

3.17 Hungary

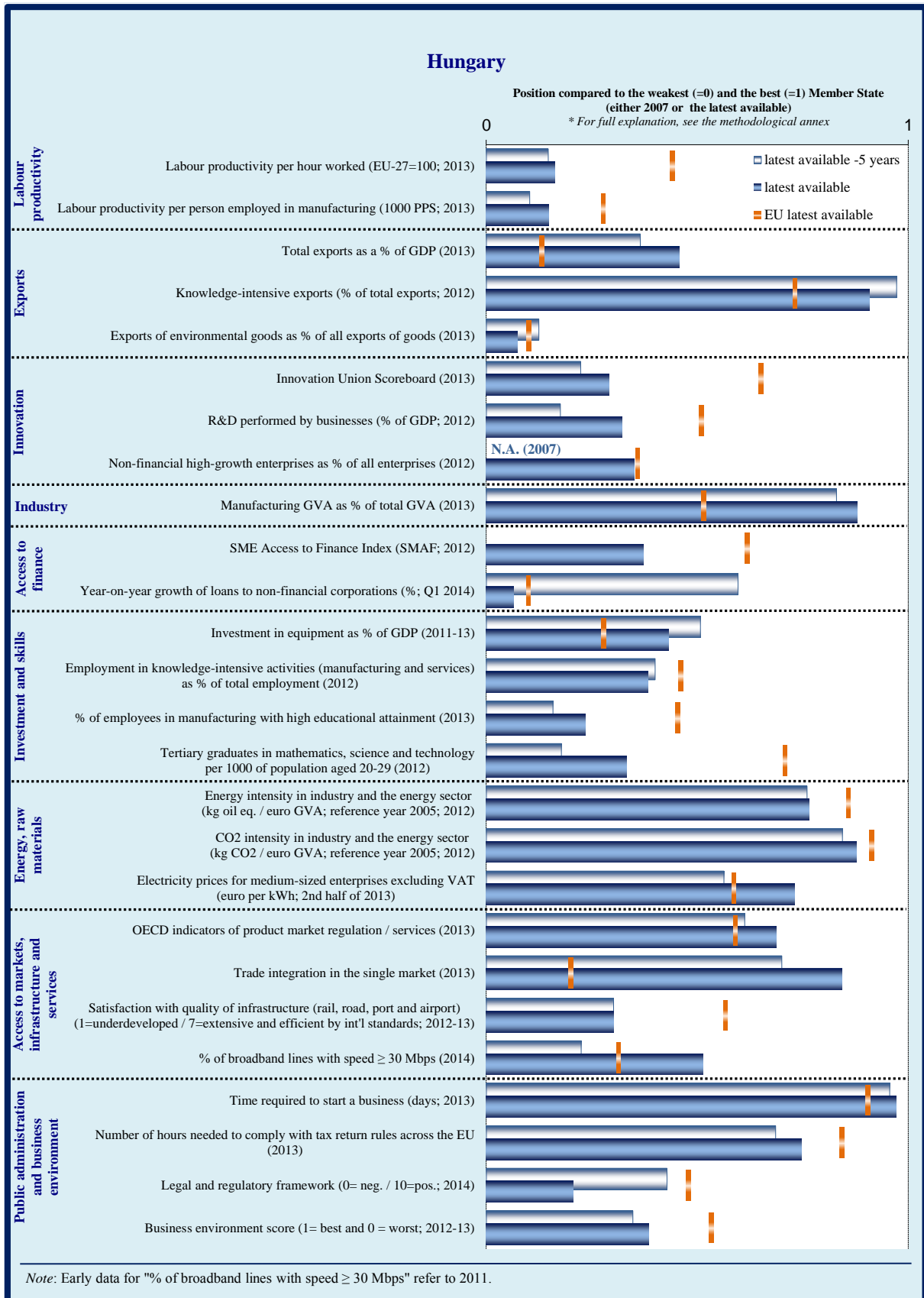
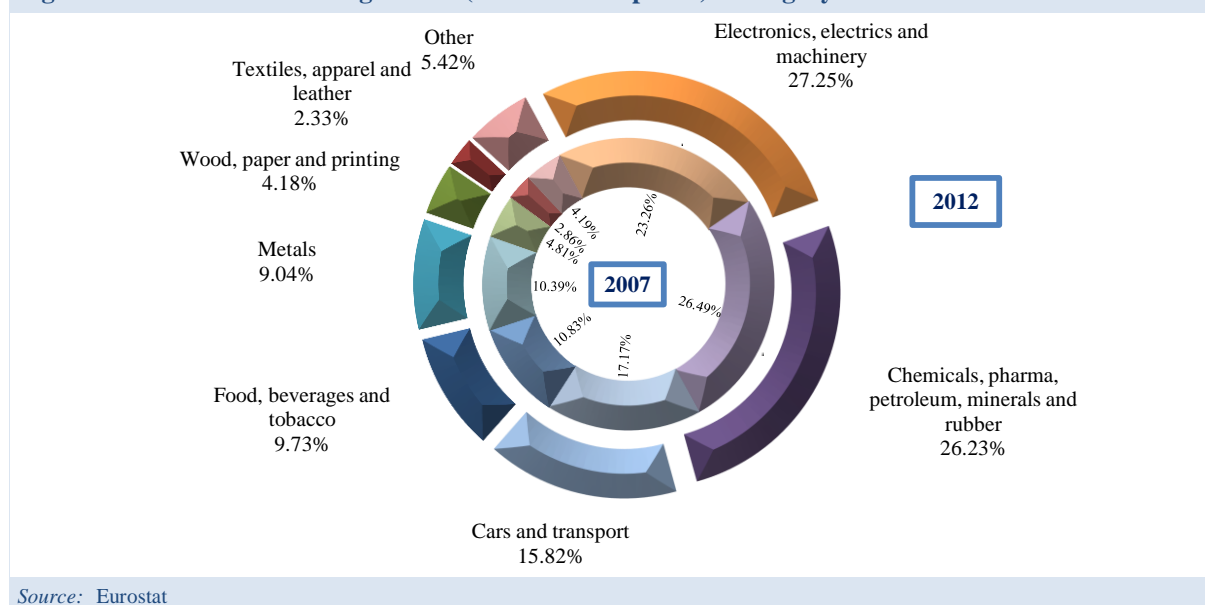


