serves the purpose of protecting the soil and the underground waters. It would be imposed on the desiccation and storage of waste water. SLF would eliminate, or at least reduce, contamination from desiccation of domestic waste water (one of the key pollutants in urban areas) by making people interested in using a more convenient public utility service at a price that is close to the payable rate of soil load fee. In addition, it would also cut back on soil contamination caused by farmers. The applicable SLF rate is calculated on the basis of the quantity of water provided for the user, and varies with the degree of hazard and with the specific features of the area concerned. The base unit fee will amount to 30 HUF/m³ (A) or 60 HUF/m³ (B), depending on which version is introduced.

Households would bear 84 per cent of the total SLF payment burden, whereas large consumers would only pay up the remaining 16 per cent. It means that the majority of industries will not or will only slightly be affected by the imposed fee. (The only sectors concerned are electricity and heat generation, gas and water supply, food processing and mining.) SLF as an incentive can only work efficiently if the payable rate is set high enough to exceed investment costs of the utility or the sewage system. A gradually introduced lower rate (say

12 HUF/m³) alone could only encourage hooking up to the already existing sewer system, and only in settlements other than Budapest.

Collecting WLF and SLF as a form of tax can slow down the pace of increasing the price of utilities (water and sewer systems) and can also provide the funds needed for the improvements. In that case, those two fees would not form part of the VAT base and would lower the profitability of the companies concerned. Consequently, no corporate taxes are to be paid on the sums involved, and they cannot be used for other purposes. In this manner, WLF and SLF may be guaranteed to be used only for development purposes. (What is more, since the investments are implemented by using public funds, they are subject to mandatory accounting and controlling.)

5.4. Increase and extended scope of environmental product charges

Regarding environmental product charges currently applied in Hungary, detailed assessments are needed to evaluate to what extent these charges have fulfilled their intended purpose, to determine whether they should be raised and at what rate, and to consider whether it is advisable to introduce new product charges or not.

Table II.5.4.: Changes in environmental product charges since their introduction in Hungary

Description	1995	1996	1997	1 Jan 1998 – 14 Feb 1998	14 Feb 1998 – 31 Dec 1998	1999	2000	from 15 Feb 2003	2004	2005
Environmental product charges on tyres (HUF/kg)										
New tyres approved by UN ECE (marked with "E"), and imports of old tyres to be restored (retreaded) under conditions and in quantities specified by separate laws	30	30	30	30	32.4	35	38.5	55.7	70.6	86
Imports of restored (retreaded) old tyres approved by UN ECE (marked with "E")	none	none	none	none	none	43	48.3	70	90	110
Imports of old tyres to be restored (retreaded) under conditions specified by separate laws	none	none	none	none	none	140	154	222.9	282.9	344
Imports of old tyres	120	120	120	120	129.6	350	500	1300	1700	2100
Environmental product charges on packaging materials (HUF/kg)										
Plastic, PVC, materials containing PVC	10	10	10	10	11	11.5	12.7	25.5	29	30.4
Combined	8	8	8	8	9	11.7	15.2	30.4	35	36.8
Aluminium	5	5	5	5	5.4	5.5	5.6	11.1	13	13.7
Metal (except for aluminium)	4	4	4	4	4.3	4.3	4.3	8.6	10	10.5
Paper, wood, natural textiles	3	3	3	3	3.3	4.3	5.6	11.1	13	13.7
Glass	2	2	2	2	2.2	2.1	2.1	4.1	5	5.3
Other	5	5	5	5	5.4	5.5	5.6	30.4	35	36.8
Environmental product charges on fuels (HUF/litre)										
Motor petrol	2	2	2	2.3	2.3	2.6	are incorporated in excise duties			
Diesel oil	2	2	2	2	2	2.25	are incorporated in excise duties			
Environmental product charges on batteries (HUF/kg)										
Batteries filled with electrolyte	38	38	38	38	41	45	50	89.1	100.3	112
Batteries not filled with electrolyte	38	38	38	38	41	63	70	124.3	140	156
Environmental product charges on other petroleum products (HUF/kg)										
Lubricating oil	none	none	none	60.8	60.8	69.9	74.5	88	92.4	97

<i>Environmental product charges on refrigerators and cooling agents (HUF/piece, HUF/kg)</i>												
Environmental product charge rates applicable to new refrigerators												
Nominal refrigerating capacity	(HUF/piece)											
up to 120.00 litres	600	600	600	600	600	600	600	600	600	600	600	600
120.01–250.00 litres	1080	1080	1080	1080	1080	1080	1080	1080	1080	1080	1080	1080
above 250.01 litres	2800	2800	2800	2800	2800	2800	2800	2800	2800	2800	2800	2800
Quantity of coolant	(HUF/piece)											
up to 0.50 kg	150	150	150	150	150	150	150	150	150	150	150	150
0.51–2.00 kg	270	270	270	270	270	270	270	270	270	270	270	270
above 2.01 kg	700	700	700	700	700	700	700	700	700	700	700	700
Cooling agents (HUF/kg)												
Hard freon and CFC mixture	250	250	250	250	250	250	250	250	250	250	250	250
Soft freon and HCFC mixture	100	100	100	100	100	100	100	100	100	100	100	100
HCFC and HCFC mixture	none	none	none	none	none	none	none	none	none	none	none	none
Environmental product charge rates applicable to imported used refrigerators												
Nominal refrigerating capacity (HUF/piece)												
up to 120.00 litres	600	600	600	600	600	600	600	600	600	600	600	600
120.01–250.00 litres	1080	1080	1080	1080	1080	1080	1080	1080	1080	1080	1080	1080
above 250.01 litres	2800	2800	2800	2800	2800	2800	2800	2800	2800	2800	2800	2800
Quantity of coolant (HUF/piece)												
up to 0.50 kg	150	150	150	150	150	150	150	150	150	150	150	150
0.51–2.00 kg	270	270	270	270	270	270	270	270	270	270	270	270
above 2.01 kg	700	700	700	700	700	700	700	700	700	700	700	700
Cooling agents (HUF/kg)												
Regenerated CFC and CFC mixture	none	none	none	none	none	none	none	none	none	none	none	none
HCFC and HCFC mixture	none	none	none	none	none	none	none	none	none	none	none	none
Regenerable HCFC	none	none	none	none	none	none	none	none	none	none	none	none
Regenerable CFC	none	none	none	none	none	none	none	none	none	none	none	none
Environmental product charge on thinners and solvents (HUF/kg)												
Thinners and other solvents	none	none	none	none	none	none	none	none	none	none	none	none
Paper used as advertising medium	none	none	none	none	none	none	none	none	none	none	none	none

Source: Appendices of annual state budgets

The need to curb environmentally harmful activities and to accomplish the necessary environment protection tasks had required and justified a marked increase of the existing product charges. This is why Clean Air Action Group welcomed the Hungarian Government's decision to raise significantly the applicable product charge rates and to introduce new ones, to be implemented in three stages, starting from 15th February 2003. Raising the environmental product charges is also justified because up until now in most cases they have only been increased at a much lower rate than the inflation. (See Table II.5.4.)

We were glad to see that in keeping with our former proposals, as from 2003 the scope of environmental product charges is extended over thinners and solvents as well, the production and use of which cause serious harm to the environment and which can be substituted by other, more environmentally friendly products.

The primary objective of introducing environmental product charges on thinners and solvents (mainly implying lacquers and paints) is not to raise the funds needed to cover the costs of removing the resultant damage or eliminating the produced waste, but rather to make those responsible pay for the environment pollution they cause and **to encourage them to restructure their production in an environmentally friendly manner**. Larger companies using state-of-the-art technologies are capable of manufacturing paints that are qualified as environmentally friendly products – such paints actually account for nearly 50 per cent of the Hungarian production – and so it is reasonable to promote the general use of such paints and to increase their market share. The generated funds should be spent partly on supporting the establishment of a uniform advanced qualification system to classify products into appropriate hazard categories, and partly on awareness raising programmes to further a shift in people's attitudes.

We do not think that it would be right to put into effect a former plan of the Hungarian Government to impose environmental product charges also on paper used as information carrier medium. This measure would result in an increased tax burden to be borne by cultural products which contribute to improving citizens' access to culture, education and information (and, last but not least, also to environmental awareness raising). Most of these publications are designed and produced for long-term use (e.g. books), which means that in the foreseeable future they will not be discarded as waste. Considering the environmental policy aspects of the issue, such regulation would also be counter-productive since it would provoke antipathy just in those who should be definitely won over to the cause of environmentalism. Another factor to be taken into account is that almost all member states of the European Union

use preferential or extra preferential VAT rates as a means to support products which contribute to propagating their national culture and language. For example, even Great Britain, homeland of the most universally used language in the world, applies a 0 % VAT rate to books, newspapers and magazines. Consequently, environmental product charges planned to be levied on paper used as information carrier medium would weaken the position of the Hungarian culture and language. However, we think that full support should be given to plans of imposing a product charge on paper, if its scope is limited to paper used as advertising medium (leaflets, etc.). (Another option would be to increase the pertinent rate of cultural contribution charged on advertisements and to redirect part of the collected revenues into the Environmental Protection Fund. Chapters 7.3. and 7.4. of the present document contain details regarding the proposed rate of, and the reasons for, such an increase.) Accordingly, Clean Air Action Group agrees with the decision that as from 15th February 2003, paper used as advertising medium is subject to the payment of an environmental product charge in Hungary.

In connection with environmental product charges it is worth remembering that the "polluter pays" principle is a key principle of the European Union and a basis for the harmonization of legal regulations (included, quite rightly, in the currently effective Hungarian environmental protection law as well). This is why we think that claims by producers to have a right to dispose of the paid product charge are unfounded. Revenues generated from this source should be regarded as a (usually only partial) compensation for the damage caused by the pollution and should be used in the most efficient manner possible to promote the interests of environment protection (e.g. for the purpose of reducing the quantity of disposable wrapping).

As a result of increasing the rate and extending the scope of environmental product charges in line with our proposals, the state budget would realize additional annual revenues worth around HUF 5 billion.

5.5. Increased mining taxes

We are proposing an increase of mining taxes to a rate which enables the Hungarian state to collect substantial additional revenues from this source. The taxes could serve the purpose of protecting Hungary's non-renewable natural resources and irreplaceable reserves of raw materials as well as relieving the adverse environmental effects of mining activities. Unfortunately, recent years have seen a declining trend in collecting revenues from mining taxes: in 1999, such revenues only

amounted to less than one third of the revenues collected in 1995. This is especially sad because these revenues are by far less than the costs of restoring the damage caused by mining. It is essential, particularly in the light of Hungary's EU accession, to increase the funds available for this purpose. EU sources could also be acquired and involved in such projects.

a) Mining taxes on hydrocarbons

The largest part of mining tax revenues comes from taxes paid on the production of hydrocarbons (in 2001, HUF 12.1 billion from the total of HUF 13.9 billion).

Domestic prices of hydrocarbons are usually adjusted to the price of imports (in the case of natural gas, this is effected with a delay of 9 months). It would be an untrue statement to claim that at present MOL Co. incurs losses

on the domestic sales of hydrocarbons. *Table II.5.5.a.* illustrates that in 1999 the actual prices of imported natural gas reached the lowest level recorded in the previous few years by falling to 15.08 HUF/m³. In 2001, import prices of hydrocarbons increased to peak levels, while in 2002 their annual average has dropped slightly.

In *Table II.5.5.b.* we have demonstrated that thanks to the favourable production conditions within Hungary, in the event that the full import price is applied, MOL Co.'s mining division realizes annual extra profits worth between HUF 65 and 149 billion over and above the currently paid mining taxes. This proves that the payable rate of mining tax on these mining products, constituting the property and wealth of the Hungarian nation as a whole, has been set too low, which ultimately means that the stock exchange rate of MOL Co.' shares has

Table II.5.5.a.: Changes in imports of hydrocarbons

Product	Unit	1994	1995	1996	1997	1998	1999	2000	2001	2002
Crude oil	thousand tons	5821	5872	5512	5480	6738	5755	5776	5579	5030
	PJ	239	241	226	225	276	236	237	229	206
	thousand USD	590623	678748	766637	688389	542925	671887	1103980	896017	834651
	million HUF	63311	84935	116902	126301	115914	162560	314338	257551	213385
	USD/t	101.5	115.6	139.1	125.6	80.6	116.7	191.1	160.6	165.9
	million USD/PJ	2.47	2.82	3.39	3.06	1.96	2.85	4.66	3.92	4.05
	HUF/t	10876	14464	21207	23046	17203	28247	54420	46166	42424
Petroleum products	thousand tons	2485	1665	1643	1537	1555	1291	1087	1284	2096
	PJ	102	68	67	63	64	53	45	53	86
	thousand USD	373308	256228	258320	240896	201868	198704	293553	322750	454203
	million HUF	39403	32068	39640	45234	43291	47161	82636	92544	117027
	USD/t	150.2	153.9	157.2	156.7	129.8	153.9	270.1	251.4	216.7
	million USD/PJ	3.66	3.75	3.83	3.82	3.17	3.75	6.59	6.13	5.29
	HUF/t	15856	19258	24122	29423	27844	36525	76043	72071	55839
Natural gas	million m ³	5640	6719	9460	7526	7692	9261	9648	9394	11096
	PJ	228	228	322	278	300	315	328	319	377
	thousand USD	490996	592958	834740	821800	730413	591825	1008097	1250863	1199755
	million HUF	51645	74377	126910	151726	155714	139642	284509	358190	312417
	USD/thousand m ³	87.05	88.25	88.24	109.20	94.96	63.91	104.49	133.15	108.13
	million USD/PJ	2.15	2.60	2.60	2.95	2.44	1.88	3.07	3.92	3.18
	HUF/thousand m ³	9156	11069	13416	20161	20244	15079	29488	38129	28157
Electricity	million kWh	2359	2781	3479	4171	3328	3334	4903	5236	4888
	PJ	24	28	35	42	33	33	49	52	49
	thousand USD	48961	61133	90249	104099	87432	106688	135399	152344	172291
	million HUF	5171	7749	13753	19088	18698	25110	37930	43627	44470
	USD/thousand kWh	20.75	21.98	25.94	24.96	26.27	32.00	27.61	29.10	35.25
	million USD/PJ	2.08	2.20	2.59	2.50	2.63	3.20	2.76	2.91	3.52
	HUF/kWh	2.19	2.79	3.95	4.58	5.62	7.53	7.74	8.33	9.10

Source: Foreign trade statistics as per HS classification of goods

been illegally manipulated. (By virtue of Article 298/A of the Penal Code, the manager of a company commits an offence by supplying misleading data on the assets of the company. Moreover, by virtue of Article 299/A of the Penal Code, those concluding securities transactions, or having such transactions concluded, to gain benefits by making use of insider information, commit a crime.)

If mining tax rates are determined on the basis of the import price level, originally proposed by Clean Air Action Group – which will soon be effected as a result of a recent resolution of the Hungarian Government – , we may reckon with the following impacts:

- Petrol station retail prices of fuels would not change, for they would continue to be set on the Mediterranean price base. Raising the price of petroleum produced within Hungary to the Russian import price base would not put an end to the profitable operation of MOL Co.'s petroleum refining plants. It would only lower the rate of extra profits realized as a consequence of the (in our opinion, unlawful) undervaluation of the Hungarian production.
- Even today, domestic natural gas prices are higher than the increased import purchase prices. The costs of imports will drop in the wake of subsiding international price fluctuations. In addition, it is advisable to change over the most expensive imports which use the Baumgarten pipeline to direct Russian barter purchase transactions. (At present, even the Baumgarten natural gas is of Russian origin. It is transited through the Slovak Republic into Austria, and arrives from there into Hungary, which means that it makes an unnecessary round trip in this region. This, again, contributes to making it more expensive than direct imports. On the other hand, this does not enhance Hungary's security, because more than the half of EU natural gas imports comes from Russia. As a consequence, if Russia fails to deliver, natural gas could not be procured from Western Europe either.)
- The Hungarian state budget would realize extra net revenues worth HUF 40 billion annually. This would bring about double benefits. On the one hand, personal income tax payments can be lowered by this sum, which in turn – among other favourable impacts – would restrain inflation. On the other, extra profits that are realized and may be repatriated by foreign shareholders would diminish, and Hungary's balance of payment would be improved by this amount.

