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FLASH REPORT

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New Economy Protection Measures will support, rather than risk, the achievement of next year's deficit target

- Hungary's Finance Minister Mihály Varga has submitted to Parliament bills with new Economy Protection and Competitiveness Improvement Measures, the most important parts of which are as follows:
  - The unification of the current employee social security contribution (SSC) system. As a by-product, this will (i) increase possible family tax deductions from SSC, (ii) decrease the minimum SSC for enterprises as well as (iii) increase SSC for engagement agreements and for small farmers.
  - Exemption of all pensioner work from employee SSC. Previously, only those with an employment contract were exempt.
  - New measures to combat the shadow economy: (i) all business invoices will be linked online to the tax authority, (ii) VAT invoices issued to individuals will be linked as well, (iii) activities exempt from VAT will be also subject to compulsory billing.
- Most measures will enter into force on 1 July 2020, with the exception of VAT reporting for invoices to individuals, which will start from 1 January 2021. All this means that at best, half of the full-year effects will appear next year.
- Overall, we estimate +0.1-0.2% of GDP full-year effect from these measures, meaning that their effect will amount to maximum +0.1% of GDP next year[1] as anti-shadow-economy measures are likely to more than offset loosening effects. However, two additional points are worthy of note here. First, it is important to stress that the loosening measures (all measures excluding anti-shadow-economy ones) are minor in magnitude. Second, the exact revenue effects of anti-shadow-economy measures are highly uncertain. However, based on the revenue effect of online invoicing so far, and the fact that Hungary's VAT gap has declined substantially, we assume that further measures to address the shadow economy will result in much lower extra revenues than the previous ones.
- To sum it up, we think that the steps altogether will support, rather than risk, the achievement of next year's 1% deficit target. Additionally, one can note that these measures simplify the tax system and help to broaden the tax base, therefore they could be considered as steps in the right direction.

[1] See Table 1 on next page for a detailed decomposition.

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Table 1 – Summary of new the Economy Protection and Competitiveness Improvement Measures*

Measure	Planned date of introduction	Annual effect on government balance (bn HUF)	Comment
(1) All employee SSC will merge into one, at 18.5%.	1 July 2020	1,5	Currently there are four employee SSCs: Pension (10%), in kind, and financial health care contribution (4%+3%), labor market contribution (1.5%)
(1a) The family tax relief could be deducted from the full new universal employee SSC.	1 July 2020	*-1*	*MinFin estimate. Up until now, the family tax relief has been deductible from the pension and health contributions.*
(1b) Loosening the rules for minimum SSC contribution for enterprises.	1 July 2020	*-7,5*	*MinFin estimate. Earlier the minimum contribution base was 1.5 times the minimum wage for health and labor market contribution; the new measure links the minimum contribution to the minimum wage for the unified contribution.*
(1c) Higher employee SSC for engagement agreements and small farmers	1 July 2020	*10*	*So far these two categories have been exempt from the labor market contribution, hence they payed only 17% employee SSC.*
(2) All pensioner work will be exempt from employee SSC.	1 July 2020	-20	MinFin estimate. So far only pensioners in employment were exempt from SSC (enterprises or those working under engagement agreements were not exempt)
(3) Anti-shadow-economy measures: (a) All business VAT receipts will be linked online to the tax authority, (b) VAT receipts for private persons will be linked to the tax authority (c) compulsory receipt for VAT exempt items. (d) the maximum deadline for invoice issuance will decrease to eight days (from 15).	1 July 2020, except (b) which is from 1 January 2021	50-100	So far only businesses' VAT receipts above HUF 100,000 have been linked online to the tax authority, while VAT invoiced to private persons were exempt. The MinFin estimates HUF 200-250 bn total extra revenues from online invoicing so far (we estimate the half-year effect for last year at HUF 140 bn). As Hungary's VAT gap fell below 10%, we reckon that the new measures will have more limited effect on revenues.
Total (bn HUF)		**31.5-81.5**	
Total as % of GDP		**0.1-0.2**	

**MinFin and OTP Research calculations*

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