Figure 3.17.1: Manufacturing sectors (GVA at basic prices) - Hungary

3.17.1 Introduction and performance

The relative importance of manufacturing is higher than the EU average in Hungary, which specialises in technology-driven industries (transport equipment, electronics, pharmaceutical and food processing are the key sectors), both in value-added and exports. The relative importance of the automotive sector, which accounts for 18 % of all exports, has increased because of new investments.⁽¹⁾ The Hungarian economy has finally entered into recovery in 2013. In the first quarter of 2014, the GDP has increased by 3,5%⁽²⁾ compared to the previous year partly due to the strong performance of industry, where the increasing export volume is driving growth. The construction sector also seems to have emerged from the recession. Nevertheless, there are some other exceptional factors that could contribute to this increase, such as the sped-up absorption of the EU structural funds from the 2006-2013 financing period.

⁽¹⁾ Mercedes has opened a plant in 2012, and Audi has expanded its investments since 2008, establishing an R&D center in 2013

⁽²⁾ KSH

3.17.2 Access to finance and investment

Bank lending

Access to finance remains one of the most problematic aspects of competitiveness.⁽³⁾ Lending conditions in the economy have worsened in the past period significantly due to the high level of non-performing foreign currency loans, high external indebtedness, as well as the special levies maintained in the financial sector.

To respond to these challenges, the Hungarian Central Bank has introduced in 2013 its Funding for Growth scheme.⁽⁴⁾ The programme has been met with high demand, with the full available amount used, (however, a significant amount of it to pay back foreign currency loans). In view of these results, the programme has been extended to 2014.⁽⁵⁾ In the new phase, the absorption has slowed down but it has gained momentum again in May and until late June 2014 HUF 223 billion has been used. It is also a positive sign that 98 % of these transactions are new

⁽³⁾ World Economic Forum, The Global Competitiveness Report 2013

⁽⁴⁾ The programme was launched in April 2013 to provide a refinancing loan to banks at 0% which could be used to provide loans to SMEs at 2.5%. The first amount was 750 bn HUF, 93% of which was used up by September 2013, The first pillar is for new loans, the second pillar is for refinancing FX loans, Annual Report MNB

⁽⁵⁾ The new phase was launched with a maximum amount of HUF 500bn in the first step, with a maximum of 2000 bn HUF

loans and 60 % are loans for investment.⁽⁶⁾ Three quarters of the loans has been made available in the agriculture, processing industry, retail and repair sectors.