**Table II.5.5.b.: Profit on petroleum and natural gas production using import prices
million HUF**

Description	1997	1998	1999	2000 *	2001	2002 expected**	2003 forecast
Net sales revenues	22618.7	24701.1					
Operating profit	725.9	2723.2					
Estimated prime cost	21893	21978	25384	27669	30021	31822	33095
Produced hydrocarbons (PJ)	222.8	200.9	184.1	173.4	170.1	153	150
Prime cost of 1 PJ (million HUF)	98.3	109.4	137.9	159.6	176.5	208	220
Imported hydrocarbons (PJ)	503.1	576.0	551.0	565	548	548	550
Imported hydrocarbons (million HUF)	278027.3	271628.3	302201.7	598846.6	615741	505963	446646
Import price of 1 PJ (million HUF/PJ)	552.7	471.6	548.5	1059.9	1123.6	923	812
Import duty burden***	580.3	483.4					
Hungarian production at import price	129289.4	97105.3	100971.6	183787.6	191126.9	141154	122029
Less: Prime cost of Hungarian production	21892.9	21977.9	25384.5	27669.1	30021.0	31822	33095
Less: Mining tax MOL Co.**	15171.2	10480.1	10060.8	11848	12067	13554	13787
Extra profit of mining (net yield)	92225.3	64647.3	65526.3	144270.5	149038.9	95777	75146

*2000 fact: Data published by the Central Statistical Office of Hungary for total sales of petroleum and natural gas production and supply: HUF 13.96 billion

**2002 expected: calculating with factual data of the period from January to September

***Up until June 1998, a 5 % customs duty allowance and statistical duty had been imposed on imports, which was subsequently released by the Ministry of Finance

Source: Central Statistical Office of Hungary, Foreign trade statistics, Tax and Financial Auditing Office, State budget bills of the Ministry of Finance (T/3122)

Table II.5.5.c.: Production of mineral raw materials and mining taxes paid on production in 2001

Mineral raw material	Production of mineral raw materials (million t)	Mining tax paid upon production (million HUF)	Mining tax paid per 1 ton (HUF/t)
Black coal	0.57		
Brown coal	5.26		
Lignite	8.04		
Coal in total	13.87	1008144	72.67
Bauxite	1.00		
Manganese ore	0.04		
Uranium ore	0.00		
Mineral mining raw materials*	3.08		
Ores in total	4.08	135125	33.13
Cement and lime raw materials	5.39		
Construction and trim-stone raw materials	13.79		
Sand and gravel	32.16		
Construction raw materials in total	51.34	666760	12.99
Ceramic raw materials	5.52	27589	5.00

*Dolomite, magnesite, magnesium silicate

Source: Hungarian Mining Office (www.mbh.hu)

Considering all the above factors, we may conclude that it is economically justified to raise the rate of mining taxes, and, in our opinion, it is also mandatory under Hungarian laws. We propose that as from 2004, mining taxes on petroleum and natural gas be raised by an additional HUF 40 billion over and above the current HUF 16 billion, i.e. their total amount should be at least HUF 56 billion.

Since the start of hydrocarbon mining in Hungary, no significant recultivation has been carried out. On the other hand, Hungarian hydrocarbon resources are being rapidly depleted. Hungary cannot afford it that revenues realized from the current higher prices are not spent on rehabilitation. MOL Co., naturally, seeks to meet the expectations of its (predominantly foreign) shareholders to maximize its profits, which, after taxation, may be repatriated by foreigners. (This contributes to the deterioration of Hungary's balance of payments as well.) If the recultivation is implemented, it will create a market for the Hungarian environmental protection industry, adding to its strength and possibly developing its export capabilities.

The austerity measures of the so-called Bokros package have taken away from the value of mining taxes the 10 per cent portion which was supposed to be used for the elimination of environmental damage caused by mining activities. In our opinion, this was contrary to the Hungarian Constitution and the provisions of the Act on Environment Protection, which is another reason why it is necessary to restore this part of the mining tax.

We recommend that part of the amount resulting from the increase should be returned to the companies concerned for the purpose of restoring the damage caused by mining. This would enhance their economic value and

performance. For instance, the stock exchange rate of MOL Co.'s shares could also be improved as a result.

b) Mining taxes on mineral raw materials other than hydrocarbons

At present, the Hungarian state budget only realizes negligible revenues from mining taxes paid on construction material type mining products: only less than HUF 0.7 billion in 2001, despite registered production totalling 51.3 million tons. (We may presume that considerable volumes are produced illegally, too, over and above the registered amount.) The average mining tax payment on construction materials came to 13 HUF/ton, which is a ridiculously low value. Besides that, 5.5 million tons of ceramic construction materials were also mined in 2001, and a mere HUF 27.6 million were paid as mining taxes on those materials, that is, only HUF 5 per ton. (See Table II.5.5.c.)

Low rates of mining taxes have multiple adverse effects:

New raw materials are used even when the secondary use of part of the construction materials could be arranged on the spot, which would also alleviate environment pollution caused by transportation.

These mineral products are non-renewable raw materials, so the mined materials cannot be replaced. As a consequence, Hungary's natural resources are reduced by their volume.

Mining itself entails considerable environment pollution.

Low mining tax rates provide false orientation to business organizations, which is clearly illustrated by the following example of exports into Austria:

The ex border average price (inclusive of the transportation costs up to the country border) of the 715 thousand tons of stone, pebble and sand exported into Austria in 2000 was as low as 2.8 EUR/ton, which testifies to the extremely low rate of mining taxes (see Figure II.5.5.).

It would be worthwhile to look into the question of who might possibly be motivated to export such products into Austria at an average price of only EUR 2.8 per ton, considering that transportation costs alone are higher than that. These transactions did not only cut down state budget revenues from mining taxes, but also caused damage to the environment and infrastructure of Hungary by transporting such volumes of goods. Moreover, secondary utilization of waste construction materials is hindered or sometimes even made impossible by such practice.

We recommend that instead of the currently effective rate of a few tenths of per cent the applicable rate of the mining tax should be 12 per cent of the in situ value (i.e. the value near the mining production value). Our calculations – which took into account the 2002 production level – have shown that this would bring about extra revenues worth some HUF 3.8 billion. Owing to the setback of production, however, this could realistically increase revenues by some HUF 3 billion. This sum should be entirely devoted to promoting the secondary use of construction materials. (The quantity of construction waste would also be reduced as a result – by several millions of tons a year.)

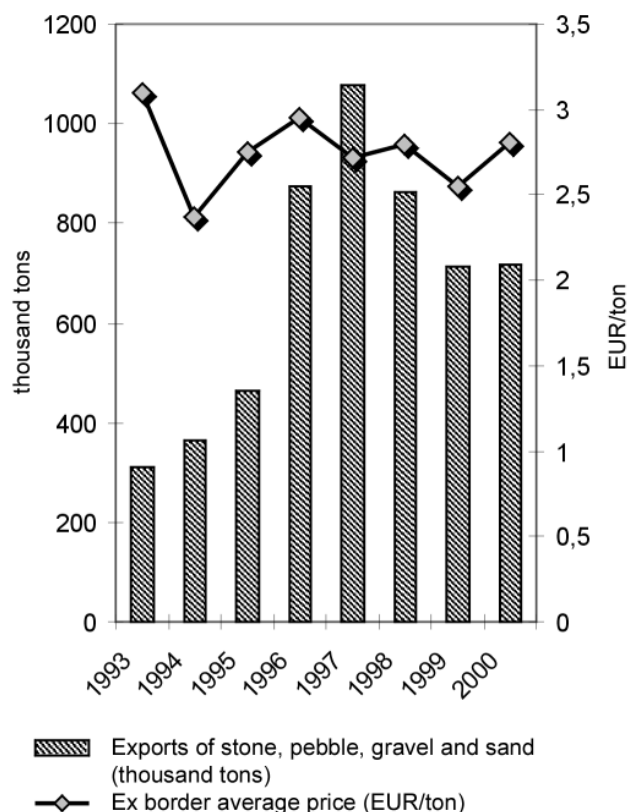
5.6. Stricter rules for the treatment of hazardous wastes

Both the effective Act on Waste Management and Hungary's commitment to comply with several international agreements require stricter regulations and penalties concerning hazardous wastes, as well as enhanced control of the enforcement.

Electronic wastes add new types to the range of hazardous wastes and also increase their quantity. As regards everyday consumption goods, the widespread use of batteries causes increasingly serious problems.

In Hungary, among all hazardous wastes, the so-called red mud has the largest volume, estimated at some 30 million tons, as a result of accumulation over several decades. The red mud comes from processing aluminium oxide. The problem is twofold here. On the one hand, the accumulated waste material consti-

Figure II.5.5.: Exports of low-specific-value goods into Austria



Source: Foreign Trade Yearbooks of the Central Statistical Office of Hungary

tutes an environmental hazard. On the other, production of aluminium oxide and hydrate is still going on today – although in reduced quantities. While processing one ton of aluminium oxide, two tons of hazardous substances are produced.

The environmental problem posed by red mud has been recognized by professional circles:

- waste banks take away valuable lands from agricultural cultivation,
- dry red mud is carried by the wind as dust-clouds even to distant (10–15 km) inhabited areas,
- the mud's diluted lye content ($\text{Na}_2\text{O}_\text{e} = 5\text{--}6 \text{ g/l}$) infiltrates into the soil, which represents a hazard for the vegetation and the region's drinking water supply

During privatization, the new proprietors assumed a contractual obligation to remove the environmental damage worth around HUF 10 billion. Up until today, however, no information has been published about any measures taken, although under current Hungarian laws such news are considered as information of public concern.

Storage and treatment costs of a single ton of red mud can be estimated at HUF 50 to 100 thousand. In addition to the accumulated waste material, the restart and expansion of the production of aluminium oxide and hydrate may cause damage worth HUF 5 billion annually due to hazardous wastes, not including indi-

rect state support through relatively low domestic prices of energy that is provided for the highly energy-intensive aluminium oxide processing plants.

Hungary's accession to the EU requires extremely strict measures in this area.

We recommend that a comprehensive international campaign should be launched to remove and utilize the red mud dumping grounds. We should request assistance from the EU and other developed countries to re-use or remove that waste material in an environmentally safe manner. The Hungarian Government should elaborate a specific programme to achieve this goal. Several thousands of people could find long-term jobs as a result.

Removal of the environmental damage, undertaken at the time of privatization, should be launched. Consequently, further dumping of red mud should only be authorized in a fully neutralized manner on condition that the recultivation should also be started. In the near future this will not result in any state budget revenues, but thereafter the state will be relieved from the burden to finance the environmental damage removal worth several tens of billions of forints.

5.7. General and mandatory use of deposit refund

Elaboration of a concept on the scheme of deposit refund has been going on for some time in the Hungarian Ministry of Environmental Protection. This work should be continued in close cooperation with the Ministry of Agriculture and Rural Development. Introduction of deposits on specified products would

- protect the environment,
- cut back on inflation, because instead of the high costs of disposable packaging, deposits would be introduced, which do not generate practically any inflation at all and which are refunded to the consumer,
- protect domestic industry,
- promote the development of the Hungarian environmental protection industry,
- reduce waste production allowing to save waste treatment and disposal costs.

The anti-inflationary effect generated here would lessen the impact of price rises caused by other product charges.

6. Protection of green areas and arable land; taxes promoting environmentally friendly agriculture

The area of arable land, one of Hungary's most valuable assets, is decreasing at a quick rate. The area of land taken out of agricultural utilization comprised only 6.6 per cent of the country's total area in 1938. Then this portion increased to 11.5 per cent in 1990, and in 1996 it already reached 13.8 per cent. (It is important to note that the pertinent statistical data have not properly reflected the real changes taking place in Hungary in recent years. Therefore we recommend that in addition to traditional statistical methods, space photographs should also be utilized for the continuous monitoring of changes in land use practice.) Industry, mining, transport, commercial and residential buildings, as well as other facilities occupy more and more valuable land – virtually irreversibly. Growing suburban areas, exploding road transport, ever-growing numbers of shopping centres and other green-field investments cause serious harm not only to the physical environment, but often to the entire national economy and society as well. One of the main reasons of the problem of destroying arable land and green areas can be found in the inappropriate price system. The price of land in Hungary is only a fraction of that in Western European countries, but even western prices fail to represent all the factors that determine the real value of land. If implemented, our proposals listed below, and described in detail in Appendix 12 to this document, could help land prices move closer to the real values. They could also encourage investors to prefer brown-field sites (areas of land, not covered with green surfaces, which have been deteriorated due to former industrial or other use) to green-field ones for their investments, which would be beneficial for both the environment and urban development.

Similar measures are planned to be taken in several EU countries. In Germany, the Parliament's Human and Environmental Protection Committee (Enquete-Kommission „Schutz des Menschen und der Umwelt") made a proposal in its report completed in 1998 to introduce taxes of this type in order to protect arable land and green areas. The measures proposed by the Committee are estimated to reduce the annual shrinking of arable land by 90 per cent by 2010, as compared to that of 1995. The British Government is also considering using taxes as means of attempting to protect green areas and to restrict the area of land available for housing, industrial and road construction purposes.

6.1. Increased land protection fees

Paragraph (1) of Art. 52 of Act LV of 1994 on Arable Land says: „When arable land is utilized for other than agricultural purposes, a one-off land protection fee shall be paid to an account specified by a separate statute."

At present, however, land protection fees are so low and there are so many ways to gain exemption from the payment that they do not provide adequate stimulation to preserving arable lands. Therefore, the applicable rates of land protection fees should be multiplied (see Appendix 12). Raising the fees could prevent the squandering of arable land, one of Hungary's most important national assets.

The goal of this measure is not to generate extra revenues, but to force back markedly the utilization of arable land areas for other than their core purpose. Unfortunately, however, current land prices in Hungary are so low that, despite a high rise in the rate of the fees, it cannot be expected that thereby we can provide adequate protection for the country's arable land. Nevertheless, even so, some results may be achieved; therefore we deem it an urgent task to carry into effect the increase. Extra revenues generated as a result – collected by the Ministry of Agriculture and Rural Development – can be estimated at HUF 20 to 30 billion annually.

The current practice of collecting land protection fees should be investigated to find out whether they are in fact always properly collected. If the findings of such assessments indicate the contrary, appropriate measures are to be taken without delay.

6.2. Extended scope of land protection fees

Act LV of 1994 on Arable Land defines arable land as „land that is registered in the outskirts of settlements in the cultivation category of plough-land, vineyard, orchard, garden, grassland, reeds and forest, or as fish pond."

Land protection fees should be imposed not only on the types of land that are defined by effective law as arable land, but also on any other areas which are at present green areas or non-built-up areas (potential green areas). Furthermore, land protection fees should

be significantly higher for such areas within the boundaries of towns and villages than for areas in the outskirts of settlements. Contrary to the currently effective provisions of Act LV of 1994 on Arable Land, land protection fees should also be paid when arable land areas or non-built-up areas are intended to be destroyed by housing constructions or by any other means.

Even though this tax is not designed to increase state revenues, the modification of the statute may bring, roughly estimated, extra revenues worth HUF 10 to 20 billion annually for the Ministry of Agriculture and Rural Development.

6.3. Introducing up-to-date appraisal methods for the evaluation of trees and shrubs

The current practice of assessing the price of a tree cut is to determine its value as firewood. It is needless to say that such a price is far from being the real value of the tree. This is true everywhere but it is especially so in densely inhabited parts of settlements. Several methodologies have been elaborated to assess the real value of trees and other plants. One of them is the so-called Radó-Párkányi method, which is based on a foliage equivalent. This methodology has been published by the Ministry of the Interior as a recommended way of assessment. Another method is a simplified, but more clear-cut calculation which takes into account the girth of the tree. Value-proportionate protection of the vegetation could be achieved through the modification of the currently effective Government Decree on the Protection of Trees. Pertinent proposal of Clean Air Action Group can be found in Appendix 13. (We have been informed that the Ministry of Environmental Protection intends to submit a bill instead of a modification of the Government Decree. In principle, we can support this initiative, because a law is capable to secure a more efficient protection for trees. On the other hand, it is to be feared that the legislation process may take a longer time, which definitely should be avoided. Our proposal prepared for the modification of the Government Decree could also be used for the elaboration of the new law.)

