Hungary: Policies for a stronger and sustainable recovery

By Jens Høj and Martin Borowiecki, OECD Economics Department

The COVID-19 pandemic abruptly ended the strong economic growth performance in 2016-19, which entailed large increases in employment and real incomes, and the lowest unemployment rate in thirty years. What followed was a severe economic contraction as containment measures and a drop in international demand hit hard the export-oriented economy.

The Hungarian economy is now emerging from the crisis. A fast vaccination rollout allows a rapid economic recovery from mid-2021 onwards. The 2021 Economic Survey of Hungary projects annual growth of about 5% per annum in 2021 and 2022, with GDP recovering to pre-crisis level at the beginning of 2022. The recovery will be driven by the release of pent-up demand and stronger external demand.

Prepare for fiscal consolidation once the recovery becomes self-sustained

However, the crisis is not over yet. Uncertainties around the strength of the recovery remain, reflecting the potential scarring of the economy arising from the prolonged crisis. For instance, semiconductor shortages could continue to interrupt the Hungarian car production. Also, new COVID variants may emerge and could potentially lead to new restrictions and lower domestic spending. The Survey recommends to continue to provide targeted fiscal support as needed. Once the recovery has become self-sustained, the government should prepare for fiscal consolidation. Such consolidation is needed to address long-term fiscal challenges that arise from population ageing.

Exit from unconventional monetary policy measures

As the recovery gathers pace, a combination of stronger wage growth and supply shortages could fuel rising inflation expectations. Inflation is above the inflation target of 3% and moved outside the central bank's upper tolerance band of + 1% in spring 2021. Now is the moment to gradually exit from unconventional monetary policy measures. Monetary policy should also continue to increase policy interest rates if inflation expectations become unanchored.

Reforms for strong and sustainable growth

As the recovery becomes self-sustained, attention should be given to structural reforms to secure the impressive income gains achieved before the pandemic. The OECD Economic Survey of Hungary highlights three main challenges to long-term growth and provides recommendations to address them.

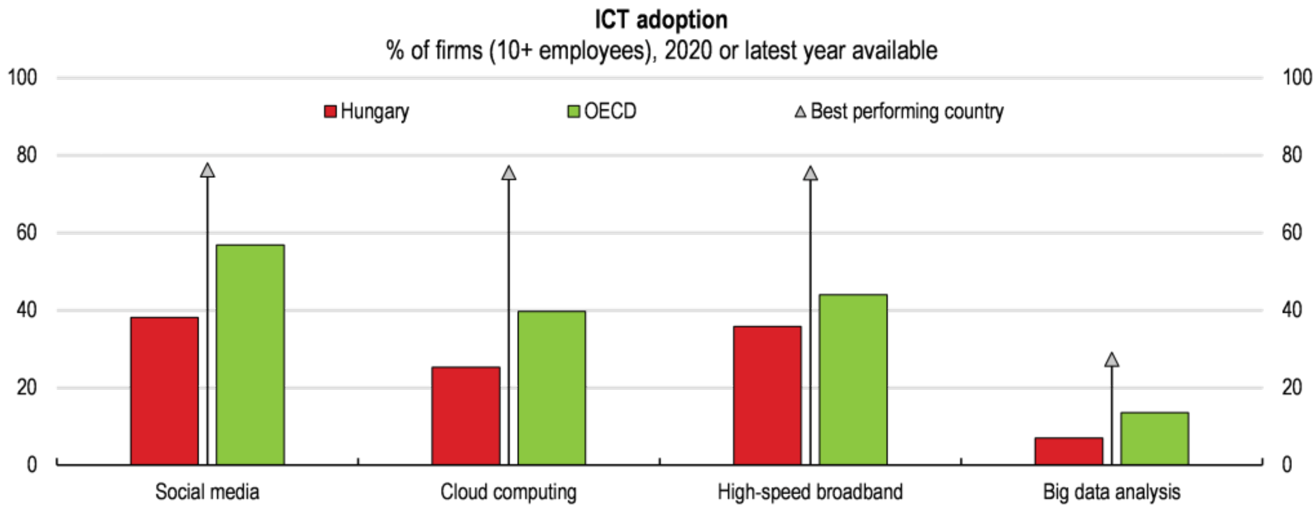
Bolster productivity growth

First, population aging will lead to an older and smaller work force, reducing growth. Demographic change makes it necessary to improve the productivity performance of the economy, which has been weak in the decade leading up to the pandemic. Stronger productivity growth will help to continue the income gains achieved before the pandemic and close the income gap vis-à-vis richer OECD members.

The OECD provides in this Survey key recommendations to achieve faster productivity growth. In the near-term, the employment prospects of low-skilled workers need to be raised through skills upgrading and higher labour mobility. Thereafter, faster productivity growth requires improved vocational and tertiary education, more competitive markets, and faster adoption of new technologies, particularly to accelerate the digital transformation of the economy (Figure

1). Also, intensifying efforts to fight corruption would ensure a better use of public resources, including the efficient use of procurement in the roll-out of public investments, and foster stronger business dynamics.

Figure 1. Hungary lags in ICT adoption



Note: Firms from the financial sector are excluded. High-speed broadband are subscriptions with 100+ Mbps.
Source: OECD ICT Access and Usage by Businesses database.

Secure the fiscal sustainability of the pension system

Second, population ageing is accelerating, boosting ageing-related spending in areas such as health and pensions. If not contained, these will lead to sharp increases in public debt. This reflects that many pensioners retire early, despite recent increases in the effective retirement age. Addressing this challenge requires longer and healthier work lives.

To this end, the OECD recommends to complete the ongoing increase of the statutory retirement age to 65 by 2022, and thereafter, to link further increases to gains in life expectancy. To prepare the health care system for an older workforce, the autonomy of hospitals should be enhanced to adjust the supply of health services to future needs.

Improve environmental outcomes

Third, better environmental outcomes require a further decoupling between economic growth and greenhouse gas emissions. Environmental policy is currently based on a combination of regulations, subsidies and tax rates that vary across sectors. This means that polluters do not necessarily pay the cost of pollution. In addition, prices of energy, water and waste collection are regulated for affordability reasons, often to below-cost levels. Low regulated prices discourage investment in much-needed greener technologies. Addressing the challenge of reducing greenhouse gas emissions requires setting higher and more uniform prices on emissions.

To make polluters pay a higher price for polluting, the OECD recommends to gradually unify carbon taxes. Non-carbon environmental taxes should be set according to the polluter pays principle. In addition, the government should ensure cost recovery in regulated energy sectors. Higher waste collection fees and water and wastewater service tariffs can help finance the needed investments. To help low-income households, the government should introduce well-targeted affordability measures.

References

OECD (2021), *OECD Economic Surveys: Hungary 2021*, OECD Publishing, Paris, https://doi.org/10.1787/1d39d866-en.