The Szechenyi card programme, which provides credit-card based low-interest loans for micro- to medium-sized enterprises at Hungarian credit institutions, continues to be an important tool in the financing of SMEs. However, according to stakeholders, its attractiveness has been somewhat affected by the Funding for Growth scheme, due to the discrepancy of interest rates.

Venture capital and other finance

Access to venture capital has improved over the last year, having changed from being below the EU average to slightly above.⁽⁷⁾ The JEREMIE⁽⁸⁾ scheme of the structural funds continues to be the most important source of venture capital in Hungary. However stakeholders note a mismatch between the size of the funding and the needs in the economy. Notably, it has been difficult for start-ups to obtain a “seed capital” type of funding.⁽⁹⁾

Investment

The Hungarian Investment and Trade Agency⁽¹⁰⁾ provides international investors with a wide range of information and support services. Foreign direct investment inflows have started to increase again primarily due to new investments in the automobile sector, however in regional comparison Hungary’s net FDI inflow position is lagging behind.⁽¹¹⁾ There seems to be a slight positive turn in the expectations of some foreign investors, who foresee further growth in investments in 2014.⁽¹²⁾

⁽⁶⁾ http://www.mnb.hu/Root/Dokumentumtar/MNB/Monetaris_politika/NHP/NHP2_kihasznltsag_kozlemeny_20140506.pdf

⁽⁷⁾ 2013 SBA Fact Sheet Hungary

⁽⁸⁾ Joint European Resources for Micro- to Medium-Sized Enterprises

⁽⁹⁾ The government has started to tackle this issue partially via the incubator programmes set up in the ICT sector

⁽¹⁰⁾ <http://hita.hu/>

⁽¹¹⁾ Macroeconomic Imbalances, Hungary 2014, http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/pdf/ocp180_en.pdf

⁽¹²⁾ Konjunktúra jelentés, Magyarország 2014, Német Kereskedelmi és Iparkamara, http://www.ahkungarn.hu/fileadmin/ahk_ungarn/Dokumente/Bereich_CC/Publikationen/Konjunktur/2014/Konj2014_hu_web.pdf

The government has also continued concluding strategic partnership agreements with big companies already present in Hungary. The government sees these agreements as a tool to stimulate the R&D activity, to increase the proportion of Hungarian subcontractors, and to involve these companies in the dual vocational training system, among other objectives.

3.17.3 Innovation and skills

Innovation

The Innovation Union Scoreboard 2014⁽¹³⁾ confirmed Hungary's position among the “moderate innovators” of the EU.⁽¹⁴⁾ While Hungary is still on track to achieve its R&D expenditure target of 1.8% of GDP,⁽¹⁵⁾ the ambitiousness of the target itself can be questioned from a long term competitiveness perspective. Moreover, significant disparities exist in innovation performance and expenditure at regional level, as almost all R&D activity is concentrated around the capital. This approach has also been confirmed by the new Innovation Strategy⁽¹⁶⁾ which was adopted on 13 July 2013. The strategy sets the framework for innovation spending in the period of 2013-2020 with a special focus on high-growth capacity start-ups in the ICT sector.⁽¹⁷⁾

The tax treatment of R&D expenditure⁽¹⁸⁾ has undergone some changes in businesses, most notably as regards the deductibility from the innovation levy.⁽¹⁹⁾ The importance of this fiscal incentive was to create links between businesses and local universities and research institutes that may have not arisen otherwise. A new fiscal incentive has been introduced for the deductibility of social contribution when employing PhD students. It remains questionable if this incentive is a suitable tool to boost innovation capacity in SMEs.

⁽¹³⁾ European Commission, Innovation Union Scoreboard 2014, <http://ec.europa.eu/enterprise/policies/innovation>.

⁽¹⁴⁾ Together with HR, CZ, EL, IT, LT, MT, PL, PT, SK and ES.