It is extremely difficult to estimate the extra revenues that local governments may realize as a consequence of this measure. But the primary goal here is not to generate further revenues but rather to prevent green areas from being destroyed. The state budget would only realize indirect benefits – from better environmental conditions, healthier lifestyles and more rational management of Hungarian towns and villages.

6.4. Environment-oriented taxes on agricultural production

Agriculture needs to operate in a way which causes the least possible harm to the environment. This is an indispensable prerequisite to making the Hungarian agriculture sustainable also in the long run and to enable Hungary to join EU agrarian programmes. Environment-oriented taxation imposed on agricultural production could be one of the means to achieve those objectives. The taxes can be divided into three groups:

- a) progressive ecological taxes on different types of agricultural activities; the rate would vary depending on the degree the activity concerned fits in with its environment;
- b) bracket progression of ecological taxes depending on the intensity of land use;
- c) differentiated taxes on unit expenses by agricultural production sites.

Further research is necessary to calculate the extra revenues arising from such measures. We recommend that the realized revenues should be used for agriculture-related environment management purposes.

This subject is discussed in detail in Appendix 2.

6.5. Transformation of the agrarian subsidization system

The European Union's agrarian subsidization system (CAP) does not promote either the competitiveness of the Hungarian agriculture or nature-friendly farming. It jeopardizes the still existing comparative advantages of the agrarian sector. The funds flowing in as part of the CAP cause more damage than benefits, because they – as production subsidies – promote, and contribute to, the widespread use of intensive farming methods. It is necessary that independent expert analyses be prepared on the subject.

In the European Union, economic pressure groups interested in intensive agricultural production have extremely powerful interest enforcement capabilities. Their influence can be felt in Hungary, too. In our opinion, it is unacceptable that by using periodical overproduction crises as the reason, they expand certain production lines that are harmful to the environment and human health, and can only be made economically viable by substantial tax allowances and subsidies: such as bio-petrol, fuels produced from alcohol, genetic engineering.

From a market and consumer protection viewpoint, we think that similar dangers are implied by the an-

nouncement of the food processing sector saying that as from 2004, they intend to procure basic materials (pork, cereals and vegetables) from the cheaper EU markets. In the long run Hungary is interested in preserving and reinforcing the practice of giving priority to the quality, rather than the quantity, of production (animal husbandry without using antibiotics, broad range of varieties, fruit-growing in river flood basins, etc.).

We recommend that the system of agricultural subsidies should be transformed in a manner to increasingly promote the implementation of the National Agrarian Environmental Protection Programme. This would involve regrouping of funds within the budget of the Ministry of Agriculture and Rural Development – according to our proposal, in a value of HUF 20 billion in 2004 (for details see Appendix 2).

6.6. Introduction of a charge on covering large areas

Large areas covered by concrete or asphalt eliminate the green areas needed for biological assimilation, which significantly deteriorates the state of the environment. Additionally, these hard-covered surfaces are unable to absorb rainwater; therefore the surrounding areas require larger sewer capacities, which entail substantial extra costs. We are proposing a charge on covering large areas to be paid according to the type of the covered surface.

Such charges have been successfully used, for instance, in Berlin. The city's entire area had been surveyed with a resolution of 5 square metres (!) to identify covered surfaces (rooftops, parking lots, roads, etc.). Thereafter, survey data were sent to each real property owner for confirmation. Based on the data, the charge to be paid on covered surfaces was calculated. Within a short period of a couple of months, total covered surfaces in the city were reduced by some 20 per cent. Owners of real properties were able to achieve this by using the following methods:

- on flat or slightly rising rooftops green roofs are formed;
- concrete surfaces are broken up in yards, and are replaced – where indispensable – by “green concrete” (concrete grate with grass growing in between) or by permeable crushed gravel;
- on the pavements, concrete or asphalt covers are substituted by cover tiles laid in sand (not in concrete!).
- Pavements, walkways and squares may have similar stone or cast-stone covers, which have multiple simultaneous advantages:

- they absorb precipitation, and then evaporate it when necessary, which creates air movement and a local cooling effect;
- soil will not be destroyed under the cover;
- it is easier to carry out repair work on public utility infrastructures;
- they are much more appealing to the eye.

We think that it is worth considering that the charges to be imposed should increase progressively above a certain size (e.g. 500 square metres of unbroken covered surface). Thorough preparatory work is needed prior to imposing the charge. Once this work is completed, the Hungarian Parliament should enact a law to specify the conditions and rates of the charge, and make the introduction mandatory for all local governments – following a period allowed for making the necessary preparations.

6.7. Lowering the rate of local trade taxes

In economies in transition, so-called activity-type (trade, tourism) taxes are more frequently applied than property-type taxes (ground-tax, added value tax).

Concerning trade taxes collectable by local governments of the area where business premises are located, one of greatest problems is that the taxes are not proportionate to the size of the settlement and the enterprise concerned. As a consequence, certain towns or villages have a disproportionately high tax potential, whereas the harms resulting from the activity concerned affect larger areas. Owing to such disproportions, local governments of smaller settlements are often willing to offer substantial tax allowances to attract investors.

In Germany, this contradiction is solved by distributing larger tax revenues among several local governments, on a regional level.

Experience has proved that taxes paid to local governments by local companies and entrepreneurs often have a critical impact on the state of green areas. That is why this issue is discussed in this chapter (although we are well aware that the interrelationship is much more complex, and that local trade taxes are in close connection with several other factors as well).

Local governments use all possible means to attract big investors, sometimes disregarding environmental and health protection considerations. Green areas are also often destroyed by such investments. One of the main reasons is that local trade tax is often a major source of revenues for local governments. (For instance, out of total revenues of HUF 213 billion of the Budapest Municipality in 2001, local trade tax accounted for HUF 104 bil-

Table II.6.7.: Changes in local tax revenues
million HUF

Description	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Building tax	200	2119	2294	3255	4145	8313	10752	13056	16629	22262	26138
Ground-tax	15	394	474	710	813	1296	1717	1811	2262	3099	3221
Communal tax (private)	304	420	530	516	747	1492	1980	2698	3422	4557	4933
Communal tax (enterprises)	646	933	1222	1200	1075	1174	1178	1161	1354	1192	1174
Tourist tax (on tourists' stay)	270	455	510	745	768	1505	1878	2147	2396	2942	3125
Tourist tax (on buildings)	92	400	407	309	363	461	524	637	824	892	1032
Trade tax	2500	12110	21652	27257	38472	66130	93133	124316	171476	186822	226084
Other, council tax	5451	390									
Local taxes in total	9478	17221	27089	33992	46383	80371	111162	145826	198363	221766	265707

Source: Ministry of Finance

lion, i.e. 43 per cent.) Consequently, there is a keen competition among local governments to “acquire” industrial plants, shopping centres, power stations and other environmentally damaging establishments. (Corruption is also heavily involved in this phenomenon.) As a matter of fact, the local trade tax often encourages local governments to play against each other and partly also to neglect the interests of their local residents. Gradual reduction or even abolishment of the local trade tax could calm down this destructive “competition”.

Another adverse impact of the currently applied local trade tax is that it only brings about significant revenues in advanced industrial areas, which means that the backwardness of regions falling behind will be exacerbated. This is unacceptable. On the other hand, taxation policies of individual local governments may vary; therefore the true interests of the regions concerned are not being enforced in many cases.

In the event that local trade tax is abolished, however, local governments would lose revenues worth some HUF 226 billion annually (see Table II.6.7.), which can be partly offset by other extra revenues included in our proposals. This would make the administration work related to local trade taxes unnecessary, which results in cost savings for the enterprises and local governments concerned, and also for the state. We have to point out that collection costs of this tax are extremely high – amounting to about the half of the collected sum –, which is another reason why it cannot meet the criteria of public taxes. As a consequence, lost net revenues can be estimated at only HUF 80 billion. Furthermore, this measure would

contribute to shifting excessive tax burdens from useful entrepreneurial activities to environment pollution. Some local governments have been making such efforts to increase their revenues from local taxes which already endanger the environment and quality of life of local residents (see the example of Budaörs, situated near the Hungarian capital).

6.8. Increasing the locally used portion of environment protection fines

Local governments should impose local taxes and charges in a manner that they contribute to restraining activities which are harmful to the environment and society. This objective can be achieved, for instance, by introducing and/or raising parking fees and road charges, and by imposing penalties more frequently and at the highest possible rate allowed by legal regulations. To facilitate the latter measure we propose that the portion of the environment protection fines remaining with the local government concerned be raised from the current 30 per cent to 60 per cent. On the other hand, we recommend that the rate of these fines should be considerably increased.

It is important to underline that local trade tax should only be reduced or abolished if, concurrently with that, other sources of funds are made available for local governments to make up for their lost revenues.

7. Increased taxes on luxury goods and higher cultural contributions

7.1. Increase of excise duties on tobacco products at a rate exceeding the consumer price index

Throughout the 1990s, right up to 1999, the rise of consumption taxes (excise duties) on luxury consumer goods (alcoholic beverages and tobacco) has not kept pace with the rate of inflation in Hungary. This has been an indirect encouragement for consuming these injurious products – which is contrary to the interests of the society as a whole (primarily afflicting families). This adverse trend reversed in 1999, when the Government, quite rightly, started to bring excise duties on tobacco products closer to the rate applied in the EU. This process should have been further accelerated afterwards so that the rate of excise duties on tobacco products could equal the EU level already as from 1st January 2003. Excise duties on tobacco products rose by 14 per

cent in 2001. During 2002, the applicable rate was raised twice. (The current Hungarian Government increased the duties earlier than the originally planned 1st January 2003, already with effect from 15th August 2002. Instead of the HUF 3,435 paid up until that time on 1000 pieces of cigarettes, the payable rate of excise duties went up to HUF 4,200, i.e. this tax increased by 22.2 per cent. Even the excise duties imposed on small cigars, formerly of a lower level, were brought up to the rate applicable to cigarettes.) In 2003, this tax will be raised in the mid-year period as well. So, we are glad to see that Clean Air Action Group's proposal to raise taxes on tobacco products at a higher rate than the inflation has in fact been put into practice in recent years.

The following analysis provides an instructive example of the situation in Hungary: In August 1996, consumer prices of tobacco products were 36.1 per cent higher than in the previous year. Consumption taxes, however, increased only by 7.6 per cent over the same period, i.e. while prices went up significantly, the con-

Table II.7.1.: Summary of calculated economic losses caused by smoking (at 1995 prices)*

Areas of assessment	Costs and losses of income imputable to smoking	
	minimum value	medium value
	billion HUF	
Direct impacts		
Loss of income due to sickness	14	31
Hospital treatment	5	5
Disability pensions (1 year total)	6-7	6-7
Sick pay	2-3	5-6
Out-patient and district medical services	3	6-7
Subsidies on pharmaceuticals	4	10
Subtotal of direct impacts	34-36	63
Indirect impacts		
Loss of income due to death	300-310	300-310
Subtotal of indirect impacts	300-310	300-310
Total	334-346	363-373

*At 2001 prices these amounts are about the double of the indicated ones
Source: National Health Protection Institute of Hungary, 1996

sumption tax saw only a minor increase. As compared to 1996, domestic sales volumes (quantity) of tobacco products increased by 9.2 per cent in 1997. It means that the real-term drop of the consumption tax was not the consequence of lower consumption, but, just the opposite: consumption taxes went down while consumption was growing. During 1998, consumer prices of tobacco products rose by 19.9 per cent, whereas the average consumer price level only increased by 14.3 per cent. On the other hand, excise duty revenues from tobacco products grew by a mere 11.8 per cent, and most of this increase is estimated to come from the stricter enforcement of collection and from the unfortunate rising trend of consumption. It also means that unless consumption taxes rise at least by the rate of inflation, tobacco companies will be able to increase their extra profits at the expense of state revenues. Most of these profits are repatriated, which ultimately deteriorates Hungary's balance of payment as well. Additionally, the more such products are sold, the more damage is caused to people's health, and the ensuing healthcare costs are to be borne by the Hungarian society. All this clearly illustrates the worth of a similar anti-inflationary policy. Consequently, it has been a right practice in recent years to raise taxes at a higher rate than the inflation.

Inflation could also be lessened by launching a powerful programme to make people leave off smoking and to prevent them contracting this injurious habit. To achieve this goal, most of the extra revenues from tobacco taxes should be devoted to this task.

The excise duty rates applicable to tobacco products should be raised to the level of taxes in the European Union as soon as possible. EU regulations, compulsory for all member states, provide that taxes on cigarettes cannot be less than 57 per cent. In some countries these taxes have even higher rates than that: in the Netherlands, for example, 62.7 per cent, or in France 59.3 per cent. The Hungarian rate is significantly lower than that. It would favourably influence international opinion on Hungary if these taxes were adjusted to EU standards without delay and if this step was given adequate publicity abroad.

We cannot accept the argument that higher tobacco taxes would lead to increased smuggling of the product:

1. The bulk of cigarette smuggling is made up by taking cigarettes out of the EU legally and exempt from tax, and afterwards smuggling them back into the Union. Hungarian cigarette prices have no influence whatsoever on these transactions.
2. If cigarette prices in Hungary are lower than in the European Union, it is an incentive to smuggle them from Hungary into the EU countries.

3. Already today, there is a substantial difference between cigarette prices in Hungary and in some nearby (non-EU) countries. The proposed increase will not change this situation significantly; therefore it will not contribute to growing smuggling. Even without the increase of tobacco taxes, cross-border smuggling should be stopped by strong enforcement of measures and sanctions.

Should excise duties on tobacco products be raised to the level in Austria, state budget revenues might well increase by tens of billions of forints compared to the current amounts. Counting with more effective measures taken by the government to curb black economy, collection of those substantial additional revenues (including VAT as well) can be realistically expected. **The entire amount so collected should be transferred to the Health Security Fund.**

Health damaging and other harmful effects of the mentioned products amount to many times this sum every year. Research studies carried out in the United States of America and in the EU have proved that social costs related to smoking are much higher than state revenues from taxes imposed on tobacco products. A similar study, prepared jointly by GKI Gazdaságkutató Rt. and Alius Kft. (economic research firms), has concluded that in Hungary the amount of social losses incurred owing to smoking totalled HUF 334–373 billion in 1995, which is HUF 660–741 billion at 2001 prices (see Table II.7.1.). It is important to note that the study's data may be regarded as underestimated, because several factors, such as fire and other accidents caused by smoking, have not been taken into account. (In Great Britain, 6.5 per cent of all industrial fire accidents are imputed to smoking, for example.) At the same time, state revenues from excise duties on tobacco products were not more than HUF 44 billion in that year. Other state budget revenues from the tobacco sector, amounting to HUF 18 billion, (VAT, customs duties, the health insurance part of social security contribution and of individual insurance fees) should not be considered here, because these revenues are designed to finance the general "overhead" costs of the society as a whole (just like similar revenues from any other economic sector). Moreover, losses are likely to be even higher because these taxes and contributions are not paid at all on most of the costs of smoking.

We estimate that extra revenues of around HUF 40 billion can be expected annually if excise duties on tobacco products are increased. From that sum we propose to use HUF 10 billion on health protection awareness raising, primarily on programmes against smoking and helping people breaking with the habit of smoking. (Hungarian tobacco companies spend roughly the same

amount on advertising smoking.) Additional tens of billions of forints of annual budget savings or extra revenues can be realized owing to the reduced level of damage caused by smoking.

7.2. Increase and efficient collection of cultural contribution charged on products and services involving pornography, sex and violence

Violence and pornography have become universal on television and video, in cinemas as well as in printed materials. It is needless to discuss here the serious harm they cause to society by contributing to the expansion of several adverse social phenomena (deviation, crime, etc.); social scientists, psychologists, educators and other specialists have already thoroughly expounded the subject. The scientific journal "Science" published in its issue of 29th March 2002 the findings of a research programme which has been going on for two decades. These results have proved beyond any doubt that such correlation does exist (*see issue 2002/7–8 of Lélegzet,*

Hungarian environmental monthly published by Clean Air Action Group). These harmful trends cause substantial losses to the whole society, which can be expressed in pecuniary terms as well. On these grounds, we have recommended that the rate of cultural contribution charged on products and services involving pornography, sex and violence should be raised from the 20 per cent rate applicable in 1998 to 50 per cent.

The same considerations have led us to propose an increase of cultural taxes on toy guns from the current 10 per cent rate to 30 per cent. On the one hand, we think that these toys, too, contribute to making children accustomed to violence, and as a consequence, also to the spreading of violent acts. On the other hand, by this gesture we would like to join the anti-war initiative of young people in Croatia who, among other things, urge that the sales of toy guns should be banned.

We were glad to see that the Hungarian Government and the Parliament have partly accepted our proposals for the rise, and with effect from 1999, the rate of the contribution payable on products and services involving pornography and violence has been increased to 25 per cent. However, in contrast to our recommendations, when elaborating the state budget for 2003, **further increases** were not carried into effect in line with the rates indicated in *Table II.7.2.* (we have shown the currently effective rates in square brackets).

Table II.7.2.: Proposed increase of the rates of cultural contribution imposed on products and services involving pornographic, sexual and violent features

Domestic Product Classification number	Description	Applicable rate of contribution %	Entity liable to payment of the contribution
Of 221120 (printed books, brochures, leaflets and similar products)	Products involving pornographic, sexual and violent features	[25] 50	Publisher (importer)
Of 221500 (postcards, greeting cards, pictures and other printed products)	Products involving pornographic, sexual and violent features	[25] 50	Publisher (importer)
Of 223200 (tapes and discs containing video recordings)	Products involving pornographic, sexual and violent features	[25] 50	Publisher
Of 223300 (magnetic tapes and discs, as well as compact discs containing data processing information)	Products involving pornographic, sexual and violent features	[25] 50	Publisher (importer)
Of 365041 (cards)	Cards involving pornographic, sexual and violent features	[25] 50	Manufacturer (importer)
Of 365042 (video game stations attached to TV sets)	Video games involving pornographic, sexual and violent features	[25] 50	Manufacturer (importer)
Of 11343 (Services Index number; lending goods and equipment for entertainment, cultural, sports and other leisure activities)	Lending products involving pornographic, sexual and violent features	[25] 50	Service provider
Of 1913 (Services Index number; films presented in cinemas)	Projecting films involving pornographic, sexual and violent features	[25] 50	Distributor (publisher)
365033 50 00	Toy guns	[10] 30	Distributor

Supposing strict collection of the contribution, extra revenues from this source are estimated to reach HUF 4 to 6 billion a year. It is essential to establish the necessary preconditions for the comprehensive collection of the cultural contribution. We were contented to receive news about the initiative launched by Zoltán Rockenbauer, former Hungarian Minister of Culture, aiming at achieving the same goal: "We are considering setting up a Film Centre, shaped upon a French model, which would handle state funds related to films, as well as the national stock of Hungarian films. The institution of film registration would also be allocated here, which would make it unavoidable that the 25 per cent cultural contribution imposed upon films propagating violence and involving pornography is in fact paid into the National Cultural Fund." ("Magyar Hírlap" Hungarian daily, 1st April 2000) However, we were sad to find that unfortunately this right concept has not been put into practice.

We recommend that this source should be used for financing the film, planned by the Ministry of Culture, based on the novel "Without a Fate" ("Sorstalanság") by Imre Kertész, Hungary's Nobel Prize winning writer (HUF 900 million).

The cultural contribution is collected by the Tax and Financial Auditing Office, but our experience has been that the definition of products and services upon which the contribution is to be imposed, the determination of the scope of those subject to payment of the cultural contribution, the efficiency of the collection, as well as the related controls and sanctions are very much under the required standard. Payment of the cultural contribution is based on self-assessment, but due to the mentioned deficiencies of the system it is practically untraceable how much contribution should be paid to the Tax and Financial Auditing Office, and how much revenues are in fact

collected. Those who choose simply not to pay this contribution, actually do not have to fear any sanctions because at present key information, which are indispensable for collecting this tax, are not available for the tax authorities. Clean Air Action Group has made several attempts to obtain information from the Tax and Financial Auditing Office about the modes of imposing the cultural tax, but has not been given any substantive response to its inquiries. During the exchange of letters with the tax authorities it has become evident that the authorities are unable to construe the pertinent rules of law. (The letters are available in the offices of Clean Air Action Group.) In our opinion, cultural contributions cannot be collected in compliance with statutory provisions, if the collecting tax authorities are not fully aware of the precise scope of products and services subject to payment of this tax. As a consequence, statutory provisions pertaining to cultural contributions are only partly useful means to achieve the socially desirable goal of this tax. The above statement is particularly true for cultural contributions imposed on advertisements, as well as on products involving pornography and violence. **Therefore we recommend that the pertinent rules of law should be modified to make them more accurate and unambiguous.**

7.3. Increase of cultural contribution charged on advertisements

We are proposing an **increase of cultural contribution imposed on advertisements by 14 percentage points** (see Table II.7.3.a. – the currently effective rates are indicated in square brackets). Extra revenues from this source should be used entirely for educational advertising.

Table II.7.3.a.: Proposed increase of the rates of cultural contribution imposed on advertisements

Services Index number	Description	Applicable rate of contribution %	Entity liable to payment of the contribution
222212 00 00			
(Domestic Product Classification number)	Technical advertising materials, trade catalogues and similar products	[1] 15	Publisher (importer)
143	Advertisements	[1] 15	Service provider
Of 143	Advertisements published in the printed press	[0.5] 15	Service provider
Of 143	Leaflets, advertisements distributed by post, promotion gifts, as well as advertisements published in papers in which advertisements occupy over 70 per cent of the total space	[0.5] 25	
913-5	Structures used for advertisements	[1] 15	Building contractor

**Table II.7.3.b.: Changes in advertisement orders placed with various types of media
(billion HUF, at current prices)**

Description	1996	1997	1998	1999	2000	2001	2001/1996
Television*	25.2	34.3	55.5	78.5	125.3	153.3	608.3
Daily newspapers	17.7	22.4	25.5	29.3	33.0	37.4	211.3
Periodicals	11.2	15.3	21.3	26.3	31.7	35.9	320.5
Cable television	4.1	15.4	25.2	16.5	4.3	6.1	148.8
Other**	12.7	15.0	17.8	22.4	30.0	34.2	269.3
Total	70.9	102.4	145.3	173.0	224.3	266.9	376.4
Total, at 2001 prices	126.4	154.4	191.6	207.4	244.9	266.9	211.1
* Out of which public service television							
Billion HUF		16.7			2.0		
Workforce (persons)		2765			1676		

(as a percentage of the previous year)

Description	1997	1998	1999	2000	2001
Television	136.1	161.8	141.4	159.6	122.3
Daily newspapers	126.6	113.8	114.9	112.6	113.3
Periodicals	136.6	139.2	123.5	120.5	113.2
Cable television		163.6	65.5	26.1	141.9
Other**	118.1	118.7	125.8	133.9	114.0
Total	144.4	141.9	119.1	129.7	119.0

(previous year = 100)

**Public places, radio, cinema ...

Source: Médiaágazás

Earlier we had proposed that a much higher (50 per cent) contribution rate should be imposed on leaflets, printed publicity materials distributed by post, as well as on advertisements published in papers and periodicals in which advertisements occupy over 50 per cent of the total space. Advertisements of that kind already inundate mail boxes, bother the population and cause substantial waste and environment pollution as well. (This is proved by the fact that more and more people put signs on their mail boxes saying that they do not want any publicity materials.) We were glad to see that the Hungarian Government has in fact accepted this proposal of ours, and with effect from 2003, it has imposed product charges upon the mentioned products. On the other hand, it is to be feared that the regulation is not accurate enough to ensure that this charge is properly collected. Therefore we urge that pertinent legal regulations should be modified to make them more accurate as soon as possible.

All the above is applicable to commercial advertising only. Educational and political advertising should be exempt from payment of the contribution.

The proposed modifications would greatly contribute to achieving the goals listed in the introductory part of the Act on Commercial Advertising, especially the objectives of protecting the rights of consumers, sustaining market competition to ensure economic efficiency and social welfare, and providing fair information to the public. Commercial publicity, by its very nature, only presents the advantageous aspects of the advertised product or service. A motorcar advertisement, for example, never calls the attention of the public to the serious environmental and health impacts of motor vehicle transport. Have advertisements of washing powders ever mentioned the environmental harm that these products cause by polluting live waters? Or, have commercials of food or drinks ever described all the beneficial or adverse impacts that the consumed products may have on the human body? We could continue listing the examples, which all prove that at present the interests of consumers are often disregarded, market competition becomes distorted and the public is not supplied with adequate and fair information. This situation, which is harmful for both the national economy and the Hungarian society as a whole, could be changed if

- advertisers paid for the above-mentioned damage,
- adequate funds were made available for educational advertising, independent from commercial advertisers, for purposes of consumer protection, health and environment protection, public safety, etc.

From an economic point of view, the cultural contributions imposed on advertisements may be regarded as the **costs of eliminating the negative externalities caused by commercial advertising**.

Freedom of the press may also be jeopardized if newspapers and periodicals are to a large extent dependent on commercial advertisements. The International Institute of Journalists published a report in 1997 saying: "Hungarian media companies and former party periodicals have only in principle the freedom to publish what they want; actually, increasing economic pressure causes the borderline between advertising and editing to become indistinct. ...Ten of the eleven daily newspapers in Budapest are admittedly on their way to go bankrupt, and the management cannot but demand that journalists humiliate themselves before people from whom they receive their salary, or else they take the risk of losing their jobs. Reporters write the required flattering pseudo-reports, and an ever increasing number of journalists are even zealous to do so, in exchange of obtaining, as a supplement to their salaries, 20 per cent of the advertisement fee paid by the advertising company to the newspaper." ("Magyar Nemzet" Hungarian daily, 6th January 1997) The risk could be lowered by opening up more opportunities to publish educational advertisements.

Some say that raising the applicable rate of cultural contribution would lead to a higher inflation rate. We do not think that this counter-argument is well-founded. On the one hand, the proposed increase by 14 percentage points would only cause a slight rise in the costs (in general less than half per cent) of the companies concerned. On the other hand, international experience shows that thanks to the accurate and unbiased information received, consumers are capable of achieving substantial savings (e.g. through energy saving methods), which, in turn, lead to lower rates of inflation.

We recommend that the cultural contribution should be imposed upon the gross value of the product concerned, i.e. that allowances must not be used for reducing the payable amount of contribution. Such cases should be considered as tax evasion.

The aggregate value of orders placed for commercial advertisements is growing steadily and significantly year after year (see Table II.7.3.b.). Before the ban was imposed on tobacco advertisements, representatives of the advertising industry "had frightened" those concerned by the prospect that revenues from advertise-

ments would substantially decrease as a result. Actual figures, however, have clearly proved since then that this prediction was perfectly groundless. The main aim of imposing cultural contributions is not to force back advertisements, anyway, but rather to enhance and make more colourful the range of advertisements.

The above-mentioned increase of the applicable rates of cultural contribution may bring extra revenues worth some **HUF 25 billion** annually.

Implementing this measure could raise adequate funds for non-commercial communications and educational advertising activities (see Section 2.7.1. and Chapter E. for details).

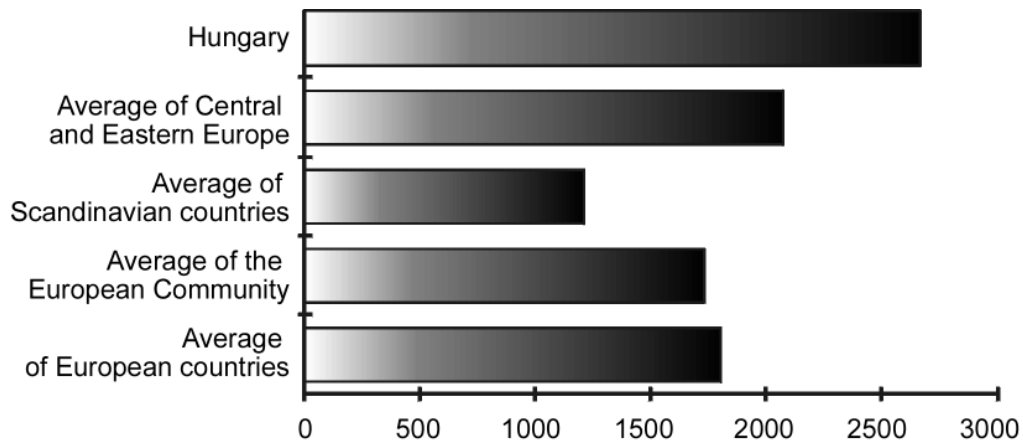
Extra revenues that come from cultural contributions imposed on advertisements published in the printed press, radio and television should be fully returned to the media that originally paid it in, on condition that they use it for educational advertising. It is important to involve non-governmental organizations working on the issue concerned in the preparation of such advertisements or publicity campaigns, because this can better ensure that the available funds are efficiently used. (For example, this may help avoiding publicity campaigns like the one conducted by tobacco companies, allegedly to prevent children from contracting the habit of smoking. The campaign's main slogan was: "Smoking is a custom of adults".)

It is worth noting that imposing surtaxes on advertisements is not uncommon practice in EU countries. In Sweden, for instance, a 4 per cent surtax has been levied on commercials published in newspapers, and a tax of 11 (!) per cent on other advertisements. In Austria, publicity is subject to the payment of a surtax of 5–10 per cent.

7.4. Stricter prohibition of tobacco advertisements

For many years, Clean Air Action Group has been strongly advocating the imposition of a comprehensive ban on tobacco advertisements. We have been working very hard, and successfully, towards achieving this goal, which was also recognized by competent decision-makers (see issue 2001/2 of "Lélegzet"). Therefore we were glad to see that tobacco advertisements were banned almost comprehensively in Hungary with effect from 1st January 2002. Unfortunately, however, tobacco companies often circumvent this prohibition by using various tricks: for instance, tobacco brands appear in giant letters as inscriptions of shops, or they are advertised via the Internet. This makes it essential that the pertinent regulations, con-

**Figure II.7.4.: Per capita consumption of cigarettes
(pcs/year)**



Source: National Health Protection Institute of Hungary

trols and sanctions are made even stricter. Clean Air Action Group supports the well-known position of healthcare organizations on the subject, which they have already expounded in detail on several occasions. We would like to mention here only two arguments which are less frequently quoted. It is common knowledge that the state of health of Hungarian citizens is among the worst of all European countries. Therefore, it is especially unethical to promote a habit that aggravates this problem. **A comprehensive prohibition, with no loopholes allowed, of tobacco advertisements** is an unavoidable issue for all governments, which launch attacks against **morally inadmissible activities and behaviour**. Another important factor to be taken into consideration is that at the time of privatizing Hungarian tobacco companies, the new proprietors purchased these firms at a value not including the possibility of advertising. Removal of the ban on advertisements allowed the mentioned companies to realize extra revenues worth several billions of forints annually. Consequently, tobacco companies should offset this by paying a one-off supplementary charge (of HUF 10 to 20 billion).

We have already mentioned earlier the external costs of smoking (i.e. the costs that are not paid by smokers only but by the entire society). On the Hungarian Parliament's session of 16th April 1996, György Szabó, Minister of Public Welfare, said the following about this subject: "Nearly all experts share the opinion that state budget revenues from smoking are notably less than the related expenditures which appear in the healthcare system. This is particularly true in a country where diseases of the cardiovascular system cause 52 per cent of all deaths, and cancer diseases have a share of 22 per cent, and when it is indisputable that smoking and these two dominant disease

groups are interrelated." Unfortunately, the extremely powerful tobacco lobby was at that time still capable of preventing the approval of the bills and amendment proposals aiming at a considerable restriction of tobacco products.