⁽¹⁵⁾ GERD in % of GDP is 1.3% (2012), Eurostat

⁽¹⁶⁾ <http://www.nih.gov.hu/strategiaalkotas/hirek-esemenyek/nemzeti-kfi>

⁽¹⁷⁾ The Budapest 2.0.2.0 Runway Start-Up credo has been adopted in early 2014 with the participation of the start-up community <http://www.nih.gov.hu/strategy/publications/budapest-2-0-2-0-runway>

⁽¹⁸⁾ The innovation levy is no longer tax deductible, even in case of in-house innovation..

⁽¹⁹⁾ The deductibility was discontinued due to the possibility of tax evasion.

While in general the share of businesses in R&D has grown, indicators for non-R&D innovation expenditure in firms and in-house innovation by SMEs have declined in 2006-2013. ⁽²⁰⁾ Innovation in SMEs in general is lacklustre ⁽²¹⁾ suggesting weak spill-over between the technologically advanced foreign companies and the local SMEs. Better integration of SMEs into the supply chain of these large companies is an identified objective of the SME Strategy of the government, adopted in January 2014.

Skills

Skilled labour force is an important element in attracting foreign direct investment. While labour productivity in manufacturing has increased along with the number of science, technology and math graduates, Hungary's performance is still far from the best-performing Member States. The vocational training system has been reformed recently in close cooperation with industry reinforcing the dual training elements of the system. The new system was rolled out on 1 September 2013, and therefore there are no evaluations available yet. However, it seems that at this stage there is room for improvement as regards the capacity of vocational placements to meet the demand.

This could be partially due to the tax incentives linked to vocational training, as these are more suitable for big companies as compared to SMEs. There are however some direct support schemes available to SMEs, such as development of training workshops.

3.17.4 Energy, raw materials and sustainability

Energy use and prices

The energy intensity of the economy overall has slightly increased with significant potential for savings. About 70 % of the current building stock is

⁽²⁰⁾ Business enterprise expenditure on R&D (BERD) was 0.85 % of the GDP in 2012, making Hungary rank 15 in the EU. However a high proportion of BERD is carried out in foreign partners engaged in high- and medium-technology manufacturing, while domestically owned industry performs little innovation.

⁽²¹⁾ http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/index_en.htm#h2-2 In Hungary only 13% of the SMEs carry out innovation activities, far behind the EU average of 30%.

in need of renovation, as 40 % of all energy use is linked to the heating and cooling of these buildings (including hot water). The sector also accounts for the largest part of CO₂ emissions. The National Building Energy Strategy, which would draw up the most important objectives in this area for the investment of the EU structural funds for the 2014-20 period, was planned to be adopted by June 2013. This has been delayed however, even though investment in energy efficiency, besides the environmental and cost saving benefits could also be a trigger to stimulate the construction sector.

Energy prices on the other hand have been reduced in the household sector via regulatory measures putting the long-term sustainability of the network at risk, as the providers cannot fully recover their costs. Therefore some of these costs may be offset via the prices charged for industrial users, negatively affecting their competitiveness. ⁽²²⁾ The repressed prices in the household sector also make the recuperation of investments in energy-efficiency more difficult, and may be a disincentive for new investments. These potential distortions have been addressed in the 2014 country-specific recommendations.

Resource efficiency

Resource efficiency in Hungary is weak with low levels of recycling. In 2012, Hungary used landfills for as much as 65.4 % of its municipal waste and recycled only 25.5 %; ⁽²³⁾ this latter figure is below the EU average. ⁽²⁴⁾ In 2013, Hungary adopted a new waste management law, strengthening the role of government and municipalities by prescribing rules of majority ownership by these public actors in the waste collection sector and introducing price-regulation. ⁽²⁵⁾ This reorganization has affected market-based investments into complex waste management infrastructures. The government has also introduced different fees in the sector, including a landfilling tax which is scheduled to progressively increase until 2016. As the changes have only entered into effect as of 2014, it is yet to be seen if the

⁽²²⁾ Macroeconomic Imbalances, Hungary 2014, http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/pdf/ocp180_en.pdf

⁽²³⁾ 9% of this waste-stream was used energy recovery.

⁽²⁴⁾ EUROSTAT 2014.

⁽²⁵⁾ As of 1 January 2014 only companies where the state or local authorities are majority owners can be registered waste collectors. Provisions regarding the fees paid by residents for the collection and treatment of municipal waste is part of the law, however those will enter into effect as from 2015

measure will contribute to its stated objectives, namely increased resource efficiency and improved quality and safety in public waste management services.

Other sustainability issues

The green economy in Hungary is driven by infrastructure investments, such as water treatment facilities, mostly financed by EU structural funds. Green entrepreneurship on the other hand has not yet taken root in Hungary; 82% of Hungarian SMEs do not offer green services or goods,⁽²⁶⁾ mostly for a lack of demand. The share of environmental goods in all exports has decreased over time.

3.17.5 Access to markets, infrastructure and services

Internationalisation

Weak internationalisation⁽²⁷⁾ and a modest level of innovation in the business sector, particularly among SMEs, remains an obstacle to increased competitiveness.⁽²⁸⁾ Only 13 % of Hungarian SMEs carry out innovation activities as opposed to an EU average of 30 %.

Notable measures to enhance internationalisation were the export credit programme of EXIMBANK and the setting up of trading houses in key new markets within the context of the “Opening to the East” strategy in order to help market access for SMEs. Moreover, the Hungarian Chamber of Industry and Commerce has extensive programmes to enhance the export activity of Hungarian SMEs.

So far the different support tools and funding schemes for SME competitiveness have failed to bring about significant increase in SME’s capacity to internationalise and innovate. In 2014, Hungary adopted the ‘Strategy for the development of SME 2014-2020’ to enhance the growth potential of these companies setting out specific objectives for the next EU financing period. The effective deployment of these funds will be an important tool to tackle the competitiveness challenges of Hungarian SMEs.

⁽²⁶⁾ http://ec.europa.eu/public_opinion/flash/fl_381_en.pdf

⁽²⁷⁾ http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/index_en.htm#h2-2

⁽²⁸⁾ http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2013/hungary_en.pdf

Business services and network industries

Hungary continues to maintain the additional sector-specific taxes introduced after the financial crisis. Moreover, a new special tax on advertisements was adopted in June 2014.

In certain service sectors (household waste treatment, pharmacies, mobile payment services, retail tobacco and publication of school textbooks) new barriers have been introduced. All these recent measures, coupled with those previously introduced (e.g. retail, meal vouchers), have contributed to the uncertainty of the investment climate.

Infrastructure

While road infrastructure has improved in recent years, the rail and waterway infrastructure continues to be a barrier to competitiveness. As of 1 July 2013, the government has introduced an e-toll for distance-based charging of heavy goods vehicles. Being an average logistics performer⁽²⁹⁾ at the crossroads of trans-European corridors, there is room in Hungary for exploiting the capacity of inland ports and (intermodal) terminals,⁽³⁰⁾ e.g. by improving their accessibility and service level. The Hungarian National Transport Strategy, expected to be finalized in 2014, will provide the framework of strategic prioritisation of transport developments.

3.17.6 Public administration and business environment

Entrepreneurship and Small Business Act (SBA)

SMEs play an important role in the Hungarian economy in terms of employment, however the value added generated by these companies is significantly lower than the EU average.⁽³¹⁾ While manufacturing is an important driver of the economy, the percentage of SMEs active in the sector is below the EU average. SMEs were also slower to recover from the crisis; their value added output has been growing constantly, but in 2012 was still below the 2008 levels. One notable exception is the information and communication sector, where important success

⁽²⁹⁾ <http://lpi.worldbank.org/international/global>

⁽³⁰⁾ The utilisation of Hungarian ports is around 50%, http://ifka.hu/ifka2/img/files/logstrat/logstrat_final_0816.pdf

⁽³¹⁾ http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2013/hungary_en.pdf

stories have emerged. Building on these success stories, the government has put in place a business incubator programme in 2013, with three incubators focusing on ICT, and one on the biotech sector.

SME performance improved for the areas of single market, access to finance, responsive administration, state aid and public procurement where Hungary performs in line with or in some cases even outperforms the EU average. SME performance in general is still lagging behind the EU average in the aspects of internationalization, environment, skills and innovation, the think small principle and second chance.⁽³²⁾ To combat these weaknesses, the SME Strategy identifies three main areas of intervention: the enhancement of growth potential, the improvement of access to external funding sources and the development of the business environment.