Imposing a comprehensive ban on the advertisement of tobacco products is especially justified by the fact that cigarette consumption in Hungary is extremely high in international comparison (see Figure II.7.4.). Spreading of this injurious habit among young people gives cause for particular alarm. Data of the Ministry of Sports and the Youth reveal that among pupils in the second year of secondary schools (aged 16), every third boy and every fifth girl smokes regularly.

A joint study of the World Health Organization and the World Bank has concluded that smoking may be cut back by 7 per cent in general if tobacco advertisements are prohibited. In the case of Hungary this means that as a result of banning tobacco advertisements, the damage caused by smoking – including healthcare expenditures – is reduced by HUF 45 to 50 billion a year. On the other hand, the study underlines that such favourable impacts will primarily emerge if the imposed prohibition is comprehensive.

Financial regulation of the Hungarian tobacco product manufacturing sector is extremely lax. For lack of more recent data, we will mention here a couple of relevant examples from earlier years. The tobacco industry was given considerable tax allowances (nearly HUF 1.1 billion in 1999), its profit on sales ratio increased from 8.9 per cent in 1996 to 21.5 per cent in 1999, whereas its profit after taxation rose from HUF 3.5 billion in 1996 to HUF 13.3 billion in 1999. In our opinion, an activity which causes more social damage than the value of its production, must not be allowed to have growing freely disposable funds, because in

practical terms this means that an activity causing damage (in this case health damage) to society is supported financially. This negative trend is also illustrated by the fact that between 1996 and 1999, profits after taxation went up by nearly 383 per cent in the tobacco industry, while excise duties levied on tobacco products only increased by 183 per cent.

We deem it necessary to abolish all forms of state subsidies granted to tobacco growing. We have been informed by tobacco producers that they would fully agree with such measures on condition that they obtain adequate support for switching over to growing other types of produce. We think that organic farming is best suited for this purpose, for it is an environmentally friendly and highly labour-intensive activity.

8. Modifications of the value-added tax

8.1. Keeping the 25 % VAT rate

Some government circles in Hungary have recently voiced their intention to reduce the upper rate of the value-added tax, which is currently 25 per cent. Considering what we have described in earlier chapters of the present document, we do not think that for the time being such reduction would be a rational step to take. Reduction of public charges should be implemented by cutting back the burden of taxes and contributions imposed on wages, rather than by decreasing the applicable 25 % VAT rate levied on consumption. If the government reduces the rate of the value-added tax, it will have less scope of manoeuvre to lower the taxes charged on labour, which runs counter to economic rationality and also contradicts the Hungarian Government's announced policy.

Decreasing the 25 per cent rate of the VAT would not serve the interests of entrepreneurs either. This has been demonstrated by a survey carried out by researchers of the Budapest University of Economic Sciences. One of the questions in their survey asked 1300 company managers about the impacts of various taxes and contributions upon the competitiveness of their enterprises. Their answers clearly revealed that consumption taxes and VAT affect the least their competitiveness, whereas social security contribution and personal income tax deteriorate it the most (see Figure II.8.1.).

Reduction of the 25 % VAT rate is not justified by Hungary's EU accession either. On the one hand, VAT rates differ considerably in individual member states of the European Union (see Table II.8.1.). On the other,

the Union has not set any requirements for Hungary regarding the 25 per cent rate of the value-added tax.

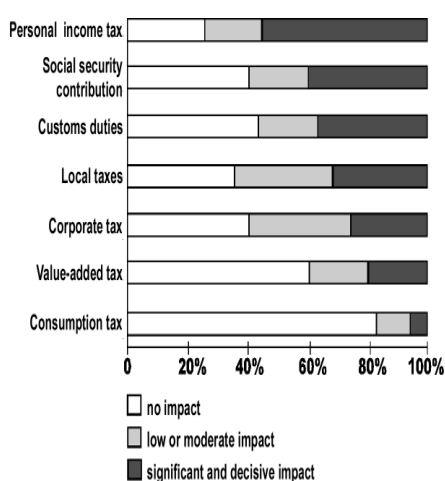
8.2. Reducing the 12 % VAT rate

We do not think that it would be beneficial to increase comprehensively the current lower 12 % VAT rate, as proposed by the Ministry of Finance. The 12 % VAT rate is primarily levied on foodstuffs, thus an increase would adversely affect the Hungarian agriculture and food industry, most of the services, as well as cultural products and activities, and would also raise the costs of Hungarian labour. (Reclassification of some products into other VAT rates is a separate issue, which we have already discussed in earlier chapters of this document. As far as the reduced VAT rates of line energies and coal are concerned, they should be offset by

Table II.8.1.: Applicable VAT rates in EU member states, in May 2000 (per cent)

Country	Extra preferential rate	Preferential rate	Normal rate
Belgium	-	6*	21
Denmark	-	-	25
Germany	-	7*	16
Greece	4	8*	18
Spain	4*	7*	16
France	2.1	5.5*	19.6*
Ireland	4.2*	12.5*	21*
Italy	4*	10*	20
Luxembourg	3*	6*	15
Netherlands	-	6*	17.5
Austria	-	10*/12	20
Portugal	-	5*/12*	17
Finland	-	8/17*	22
Sweden	-	6/12*	25*
Great Britain	-	5	17.5

Figure II.8.1.: Impact of taxes on export capabilities



Source: Hungarian daily "Népszabadság"

*These VAT rates are also applied to foodstuffs. In addition to these, in Great Britain all foodstuffs are subject to a 0 % VAT rate, while in Ireland some foodstuffs come under the 0 % rate. Source: European Commission, DOC/2206/2000

**Table II.8.2.a.: Impacts of decreasing the 12 % VAT rate to 6 %
billion HUF**

Commodity group	1997	Price change in 1998*	Price change in 1999*	At 1999 prices	At 2001 prices	Lost VAT
1. Purchased consumer goods	540.0					
out of which:						
- Foodstuffs**	117.0	1.1144	1.029	134.2	150.7	75.4
- Luxury consumer goods	59.1					
- Clothing	46.2					
- Miscellaneous manufactured goods	189.4					
- Services**	128.3	1.162	1.148	171.1	192.3	96.1
2. Investments by the population	23.4					
3. Other purchased goods	106.0					
Total	669.4					171.5

*For the commodity group concerned, as broken down by the Central Statistical Office of Hungary (previous year = 100)

**Predominantly commodity groups which are subject to the 12 % VAT rate

Source: T/42: Implementation of the State Budget for 1997, Monthly Statistical Bulletins of the Central Statistical Office of Hungary, State Budget for 2000 and Planning Directives for 2001

energy taxes.) It must be remembered that the VAT rate applicable to foodstuffs is lower than 12 per cent in several EU countries (see Table II.8.1.). Thereby Hungary would extend this indirect type of support – which is also used in the EU to generate additional demand for their products – to the agrarian sector as well. In every country of the European Union, foodstuffs are subject to a preferential or extra preferential VAT rate.

If the lower VAT rate is reduced, domestic products are given preference over foreign-made ones, since the portion of domestic production of the goods to which it is applicable, well exceeds the share of imports. (Calculated in HUF, only around 15 per cent of all foodstuffs consumed in Hungary come from imports.) Thus, Hungary is capable of protecting its national economy in a manner that conforms to WTO directives.

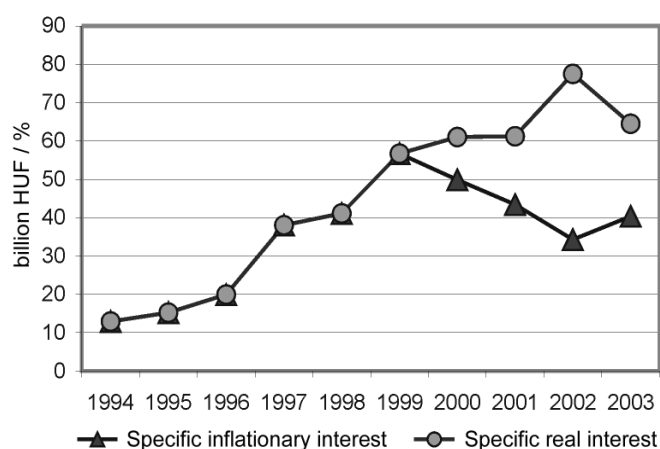
**Table II.8.2.b.: Weight of products subject to the 12 % VAT rate in the consumer price index
(per cent)**

Commodity group	Weight*	Weight of products subject to the 12 % VAT rate	VAT reduction	Impact on consumer prices
Foodstuffs	24.7			
less: coffee, tea, soft drinks	2.6			
Foodstuffs		22.1		
Cultural goods (periodicals, books)		3.6		
Household energy		8.6		
Rents, accommodation services		11.5		
Public transport		1.4		
Communications		3.8		
Culture and education		2.6		
Other services		1.2		
Total		54.8	6	3.29

*Weight in the consumer basket according to data of the Central Statistical Office of Hungary for 2000

Source: Ministry of Finance, Central Statistical Office of Hungary

Figure II.8.2.: Changes in the state budget's specific interest expenditures as a function of the inflation (billion HUF / %)



Source: Ministry of Finance, National Bank of Hungary

For the above reasons, we recommend that the lower VAT rate should be reduced from 12 per cent to 6 per cent.

Such a move would have a significant anti-inflationary impact, particularly in consideration of the EU accession.

Our calculations show that the implementation of this measure does not require any additional budgetary funds. The amount of VAT revenues lost as a result would total HUF 172 billion (see Table II.8.2.a.). As a consequence of the VAT rate reduction by 6 percentage points, however, the rate of inflation would drop by approximately 3.3 percentage points. In Figure II.8.2. we have demonstrated that a 1 percentage point reduction in the inflation rate would have caused state budget interest expenditures to fall by HUF 34.2 billion in 2002. On the other hand, if the inflation rate had decreased by the calculated 3.3 percentage points (see Table II.8.2.b.), budgetary interest expenditures would have dropped by some HUF 100 billion. (The positive difference is amply sufficient to cover possible errors due to the approximation calculation methods.)

Except for profiteers, diminishing inflation would benefit almost everyone. The resulting fall in wage costs and rise in employment would bring about additional state budget revenues. One of the main criteria of international financial institutions has also been that the inflation rate should be as low as possible in the

country. Such measure is expected to be set as an example to other candidate countries for EU membership. This is particularly important because at the time of joining the EU, the inflation rate is anticipated to increase somewhat, which can be averted for the most part by implementing the measure mentioned above. (It is worth remembering that at the time of introducing the austerity measures of the so-called Bokros package, IMF strongly criticized the inflationary impact of those steps.)

This move can only be carried into effect by means of a monetary policy coordinated by the National Bank of Hungary and the Ministry of Finance.

Considering that the preferential VAT rate is primarily applicable to foodstuffs and to the majority of services, such a measure would give a boost on the demand side to the food processing sector and to a large part of the services sector. As a consequence, new job opportunities would be established, which, in turn, would bring about additional state budget revenues. This could improve the position of those earning wages and salaries in a manner which would also ease tensions between different social groups. As another beneficial consequence, it would curb the rise of wage costs, since foodstuffs make up a considerable portion of all consumption. Competitiveness of the Hungarian economy would be enhanced through reduced costs and the relative cheapness of domestic products. (At the same time, this is a sophisticated tool to ensure protection for domestic producers.) Lower tax rates would perceptibly improve the general well-being of Hungarian citizens.

In addition, the proposed measure would lead to improving the country's balance of payment by 80 per cent of the reduction in interest expenditures, because foreign creditors would receive, and consequently can repatriate, by this amount less.

Environmental protection and culture would be considerably stimulated, for most of the related activities are subject to the preferential VAT rate.

Concurrently with the modification of the Act on Value-Added Tax, strict measures are to be taken to ensure that the tax reduction is fully enforced in the prices. The Board of Economic Competition should play an important role here, also bearing in mind the latest recommendations of OECD experts on the subject.

10. Other proposals related to environmentally and economically detrimental preferences

10.1. Review and publication of preferences

Using various exceptions to the generally applicable rules is a much-liked method of granting hidden subsidies. These exceptions are particularly non-transparent if they are determined individually in each case. It is not rare that preferential treatment is given to activities which cause serious environment pollution. (A typical example is the exemption granted to foreign trucks from the payment of motor vehicle taxes, which has already been discussed in detail in previous chapters of this document.) Furthermore, in the case of individual preferences, where the public only has an extremely limited insight into matters, the risk of corruption grows exponentially. Preferences automatically lead to higher profits for foreign companies, which they can repatriate. As a result, Hungary's balance of payments deteriorates even further, without any sound reason.

Therefore, every effort should be made to restrict the scope of preferences. Aiming at their comprehensive abolishment, however, would just be a vain hope, and in some cases would not even be advisable for social, environmental protection or other considerations. *"A potential method for a solution could be to attach to the state budget documents – both in the phase of planning and that of settling accounts – a comprehensive account of all preferences and exemptions granted. ...Detailed accounting is a must so that politicians can see and assess real budgetary processes. This requirement should be made a statutory obligation. Combined with a strong control over preferences, this would constitute an adequate solution, acceptable even considering the principle of accounting in gross terms."* (Csaba László: Tépett vitorlák /"Torn Canvas"/; p. 217)

It should be made compulsory to report in a uniform manner any kind of preferences granted to business organizations (preferential customs duties, tax allowances, public utility contributions, local taxes, direct support, etc.) to the Ministry of Finance. The Ministry should keep records of the preferences, process them and make them accessible to the public. The Ministry of Finance should publish once a year a report containing these data in a uniform structure, and forward it to the Parliament.

10.2. Review and enhanced transparency of separated state funds and ministry budgets

Separated state funds and funds managed by ministries often finance activities that are of low economic efficiency and harmful to the environment. Management and allocation of those funds are mostly non-transparent, which increases the risk of corruption, too. In some cases, their operation presumably violates the principle of market economy and also that of competition under equal terms. Therefore, reviewing these funds, setting stricter rules for their operation and increasing their transparency are tasks of pressing necessity.

If an objective is potentially beneficial for the society as a whole and as such it deserves state support, then this support should be determined by statutes in a normative manner. We are fully aware that decisions to grant individual subsidies will be necessary in the future, too. Nevertheless, the number such decisions should be minimized, while the level of publicity and transparency of such subventions, as well as the efficiency of their use should be maximized.

We believe that it has been a rational move to incorporate the separated state funds (with the exception of two such funds) into the central budget. The following reasons support this measure:

1. These separated state funds have become independent from the central budget, which has made budget accounting difficult to understand and monitor. As a result of the Government's decision, the entire budgetary system has become more straightforward and transparent.
2. Since these funds did not depend on the central budget but managed their own revenues, there was no guarantee whatsoever that – under the given social and economic conditions – optimum volumes of resources were allocated for the tasks to be accomplished. Under that system, it could happen that the financial sources raised in a particular fund were many times less than the required amount. On the other hand, in principle it was also possible that just a fragment of the available sources would have been sufficient for the given task.

By incorporating the separated funds into the state budget, the Parliament is given a greater scope to allocate funds according to needs.

3. In our opinion, the existence of separated state funds was contrary to Act XXXVIII of 1992 on State Finances, which has the objective “to promote achievement of the desired financial balance of state finances; by paying attention to... creating guarantees for managing public funds in an efficient and controllable manner; by asserting the principles of completeness, fullness of details, authenticity, uniformity, transparency and publicity”.

In connection with this subject we call the Reader's attention to a study by Anita Tanyi titled “Incorporation of environmental protection considerations into the Hungarian subsidization system” (prepared as part of the “Zöld Belépő” /“Green Entry”/ Research Programme of the Hungarian Academy of Sciences, in cooperation with Clean Air Action Group; published by the Environmental Economics and Technology Department of the Budapest University of Economic Sciences in 1999).

10.3. Stricter conditions for state guarantees and borrowings

It has been a fairly common practice in recent years that the Hungarian Parliament authorized the Government to provide guarantees without setting any limit on the amount involved in the case of state borrowings. In our opinion this contradicts the laws and Parliament resolutions in force. These regulations provide that the purpose of the funds to be used shall be specified and justified, and the use of the borrowed amount shall be determined by the Parliament. As a matter of fact, such guarantees and state borrowings partly predetermine the state budgets of following years, which is the exclusive right of the Parliament.