This Strategy together with the Smart Specialization Strategy and the RDI Strategy will form an important part of the framework of the different programmes to be launched in the 2014-2020 planning period of the structural funds. The government has announced that in this financing period 60 % of the available funds will be spent on economic development, the enhancement of the competitiveness of SMEs being an important objective in this area.⁽³³⁾

Administrative modernisation

Low levels of government effectiveness and high administrative burden have been long-standing problems in Hungary. Hungary has been ranking consistently low in indicators linked to the quality of policymaking⁽³⁴⁾ and its position in most

international competitiveness rankings has deteriorated over time.⁽³⁵⁾

Hungary has started two large-scale programmes in 2011, (the Magyary programme and the Cutting Red Tape programme) to tackle the systemic problems of public administration.

Reducing administrative burden

In the framework of the Magyary programme, reforms have been implemented both in institutional and organizational aspects. These changes have brought about improvements in the responsiveness of public administration,⁽³⁶⁾ but administrative capacities, especially human resources skills, could be further improved to increase effectiveness.

The Cutting Red Tape programme was rolled out in 2011 to reduce the administrative burden on businesses. The implementation of the 106 planned measures has largely finished by the beginning of 2014 and according to government estimates, the initial target of a 25 % reduction of administrative burden has been achieved.⁽³⁷⁾ Nevertheless these results have yet not been felt by the business sector, which continues to report a high level of administrative burden and only minor improvements.⁽³⁸⁾

While Hungary has not yet reached the EU average in the area of e-government, several measures have been put in place in the last 4 years, including electronic permissions and documentations for construction, electronic system for filing annual company accounts and electronic payment system for business taxes. On the other hand, in the area of e-procurement, the

⁽³²⁾ http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2013/hungary_en.pdf

⁽³³⁾ <http://www.kormany.hu/hu/nemzetgazdasagi-miniszterium/tervezeskoordinacioert-felelos-allamtitkarsag/hirek/a-kormany-celja-a-kkv-szektor-versenykepessegenek-novelese>

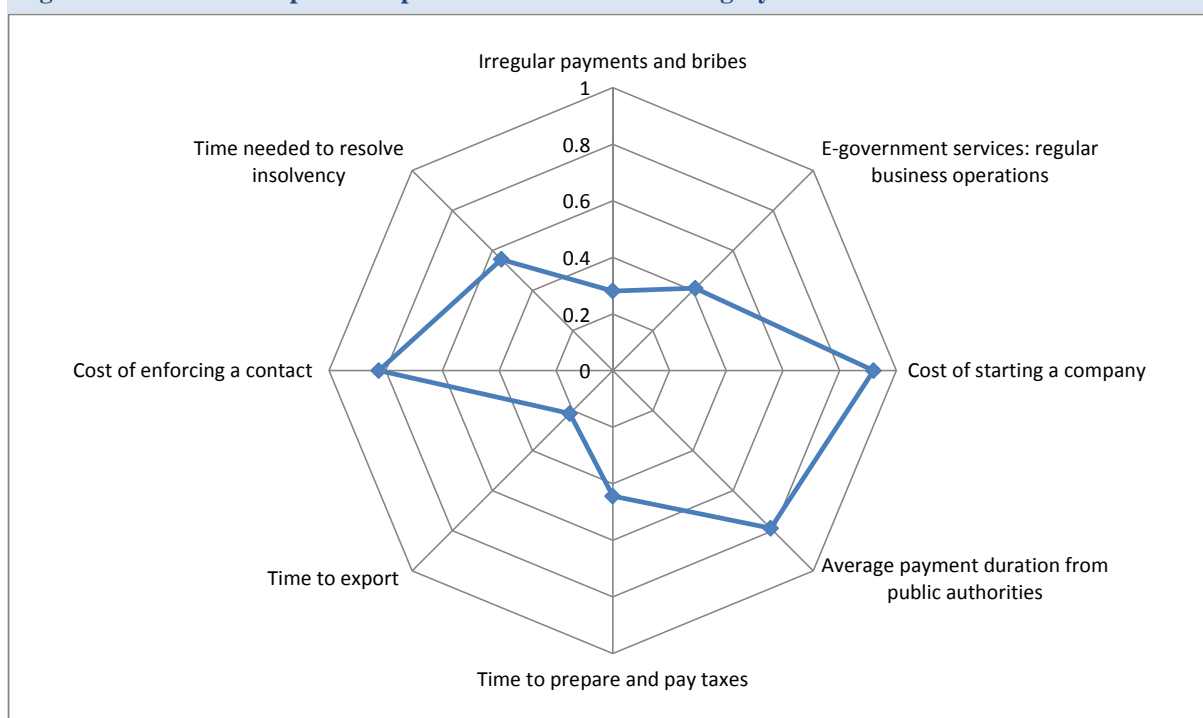
⁽³⁴⁾ According to the last World Economic Forum's Global Competitiveness Report 2013-2014, Hungary performs poorly in a number of institutional indicators: *Burden of Government Regulation* (Hungary is 25th in the EU); *Efficiency of Legal Framework in Challenging Regulations* (27th in the EU); *Transparency of Policy Making* (27th in the EU); *Lack of Trust in Politicians* (Hungary ranks 129th out of a total of 148 countries); *Favouritism in Decision of Government's Officials* (116th); *Wastefulness of Government's Spending* (110th); and *Diversion of Public Funds* (110th). Most of the deterioration in these indicators took place until 2009, while since then these indicators have remained broadly stable.