The European Union also takes ever stronger actions against such guarantees. The weekly “European Voice”, member of The Economist Group, reports in its issue of 1st December 1999 that Mario Monti, EU Chief Commissioner in charge of economic competition issues, launched another attack against guarantees which national and regional governments provide to companies and banks. The Chief Commissioner declared that such guarantees cannot be tolerated any more because they distort free economic competition. Monti even threatened those concerned with making them liable to pay back the profits realized as a consequence of the guarantee.

Undertaking guarantees also entails more insecurity for state budgets of the years to come. “When the gov-

ernment provides guarantee for a large amount of borrowings, and it has to be paid, the balance of the state budget may be seriously disturbed. It is particularly dangerous when current obligations to allocate expenditures are avoided by using the possibility of undertaking guarantees, which constitutes a violation of the principle of annual budget authorization.” (Csaba László: Tépett vitorlák /“Torn Canvas”/ ; p. 266)

In our opinion, providing unlimited guarantees contradicts, among others, the following provisions of Act XXXVIII of 1992 on State Finances:

“Art. 14, para (1) Settling deficits of state budget subsystems in a way that in turn increases state debts, as well as assuming or releasing debts, converting reimbursable subsidies into non-reimbursable ones, or undertaking any further liabilities which will increase in any other manner the level of state debts, shall only be effected through appropriate budgeting processes following the submission of pertinent estimates. (...)”

“Art. 23, para (2) For central capital investments in line with approved special programmes, three-year programmes shall be elaborated every year, and shall be submitted simultaneously with, and as part of, the annual state budget bills. In the capital investment programme, complying with the framework amount of the state budget bill, and also specifying in detail other financial sources, capital investments in excess of a total expenditure value of HUF 1000 million shall be presented in an itemized manner, whereas projects under that expenditure value shall be presented in a consolidated manner.”

“Art. 33, para (1) The Parliament authorizes the Government to undertake guarantees to the debit of the central budget, in individual cases and for well-defined purposes, **within the specified limits** set by the applicable State Budget Act.”

“Art. 36 At the time of submitting the State Budget Bill, the Government shall...

b) provide information on the expected future impacts of expenditure items involving longer-term commitment.”

Should the Government be given the authority to grant “unlimited guarantees”, there would be a significantly higher risk that the borrowed credits may increase state debts without satisfactory returns. Furthermore, experience shows that in some cases such state guarantees are supporting the implementation of environmentally damaging projects.

Accordingly, we propose that in the future **the Parliament should not authorize the Government any more to undertake unlimited guarantees.**

For similar reasons, we also urge that the Parliament should avoid, as far as possible, granting authorization to undertake guarantees even for specified limited

amounts. Nevertheless, if such guarantees are provided, we recommend that it should be set as **one of the pre-conditions of the** guarantee complying with Art. 33 of the State Finances Act, or of the **borrowing**, that **Hungarian suppliers have a share of at least 60 per cent.** (For example, local governments in the United States of America, the world's leading economic power, are only allowed to purchase buses which have a domestic added value portion of at least 60 per cent.)

Elaboration of a central budget norm for supporting public transport in Hungary is currently under way. Owing to the high overall budget support level (at least 50 per cent) it is necessary to **set the required share of domestic suppliers to be at least 60 per cent.** As a consequence of the so promoted Hungarian production and employment, the state budget will realize substantial extra revenues from personal income tax, social security contribution, corporate tax and local tax payments, as well as from consumption side budgetary incomes (VAT, excise duties). Calculating with annual net domestic orders worth HUF 50 billion, this can be expected to bring – starting from 2004 – additional state budget revenues of the gross annual value of HUF 20 to 30 billion.

10.4. Enhanced economic discipline in banking activities

Lending practices of Hungarian banks have been highly irresponsible in recent years, which is proved by several bankruptcies occurring in the Hungarian bank system, and by the subsequent “bank consolidations” involving huge financial resources. Inadequate regulation of banking activities has increased the risk of corruption and association with the black economy. A study, commissioned by the “Korridor” Political Research Centre, has surveyed the subject in February 1998. The study revealed that corruption was most typical in banks and in political parties (published in the Hungarian daily “Népszabadság” on 12th January 1999). Several statutes have entered into force since that time, and these have introduced stricter rules for the general conditions of financial institutions and banking practices (for instance measures to fight money laundering). In the light of the financial scandals which emerged in the USA during 2001 and 2002, however, further restrictions are required in Hungary as well. This is particularly important, for the excessively risky lending practices are often related to projects causing serious damage to the environment (shopping malls are typical examples). Consequently, making relevant regulations significantly stricter is a task of pressing necessity, including more stringent

environmental laws and regulations. Such measures could lead to better and more economical management of public funds (and reduce the likelihood of future bank consolidations by the state), and would have a very favourable impact on the state budget.

10.5. Enhanced economic discipline and improved social efficiency of insurance companies

In 2001 and 2002, private and voluntary pension insurance companies realized returns which remained under the inflation rate even after deducting costs, which means that deposits have lost part of their real value. Therefore, it is essential that management practices of these companies be reviewed and controlled in a comprehensive manner before the rate of the compulsory private pension insurance is raised from 6 to 8 per cent. It is a well-known fact that the previous Hungarian Government withdrew the budget guarantee granted to private pension insurance institutions. In 2003, the rate of private pension payments was raised to 7 per cent by the current Medgyessy Government, which substantially increased the state budget deficit.

The Hungarian pension scheme should be a sound and stable system. People are rightly distrustful of the pension insurance scheme, which is a motivation for those concerned to avoid paying the applicable pension contribution. In the short run, this is in the mutual interest of both employers and employees, but in the long run this will contribute to preserving for decades a situation – present in Hungary since the change of regime – in which the elderly are defenceless. Particularly in ageing societies, such “message” is inadmissible.

Simultaneously with the introduction of the private pension scheme in Hungary, the pension age limit was raised to 62 years (in the case of men, from the earlier age limit of 60 years, while in the case of women, from the earlier 55 years), although with some flexibility allowed in the implementation. This has had a serious destructive effect on people's trust in the “contract of generations” upon which the entire pension system is based. An even more serious problem is caused by the fact that by postponing the time of retirement, in practice 500 thousand jobs were “blocked” in Hungary – a country with the lowest employment level in international comparison. This contradiction should be solved by ensuring that the state only grants guarantees for pension funds invested into establishing new job opportunities. In addition to job creation, such measure would also provide extra sources for the insurance companies.

10.6. Reduction of state debt

In 1999, the Hungarian state budget allocated HUF 835 billion for the redemption of debt burdens. Interest expenditures of the debt service present a much larger burden and problem, with their value amounting to HUF 838.7 billion in 1999, as against the estimated HUF 768.7 billion. It is not only a huge burden to be borne by the national economy, but, as a matter of fact, it also functions as a “money pump” that re-channels the assets of

the tax-paying large majority into the pockets of Hungarian and foreign owners of financial resources. Therefore, every possible effort should be made to reduce the amount of the debt. One such method can be to avoid, as much as possible, taking up new loans. This can be implemented primarily through preventing that Hungary applies for loans to be used for environmentally harmful activities or investment projects which are not urgently needed for the development of the society as a whole (*see for instance Sections 3.12. and 3.14 of this study*).

C.) FURTHER MODIFICATIONS OF LAWS

11. Legislation to improve the state of the environment, enrich available human resources, streamline the economy and curb black economy

The primary objective of our proposals outlined in this chapter is to curb the black economy in Hungary. However, they also contribute to alleviating environmental pollution, easing social tensions and bettering citizens' living conditions.

Besides its other favourable impacts, transformation of the Hungarian taxation system in line with our proposals would also provide considerable assistance to the fight against black economy. Consumption-related taxes are much easier to collect than taxes charged on wages (personal income tax and social security contribution). This is particularly true in the case of energy sources (including fuels), where only a relatively small number of taxpayers need to be audited. Consequently, maintaining the current system of taxation does not only slow down economic restructuring, but can also be regarded as an open support granted to the black economy.

Serious intentions and actions of the Government regarding the black economy can only be demonstrated by actually specifying within the state budget estimates of revenues from that sphere. We are glad to see that state budgets of recent years have reckoned with such revenues in the value of tens of billions of forints. We hope that this favourable trend will continue in the future. (It can be seen as a promising sign that Hungarian customs authorities have purchased and put into operation new mobile search equipment which allows a thorough examination of trucks.)

11.1. Enhanced interestedness of the National Board of Customs and Finance Guard, the Tax and Financial Audit Office, police, foreign trade licensing institutions, environment and nature protection inspectorates, healthcare authorities and consumer protection agencies

One of the most efficient ways to restrain black economy and crime in any country is to increase the capacity and interestedness of the organizations specialized in combating them.

By further enhancing the interestedness of the National Board of Customs and Finance Guard (VPOP) it would become possible to attain several aims simultaneously. First, this could ensure protection of the Hungarian economy in compliance with WTO directives. Second, net budget expenditures could be reduced since this measure would make foreign imports finance wage rises for the staff of the Hun-

garian customs authorities and the costs of establishing better working conditions for them. Thus, extra revenues of HUF 15 to 20 billion can be secured for the purpose of creating proper interestedness for VPOP's work. At the same time, this would set free the entire amount of state budget funds which are today spent directly on the operations of VPOP (in 2003 some HUF 14 billion, which could be used for other purposes in the future).

Wages currently paid to the staff of the National Board of Customs and Finance Guard can be, and need to be, increased by 50 to 100 per cent on average. (As one of the feasible versions, we have also assessed the possibility of raising VPOP wages to the level of EU wages.) The costs involved should, of course, be entirely financed by imports. The Government should not economize on this item, because each forint spent here shrinks the competitive advantage of imports and thereby strengthens the protection of the national economy. Even after the rise, wages of Hungarian customs officers would be far lower than those of their counterparts in Western Europe; therefore it is not justified that this move be regarded by other countries as a discrimination against them.

The end result of such measures would be an organization that is more efficient and interested enough in fighting the black economy. Through the reinforcement of VPOP and other authorities **extra revenues of at least HUF 40 billion** could be realized annually. Similar transformation and development could be implemented **in the organization of the Tax and Financial Audit Office, the police, foreign trade licensing institutions, environment protection inspectorates, healthcare authorities and consumer protection agencies.**

Such restructuring would allow the state budget to reduce expenditures on financing the public administration system, and would also make a genuine modernization achievable.

Executives as well as the staff of these institutions will be interested in this kind of restructuring; for that reason, it can be rapidly implemented. The state budget also benefits from such restructuring. First, it trims down budgetary expenses. Second, the state becomes enabled to collect much more revenues as a result of the improved efficiency of its fight against black economy; and third, in the wake of the above achievements, illegal activities are expected to be significantly restricted. All in all, by putting into effect this package of measures, annual extra revenues worth some **HUF 100 billion** could be realized.

Outstanding debts due to Social Security, the National Board of Customs and Finance Guard and the Tax and Financial Audit Office total several hundreds

of billions of forints. The measures outlined above are also capable of preventing those arrears from growing further; and **several tens of billions of forints could be collected** annually. Moreover, non-payment of this amount by entrepreneurs constitutes an act of serious tax evasion. Therefore, when the state fails to collect these outstanding debts, it is tantamount to granting state support to the black economy. Some estimates put the annual value of the Hungarian black economy at more than HUF 3,000 billion. Part of this economy could be "whitened", and the amounts subsequently collected could be used by the state budget to achieve considerable improvements in education, healthcare, culture and other important social areas. Instead of that, the mentioned sum is currently being squandered by a privileged minority on – mostly seriously environment-polluting – consumption, and within that on financing unnecessary imports (consumption, rather than investments).

11.2. Other measures to prevent corruption in state administration

The measures we proposed in the chapters above (e.g. reduction of social security contribution rates) will make entrepreneurs more interested in legalizing their activities in the black or grey economy, and, by imposing stricter control and by introducing unambiguous legal regulations and more severe sanctions, the scope of the black economy will become limited. It is equally important to take further effective measures to curb corruption in public administration, which holds back the development of the Hungarian society. We urge that measures be initiated to finally identify and eliminate corruption, privileges and incompatibilities in state administration. This is why we welcomed the **adoption of Government Resolution No. 1023/2001 (III.14.) on Government Strategy against Corruption. Unfortunately, the largest part of the Government Resolution has not yet been implemented; therefore efforts to put the Resolution into practice should be intensified.**

We propose that the recommendations of Transparency International should be taken into consideration at the time of formulating pertinent laws and regulations. Relevant statutes should contain, among others, the following:

Rules on incompatibility need to be modified to render them much more severe: for instance, government officials should not be allowed to receive remuneration from business enterprises as members of supervisory boards or boards of directors. (For example, it

cannot be realistically expected that the competent head of department at the Ministry of Finance makes unbiased decisions on insurance issues if the same person is a member of the supervisory board of an insurance company.) Rules of incompatibility should apply to local governments as well. The same person or company should not be responsible for the preparation of urban development plans and also for the actual design or construction of the specific investment projects. (In our opinion, such incompatibility and unfair practices can be partly blamed for today's serious transport and environmental problems in Budapest.) Moreover, authorities should be genuine authorities, and not enterprises. (For example, environmental protection inspectorates should not be forced to raise some of the funds needed for their operation by offering and selling various services. It is highly unlikely that an inspectorate can decide without bias about an investment project of a company which had earlier placed an order with the inspectorate to carry out measurements or to prepare a study. A few hundreds of millions of forints would be sufficient to solve the problem of providing adequate financing for Hungarian environmental protection inspectorates. Such a demoralizing and detrimental regulation should by no means be kept in force just to save this amount.)

Offering unlawful privileges should be treated in the same manner as bribery, even if the actual bribery cannot be identified and proved. Article 225 of the Penal Code makes such treatment possible, for it says: *"Any official who contravenes his/her official duties, exceeds his/her scope of authority or misuses his/her official authority in any other manner in order to cause unlawful disadvantages or to acquire unlawful advantages, commits a crime and can be sentenced up to three years imprisonment."* In practice, however, the possibility of inflicting such punishment is far from being adequately used.

We believe that the Hungarian Government should pursue a much more stringent practice in this area.

In our opinion it is extremely unfavourable that the State Finances Act has been modified in a manner which makes state budget revenues and spending much less transparent and controllable. This is diametrically opposed to the reasons given by the Government for example at the time of abolishing separated state funds. The following is a quotation from an expert opinion prepared by the State Audit Office (No. T/321/1):

"Article 16 of the State Finances Act has been repealed by the law. By the new law, ordinary and extraordinary items (revenues and expenditures) are not required to be separated any more, which diminishes the possibility of assessing the justification of budget estimates, as well as their potential future impacts.

A modification of paragraph (10) of Article 18/C proposes to leave out the obligation of data supply from the text of the currently effective provision. Consistency of the system, however, requires that this obligation is maintained.

In our opinion, the proposed modification of Article 23 of the State Finances Act fails to comply with Para (1) of Art. 24, which continues to treat estimates of investment projects, renovations and other subsidies for accumulation purposes as top priority estimates within expenditures for accumulation purposes. By abandoning the requirement to break down budget estimates, less information will be available on capital investments.

Repealing Articles 27 and 30 of the State Finances Act restricts the Parliament's authority to make decisions on budget estimates and on issues related to the balance of the state budget. It is a measure that leaves out one of the most important fundamental rules of budget economics."

We urge that the State Finances Act should be (re)modified in a manner to enhance the transparency of state finances and to improve the efficiency of budgetary management.

Clean Air Action Group welcomes that a border registration system has been introduced and that finally proper measures have been taken to restrain money laundering. These steps effectively contribute to curbing the black economy and terrorism, and also to asserting the aims of environmental protection.

11.3. Introducing the obligation to provide environment and nature protection securities and to form environment protection provisions

To combat the black economy, crime and environment pollution, it is indispensable to introduce regulations which prevent that entrepreneurs start up activities if they do not have adequate assets or insurance to cover the health or environmental risks that the business may involve. (The rate of such securities should be determined by the environmental protection authorities in each specific case.) Such measures would save several billions of forints for the state budget every year. At present it often happens that entrepreneurs guilty of causing environment pollution or health damage are unable to provide the funds necessary for removing the damage they caused. Consequently the removal has to be financed from public

money. (Actually, this practice entails losses worth several billions of forints each year for the Hungarian society, because the state budget only reimburses or removes a small part of the damage.)

The Ministry of Environmental Protection has already elaborated a concept to tackle the above problem. It is an urgent task to formulate relevant statutes and to enter them into force as soon as possible.

Establishment of new petrol stations is an issue to be mentioned here. Several of them disguise money laundering or are associated with illegal trade of fuels. In addition to that, they often jeopardize the environment and the health of citizens. Funds are often scarce to properly eliminate old petrol stations out of use and to clear up the environmental damage they caused. Sometimes such damage removal has to be financed from public funds. Therefore we propose that building permits for establishing new petrol stations should only be issued on condition that the entrepreneur deposits the funds required for the potential removal of the petrol station.

11.4. Increased rates of penalties

As matters stand now, the rates of applicable penalties are often lower than the level required to have a deterrent effect, and often they are even providing encouragement to violate regulations. Therefore, the impossible rates should be significantly raised as soon as possible, especially in the case of penalties related to environment and nature protection, consumer protection penalties, as well as land protection and soil protection fines.

Fines and other penalties should be levied in such a manner that they be proportional to the committed unlawful acts; in other words, that **they have a real deterrent effect**. This is essential since in many cases the current practice even boosts the black economy and crime.

Clean Air Action Group believes that it is of particular importance to review and make more stringent the system of environment and nature protection fines (see *Appendix 16*).

D.) RESEARCH ACTIVITIES

12. Research activities necessary to provide better foundations for the measures described in Chapters 1 to 11

Article 36 of Act XXXVIII of 1992 on State Finances says: "At the time of submitting the state budget bill, the Government ... shall present key social and the economic impacts of the budget law; shall evaluate the economic and budgetary trends in the period preceding the budget year under consideration." Furthermore, Act XI of 1987 on Legislation reads as follows: "Art. 18, para (1) Before passing a law, relevant social and economic aspects, rights and duties of citizens and ways of managing conflicts of interests shall be analyzed scientifically, and the expected impacts of the new law and the conditions of its enforcement shall be investigated. Legislators need to be supplied with information about the findings."

Clean Air Action Group believes that before submitting the yearly state budget bills, the social and economic impacts should be analyzed much more thoroughly and comprehensively than it has been done lately. We think that the necessary research work should be carried out under the direction of the Prime Minister's Office, for this provides more guarantee for a comprehensive and impartial approach.

One of the aims of the present study is to make a contribution towards meeting that requirement.

It is of primary importance to assess also the environmental impacts of the yearly state budget bills. So far, no such attempts have been made, although – in our opinion – this is not only required by what has been mentioned above, but also by the Hungarian Constitution and the Environmental Protection Act.

1.) The Constitution of the Republic of Hungary declares:

"Article 18 The Republic of Hungary recognizes and enforces the right of all people to live in a healthy environment.

(...)

Article 61, (1) In the Republic of Hungary all people have the right to freely express their opinion, as well as

to become acquainted with, and to propagate, data of public interest.

(...)

Article 70/D, (1) All people living in the territory of the Republic of Hungary have the right to enjoy physical and mental health at the highest possible standards.

(2) The Republic of Hungary enforces this right by organizing the systems of labour safety, healthcare institutions and medical services, by ensuring possibilities for regular physical exercise and by protecting the built and natural environment."

2.) Act LIII of 1995 on the General Rules of Environmental Protection provides:

"Article 6, (1) Utilization of the environment shall be organized and carried out in a manner that it

a) causes the least possible degree of load and stress to the environment;

b) prevents contamination of the environment

c) precludes the possibility of any damage to the environment.

(2) Utilization of the environment shall be carried out by taking into consideration the precautionary principle, by sparing and using economically the environmental elements, as well as by reducing the amount of waste produced and by making efforts to recycle and reuse natural and man-made materials.

(...)

Article 12, (1) All people have the right to become acquainted with environmental facts and data, especially those related to the state of the environment, the degree of environment pollution, environmental protection activities and the impacts of the environment upon human health.

(2) For the purpose of exercising civic rights and fulfilling civic duties in connection with the protection of the environment, the state shall make it possible for all people to become acquainted with key relationships between health and the environment, with environmen-

tally harmful activities and with the importance of such activities.

(...)

Article 43, (1) Those preparing bills and other statutes related to environmental protection (hereinafter jointly referred to as statutes), national social and economic plans, regional development concepts and decisions having regional impacts (hereinafter jointly referred to as decisions) shall assess and evaluate the environmental impacts of the measure concerned, and shall summarize the results in an assessment analysis (hereinafter: assessment analysis).

(2) Under paragraph (1), statutes related to environmental protection are such laws, government decrees, ministerial decrees and decisions that exert an impact on

- a) environmental elements,
- b) the quality of the environment, or
- c) on human health in connection with the environment.

(3) In the case of regulations aiming at the introduction of economic regulatory instruments (rules on customs duties, taxes and duties, etc.), as well as in the case of significant modifications, the assessment analysis shall always be completed.

Article 44, (1) The assessment analysis shall cover in particular the following questions:

- a) how much do the planned regulations and measures influence or improve the state of the environment;
- b) what damage may be caused to the environment or the population if the planned measures are not implemented;
- c) how suitable are domestic conditions for the introduction of the planned measures;
- d) how prepared are public administration agencies for the implementation of the planned measures;
- e) are the necessary state, financial, organizational and procedural conditions available for carrying into effect the planned measures;
- f) how deviating is the proposal from the internationally accepted solutions.

(2) Before submitting them to the agency entitled to take the decision, the drafts and assessment analysis defined in paragraph (1) of Article 43 shall be sent to the National Environment Protection Council so that it can express its opinion about those documents. At least thirty days – counting from the date of delivering the draft – shall be ensured for the preparation of the expert opinion.”

In this respect, resolution No. 28/1994 of the Constitution Court (also reinforced by resolution No. 48/1997) is of crucial importance. The following is a quotation from the document: “The state is not at liberty to let the state of the environment decline or let the

risk of deterioration develop. ...Qualitative and quantitative fluctuations depending on economic and social conditions are not allowable when it comes to enforcing rights to environmental protection. These are not the same kind of rights as the cultural or social rights where short-term restrictions required by specific circumstances can be remedied subsequently. On account of these peculiarities of environmental protection, prevention must be given priority among the means of protection, because sanctioning the irreversible damage after the damage is done is not capable of restoring the environment to its original state.”

It is particularly necessary that the mentioned resolutions of the Constitution Court are taken into consideration when passing the yearly state budget bills, since this law, together with other related statutes, essentially determines the processes influencing the state of the environment. (These resolutions, however, do not authorize the Government to neglect the enforcement of social and cultural rights, or to impair people’s chances to exercise those rights. We believe that other resolutions of the Constitution Court clearly allow this conclusion.)

In recent years and decades, it has unfortunately been a characteristic practice that the above-mentioned considerations have been mostly ignored when passing the state budget bill. As a result, this approach, a violation of the Constitution, caused serious damage to the society as a whole by letting the environment deteriorate and people’s health standards decline. It is a situation that requires radical changes in the near future.

Clean Air Action Group places great emphasis on the need to prepare in-depth analyses about the state budget’s impact on children, which is also justified by the fact that children are the most defenceless and that they have been the main losers of the change of regime in Hungary (which is also corroborated by UNICEF’s conclusions). Still, they and their lives at present will determine the future of Hungary. Such analyses and impact assessments could serve as means to comply with the recommendation of the UN’s Children Rights Commission related to Hungary. Article 26 of that document says: “The Commission proposes that the member state should pursue a comprehensive and integrated policy to protect the interests of children. For example, it should elaborate **a nation-wide action plan** to assess the progress achieved and the difficulties experienced at central and local levels during the enforcement of rights recognized by the Convention, with special emphasis on **regularly monitoring the impacts of economic changes on children.**” (The text refers to the International Convention on the Rights of the Child, to which Hungary acceded in 1991. Among others, the Convention declares: “Countries participating in the

Convention recognize the right of children to enjoy health at the highest attainable standard.”)

12.1. Detailed preliminary impact assessment of specific measures

It has been a long-established bad practice in Hungary that the impacts of specific measures involved in the state budget law and other related statutes are not assessed in detail. (As an exceptionally harmful example of this unfortunate practice, we may refer to the austerity measures introduced in the mid-90s, the so-called “Bokros package”.) This approach should be changed as soon as possible.

This kind of research work is vital; however, we have to be aware of that they can never provide perfect forecasts about the expected impacts of the planned measures. That is the reason why we cannot accept it that undisputedly necessary and rational measures are delayed under the pretext that available data or assessments on the subject are insufficient. Deteriorating environment, tragically poor health standards of the Hungarian population, increasing social deviations and many other phenomena indicate that the currently used approach is wrong, and that changes are inevitable. Consequently, also mindful of the precautionary principle, we should take action without delay.

12.2. Determination of external costs

The costs that are not paid for by those causing them (the polluter) are called external costs. There is a growing pressure all over the world to incorporate external costs into prices. The “polluter pays” principle has been accepted and laid down in the Agreement of the European Union. In Hungary this is required by Act LIII of 1995 on the General Rules of Protecting the Environment.

Without incorporating the costs of environmental and other damage into the prices of goods, the costs of that damage are not (or not directly) paid by the users of those goods. This practice of shifting the costs is not only unfair but also economically irrational. Distorted prices can only lead to wrong decisions at all levels: in the case of consumers and business enterprises, or ministers and even the Parliament. And such decisions can bring about a serious economic crisis. (People living in Hungary and other former Eastern Bloc countries could

gather more than enough experience about the consequences of distorted prices over the past decades.) Therefore, avoiding such practices is in the interest of all players of the economy.

It is also the reason why in the European Union and in other countries of the world substantial funds are being spent on determining the amount of external costs. Clean Air Action Group believes that it is of pressing necessity that by using the findings of those research programmes, Hungary should intensify its research efforts concerning external costs.

12.3. Applying the so-called Genuine Progress Indicator to Hungarian conditions

Traditional economic indicators are not capable of adequately measuring human welfare. GDP, for instance, does not indicate all values that humans take away irrevocably from nature. GDP fails to reflect the value of “goods” found in nature and not sold through commercial distribution channels, or the worth of “services” provided by various ecosystems. This economic indicator also ignores the value of the work that people perform in households or in other communities for free. On the other hand, GDP comprises and shows as benefits several elements which are in fact detrimental both for individuals and the society as a whole (for example, GDP will also grow when people buy more burglar alarms to protect themselves against increasing crime). Consequently, **it is not rare that GDP presents as benefits the decline of people’s quality of life and the deterioration of the environment.** Therefore this traditional economic indicator misleads the public and prompts politicians to make erroneous decisions.

To remedy this undesirable situation we suggest that in addition to the GDP, also the “Genuine Progress Indicator” (GPI), proposed by Herman Daly and John Cobb, should be calculated. GPI includes the value of work performed in households and communities for free and, at the same time, deducts the damage caused to nature, environmental pollution, income structure changes and crime. Application of this indicator to Hungarian conditions is primarily a scientific research task which only involves a relatively small financing need. Once it is elaborated, politicians will have the chance to decide how and to what extent they consider the Genuine Progress Indicator. However, taking decisions without adequate information, i.e. the current practice, is utter irresponsibility.

E.) PUBLIC PARTICIPATION

The modifications proposed can only be satisfactorily elaborated and made widely accepted by the public if people themselves are extensively involved in the preparatory work preceding the decisions. Civil movements, trade organizations and other interest protection agencies should participate in this work on a continuous basis. Legal, educational and financial preconditions of making them involved in the decision-making process should be guaranteed. The Hungarian state should make a significantly larger financial contribution to improving operational conditions for non-profit organizations. Revenues of the Hungarian non-profit sector are by several orders of magnitude lower than the level characteristic of developed countries. (See Table II.13.a.) On the other hand, the tasks undertaken by these organizations are in most areas not any smaller than in the case of their Western European

counterparts; actually, the social problems to be tackled in Hungary are much more serious.

People in Western European countries and the United States of America traditionally recognize the work done by various non-profit-oriented organizations, and they express their appreciation by granting financial support to those organizations. This is not a well-established practice yet in Hungary. Moreover, the American society is rather distrustful of state interventions, and in keeping with this attitude, the government generally abstains from any such actions. Considering this, it is particularly astonishing that even the American state grants considerably more financial support to the non-profit sector than the Hungarian state does.

This is a situation which needs to be changed, particularly because state subsidies provided to non-profit-oriented organizations represent only a small portion of all budget expenditures, whereas activities of the non-profit sector are indispensable for the Hungarian society to function in an efficient and democratic manner.

Without aiming at an exhaustive description, we may characterize the current situation of the Hungarian non-profit sector as follows:

- a.) The general amount of subsidies granted by the Parliament to non-profit organizations totalled HUF 400 million in 1991, while in 2000 it already dropped to HUF 348.1 million, which, calculated in real terms, is only one fifth part of the value of support 9 years before! Financial backing received by environment and nature protection NGOs was even more severely curtailed: in real terms it fell to less than 1/8 part of the 1991 value (see Table II.13.b.). What is more, during this period the number of such organizations shot up, with citizens' expectations growing exponentially. Politicians and decision-makers ever more frequently turn to such organizations requesting opinions or position statements on various issues. Consequently, financial support only covers a steadily shrinking portion of the true value of services provided by NGOs to satisfy swelling needs of the society.
- b.) Financial assistance received from Western countries is also diminishing, for sponsors have been relocating recently into Eastern and Southern Europe a growing part of the funds earlier granted to Hungarian organizations.
- c.) It continues to be a characteristic feature that granting voluntary support to socially desirable causes, and within that to environmental protection tasks, has not yet been adequately incorporated into the corporate policies of business enterprises and financial in-

Table II.13.a.: Revenues of the non-profit sector

Country	Revenues of the non-profit sector	
	Total amount, million USD	Per capita amount, USD
USA	566 960	2155
Japan	264 366	2112
Germany	94 454	1157
Great Britain	78 220	1340
France	57 304	985
Netherlands	56 291	3643
Belgium	26 505	2629
Spain	25 778	657
Australia	20 096	1113
Israel	10 947	2027
Austria	6 262	780
Finland	6 064	1187
Ireland	4 982	1392
Hungary	1 433	140
Peru	1 190	51
Romania	1 040	46
Czech Republic	900	87
Slovak Republic	309	58
Mexico	229	2

Source: Salamon-Anheier (1998) published in Éva Kuti's book (*Hívjuk talán nonprofitnak...*)

stitutions. Additionally, most civil movements – and particularly the environment and nature protection organizations – are not willing to accept donations from companies performing seriously environment-polluting activities; they do so for ethical reasons, because they believe that this would jeopardize their independence and would undermine their credibility. It cannot be in the interest of the state either that non-government organizations come under the influence of (large) business corporations, because in that case they would not be capable of fulfilling their prime task, i.e. representing the interests of citizens in various respects. If civil organizations become excessively dependent on the interest groups of (large) companies, it will also mean that a leading social group gains even more power and influence. Citizens cannot exercise practically any control over these interest groups, because they cannot vote for, or against, these persons, and they cannot recall them either.

- d.) In contrast to the practice of Western countries, the tradition and culture of granting donations to non-government organizations has not yet developed in Hungary. Furthermore, Hungarian citizens in general have considerably lower income levels than people living in advanced industrial countries.
- e.) Even offering 1 % of the payable personal income tax cannot be a solution to provide financing for many civil movements which play an important part in the Hungarian society. Environment and nature protec-

tion NGOs, for example, stand much less chance in the competition for the 1 % donations, because people usually give those amounts to schools, healthcare or charitable organizations, which have a more direct effect on their lives (e.g. through their children).

- f.) The European Union provides increasing financial assistance for Hungarian non-profit organizations, which benefits the entire country in the form of net revenues. This support, however, is only accessible if the NGOs concerned have sufficient own funds at their disposal.