⁽³⁵⁾ The country has lost five places in the International Institute for Management Development's in the World Competitiveness Yearbook (down to 50th from 45th in the 2012 report); three places in the Global Competitiveness Report 2013-2014 (63rd from 60th); two places in the Doing Business ranking (54th from 52nd in 2013). By contrast, Hungary has gained two places in the 2014 World Competitiveness Yearbook of IDM.

⁽³⁶⁾ Notably, Hungary scores above the EU average in terms of time to obtain construction permits and starting a business. Shorter deadlines have been introduced in public administration procedures.

⁽³⁷⁾ It is not entirely clear if this figure is based only on ex-ante estimates or if burdens that have emerged in the meantime have been taken into account.

⁽³⁸⁾ As communicated by all business sector actors met by the Commission during its EU Semester mission. See also the

Figure 3.17.2: Overall profile of public administration - Hungary

Note: Values have been scaled so that the best observation (Member State) gets 1 and the worst gets 0.

Source: World Bank Doing business; Intrum Justitia; OECD; World Economic Forum; European Commission

country is still lagging far behind the EU average, resulting in a CSR on this point.⁽³⁹⁾

Another notable measure in 2013 was the online linking of cash registers to the tax office, which required upfront investment, but should result in simplification for businesses in the long run and contribute to the whitening of the economy.

Finally, the Civil Code has been reformed and re-codified to adapt it to modern business life. The changes entered into force as of 15 March 2014, affecting important aspects of business, such as the liability of managers or changes in the enforcement procedure in case of late-payment. Contracting practices will have to be reformed in order to take into account the changes.

Business environment

Frequent legislative changes have led to a regulatory environment characterized by unpredictability and uncertainty. Regulatory impact assessments are

compulsory in Hungary,⁽⁴⁰⁾ however not always applied and the quality could be improved. Although the impact assessment requirements formally include an evaluation of effects on SMEs, a proper SME test is not systematically applied.

In 2013, new measures have been introduced to strengthen transparency in public administration, such as the introduction of ethical codes and the new whistle-blower regulation. While these are steps in the right direction, further efforts are needed to tackle corruption effectively, especially in the area of public procurement.

3.17.7 Conclusions

Manufacturing, dominated by large international companies, accounts for a large proportion of the Hungarian value added and the integration of the domestic SMEs into this value chain remains weak. It is crucial that the large percentage from the EU structural funds earmarked for economic development brings about the structural changes needed for long term competitiveness. Especially the untapped

⁽³⁹⁾ *'3rd Hungarian CEO Survey'* by PWC and in particular the assessment by businesses that the costs of regulation..

http://ec.europa.eu/europe2020/pdf/csr2014/swd2014_hungary_en.pdf

⁽⁴⁰⁾ These rules can be easily circumvented though in practice, as proposals by individual MEPs are not subject to impact assessments.

Country chapters

potential in infrastructure, innovation, and sustainability will have to be addressed by these programmes. Despite wide-sweeping reforms, public administration is still burdensome and the regulatory environment continues to be an obstacle to competitiveness.