Strengthening the non-profit sector is also indispensable from the aspect of Hungary's accession to the European Union. A Communication by the EU Commission on the need to reinforce the role of voluntary organizations and foundations in Europe (COM(97) 241 final, Brussels, 6th June 1997) lays down, among others, the following: *"Voluntary organizations play an important part in nearly all aspects of social life. Through their activities they create job opportunities, enable people to participate in public life as active citizens, contribute to making democracy function, grant a wide range of services, have a key role in sports, represent people's rights against various state authorities, play an outstanding part in the enforcement and defence of human rights, as well as in the process of elaborating public policies."*

In the light of all the above, the question can be raised whether a country can afford it – in the period of the EU accession process – that its regional and national environment and nature protection NGOs go

Table II.13.b.: Changes in subsidies granted by the Parliament to non-government organizations between 1991 and 2000

Year	Total amount of allotted subsidies, million HUF		Out of which: for nature and environment protection organizations, million HUF		Consumer price index	
	at current prices	at 2002 prices	at current prices	at 2002 prices	(1991=100)	(2002=100)
1991	400.0	2028.0	57.143	289.715	100.0	507.0
1992	426.0	1757.4	63.390	261.503	122.9	412.5
1993	411.0	1383.6	69.000	232.291	150.6	336.7
1994	429.0	1215.8	76.000	215.383	178.9	283.4
1995	400.0	884.4	64.000	141.509	229.3	221.1
1996	390.0	697.7	59.400	106.266	283.4	178.9
1997	258.5	405.6	33.350	52.332	323.1	156.9
1998	291.1	404.2	37.650	52.283	365.1	138.9
1999	317.0	400.2	29.200	36.864	401.6	126.2
2000	348.1	400.2	34.000	39.088	441.0	115.0
2001	348.1	366.5	28.810	30.336	481.5	105.3
2002	348.1	348.1	24.820	24.820	507.0	100.0
2003**	400.0	384.6			527.3	96.2

*Up until 2002, the Parliament had decided about the distribution

**Calculating with the inflation rate of 4 per cent included in the State Budget Bill (the expected inflation rate is approximately 5 per cent)

Source: Parliament Resolutions, State Budget Acts, Yearbooks and Flash Reports of the Central Statistical Office of Hungary

bankrupt for lack of adequate sources to finance their operation, and stop performing, or shrink considerably, their activities serving purposes of public interest.

Considering the current situation in Hungary, Clean Air Action Group believes that it is a most pressing necessity to elaborate a mechanism which can ensure the continuous operation of NGOs, and in which **stability and predictability** are important criteria.

Accordingly, we recommend that extra subsidies worth HUF 20 billion should be granted to non-profit organizations, enabling them to exercise their rights defined in Act XI of 1987 on Legislation:

“Art. 19 Citizens (directly, or indirectly through their representatives) shall participate in the preparation and formulation of legal regulations that affect their living conditions.

Art. 20 Institutions applying the laws, non-government organizations and interest representation agencies shall be involved in the preparation of drafts for statutes that concern the interests or social conditions which they represent and protect.

(...)

Article 27 ...c) the interested non-government organizations and interest representation agencies ... shall give their opinion about bills and drafts of regulations to be submitted to the Government.”

At the same time we recommend that these funds should be used through tenders. Tenders announced for different activities should specify strict and objectively accountable criteria. Evaluation of the tenders should be carried out by persons elected by those concerned, with maximum publicity ensured.

III. Summing-up

Tables III. summarize the differences in revenues (*Table III.a.*) and in expenditures (*Table III.b.*) which would be realized if the Hungarian Parliament passed the State Budget Act for 2004 in keeping with our proposals. As can be seen, on the whole we recommend rearrangements of funds in the value of HUF 1393–1763 billion. The discrepancy between revenues and expenditures should be treated as a reserve, because owing to Hungary's accession to the European Union and the prolonged economic recession, some amounts cannot be accurately determined at the moment.

Points III. and II.1.1. in the table can be justified by the necessity to increase real wages in the public service sector (public workers and civil servants) in a manner which does not use lay-offs as a source to raise funds for the wage rise. It is to be noted that the measures taken by the Government in 2002 to increase wages of civil servants and public service employees in part complied with our proposals made up until that time. The process of accession to the EU will require efficient state administration and public services in Hungary; therefore it is essential to ensure wages equaling the EU level in certain sectors (customs officers, etc.) as soon as possible. Additional revenues needed for the wage increase should in turn be generated in a manner that the costs are mostly borne by the foreign party and by imports. Various types of contributions are also charged on the wages, and these can generate substantial amounts of other state budget revenues, but we have not taken these revenues into account here (actually, they may constitute "hidden" reserves for the state budget).

In the last line of revenue items we quantified the financial impacts of a more favourable economic environment which could be achieved through accepting and implementing the majority of our proposals. The entire national economy of Hungary would benefit from

the multiplier effects of such measures, due to the following reasons:

- increased employment creates additional demand,
- tax-paying propensity increases as a result of favourable tax restructuring and enhanced collection efficiency,
- as a consequence of modified taxes and subsidies, prices will better reflect true costs, which will make all participants of the economy act more rationally, contributing thereby to enhancing the overall performance of the national economy,
- better environment and improved public health bring about higher social efficiency and international competitiveness, and influence favourably Hungary's image and attractiveness.

The aggregate impact of all the above factors is presumably much larger than the amount included in the table as additional revenues; however, considering the difficulties of quantifying prospective benefits, we only indicated a lower sum here.

We would like to emphasize that Hungary may also acquire substantial extra EU funds as co-financing if the proposed additional revenues and expenditures are in fact realized.

The summary tables demonstrate that through our budget proposals we intend to reinforce Hungary's competitive position, improve education, culture, healthcare, scientific research and the environment, as well as curb black economy and crime, without adding to the overall burdens of the state budget, citizens or enterprises. Our proposals are feasible both economically and technically, and they are compatible with all EU requirements. As far as the political barriers of implementation are concerned, it is not our duty to assess them; nevertheless, we are fully convinced that through adequate awareness raising these barriers can be eased considerably. *Appendix 17* contains our recommendations for possible ways to achieve this.

**Table III.a.: Proposed additional revenues and expenditure reductions
as compared to the Hungarian State Budget Act for 2003
(Summary sheet)**

		minimum	maximum
Chapter No.	Sources of additional revenues:		
III.	Additional revenues from social security contribution and personal income tax owing to increased wages in the public sector	180	180
II.2.7.2.	1 % of the Crude Oil and Petroleum Products Stockpiling Association's stock value	1	1
II.2.8.	Returns from economic growth resulting from support granted to small and medium-sized enterprises	50	50
II.2.9.	Eco- and medical tourism	5	5
II.2.4.	Penalties to improve public safety	3	4
II.3.3.	Cutting back fuel tourism	60	80
II.3.17.	Introduction of urban road charges in Budapest	40	40
II.3.18.	Introduction of equilibrium parking fees	20	30
II.2.7.8.	Additional returns from the National Agrarian Environmental Protection Programme	30	40
II.3.4.	Increase and stricter collection of motor vehicle taxes	26	26
II.3.5.	Infrastructure charge – on domestic users	30	30
II.3.5.	Infrastructure charge – on foreign users	35	35
II.3.6.	Ton-kilometre charge to offset extra load on infrastructure – on domestic users	8	8
II.3.6.	Ton-kilometre charge to offset extra load on infrastructure – on foreign users	10	10
II.3.7.	Uniform rates of daily travel allowances	6	6
II.3.8.	Stricter rules and abolition of expense accounting for motorcar use	20	200
II.3.9.	Increased taxes on company cars	20	20
II.3.10.	Increased consumption tax (registration fee) on motorcars	38	38
II.3.11.	Increased consumption tax (registration fee) imposed on used motor vehicles	30	40
II.3.13.	Abolition of the possibility to retain VAT on motorcars	2	3
II.3.14.	Reallocation of funds estimated for the construction of new motorways and high-speed roads	90	90
II.3.15.	Cancelling subsidies to the Formula-1 Hungarian Grand Prix	3	3
II.3.16.	Collection of VAT on the passenger-kilometre performance of foreign buses	5	5
II.3.20.1.	Increase of air tolls to the rate prevailing in the EU	9	9
II.3.20.2.	Introduction of airport utilization fees	1	1
II.3.20.3.	Closing down duty-free shops in airports	1	1
II.3.20.5.	Cancelling subsidies to regional airport investments	2	3
II.4.1.	Energy tax	60	60
II.4.4.	Paks Nuclear Power Plant	6	6
II.4.6.	Purchase of natural gas through barter transactions	30	30
II.4.7.	VAT rate reclassification of artificial fertilizers and pesticides	3	3
II.4.7.	VAT rate reclassification of disposable diapers	1	1
II.5.4.	Increased environmental product charges	5	5
II.5.5.	Increased mining tax (hydrocarbon)	40	40
II.5.5.	Increased mining tax (other than hydrocarbon)	3	3
II.6.1.	Raising the rate of land protection fees	20	30
II.6.2.	Extending the scope of land protection fees	10	20
II.6.5.	Transformation of the agricultural subsidization scheme (reallocation)	20	20
II.7.1.	Increased excise duties on tobacco products	40	40
II.7.2.	Increase and strict collection of cultural taxes on products and services involving pornography, sex and violence	4	6
II.7.3.	Increased cultural tax on advertisements	25	25
II.9.4.	Domestication of investment imports of customs-free zones	100	100
II.9.8.	Settlement of employment issues related to foreign investments	6	6
II.9.11.	Increased corporate taxes	50	50
II.9.13.	Abolition of tax allowances for stock-exchange transactions	5	10
II.9.15.	Cutting back trade through intermediaries	100	200
II.9.18.	Embargo Compensation Fund	100	100
II.9.18.	VAT of the Embargo Compensation Fund	20	20
II.9.20.	Introducing regulation to require an at least 60 % share of domestic subcontractors	20	30
	Total (additional revenues)	1393	1763

**Table III.b.: Proposed additional expenditures and revenue reductions
as compared to the Hungarian State Budget Act for 2003
(Summary sheet)**

		minimum	maximum
Chapter No.	Target area of additional expenditures		
II.1.1.	Reduction of social security contribution	300	300
II.2.1.	Increased wage costs in education, culture, healthcare and R&D	300	300
II.2.1.	Increased material costs in education, culture, healthcare and R&D	30	30
II.2.2.	Family-related social welfare allowances	15	15
II.2.4.	Improvement of public safety	2	3
II.2.5.	Subsidies to underdeveloped and disadvantaged regions	10	10
II.2.6.	Transformation of the housing policy	130	130
II.2.7.1.	Environmental and health protection awareness raising, information supply, education and training, culture	25	25
II.2.7.2.	Compensation for increased energy prices (electricity and natural gas)	50	50
II.2.7.2.	Energy efficiency enhancement (reallocation from stockpiling fee revenues)	1	1
II.2.7.2.	Energy efficiency schemes (from mining tax)	30	30
II.2.7.3.1.	Subsidies to public transport in Budapest (from levied urban road charges)	40	40
II.2.7.3.1.	Subsidies to public transport (from imposed parking fees)	20	30
II.2.7.3.2.	Improvements in railway services	100	100
II.2.7.3.3.	Offsetting partially the costs of environmentally friendly transport modes (railway and combined freight transportation) through rebates (refunds of freight)	5	5
II.2.7.3.6.	Promoting the general use of bicycles	8	8
II.2.7.3.9.	Abolition of motorway tolls	15	15
II.2.7.8.	Subsidies to agrarian environment protection (allocating increased funds for the Ministry of Agriculture and Rural Development)	20	20
II.2.8.	Subsidies to small and medium-sized enterprises	20	40
II.2.9.	Subsidies to eco-tourism	5	5
II.3.2.	Enhanced social opportunities for the disabled	2	2
II.3.15.	Anti-drug measures (reallocation from Formula-1 subsidies within the funds of the Ministry of the Youth, Children and Sports)	3	3
II.3.17.	Non-recurring costs of introducing urban road charges	5	5
II.4.7.	Subsidies to agrarian environment protection (from increased VAT)	15	15
II.4.7.	Reduced VAT rate of cotton (not disposable!) diapers	1	1
II.5.5.	Promoting secondary use of building materials (reallocation of funds from mining taxes)	3	3
II.7.1.	Health protection awareness raising (from tobacco taxes)	10	10
II.7.2.	Film based on the novel "Without a Fate" ("Sorstalanság") by Imre Kertész, Nobel Prize winning Hungarian writer (from cultural taxes)	1	1
	Total (additional expenditures)	1166	1197

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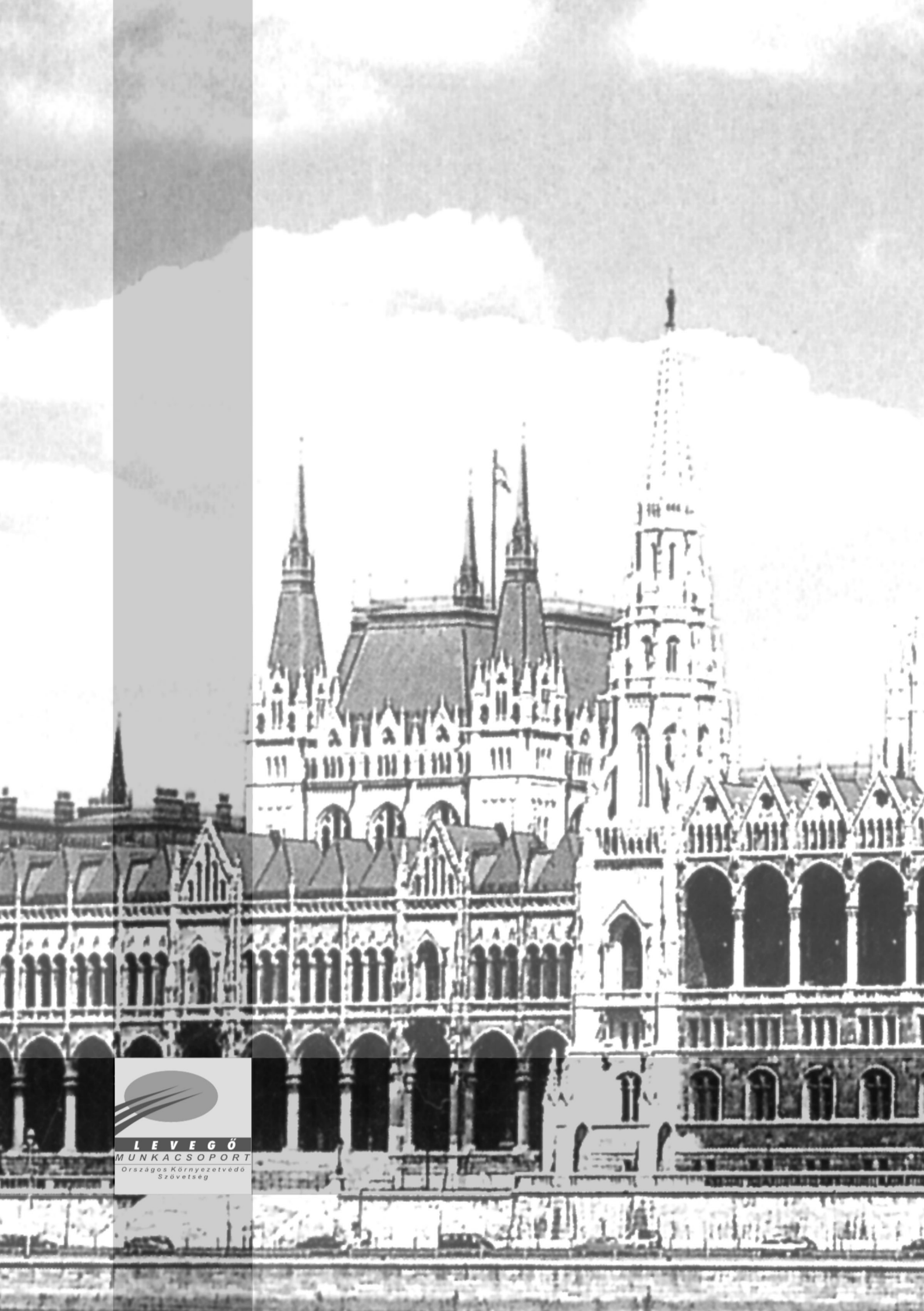
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