

# Why I would not like to be in the shoes of the Minister of Finance?

By Tibor Erdős



be essentially higher than the official rate of 40 %, since a great part of depreciation continues to be taxed. The proposal also states the reason: "the tax base has to be protected". That is, the grave position of the state budget does not allow to dispense with the taxation of depreciation allowance. Should the economic situation later improve, the writing off of old equipment may be accelerated with a new economic decision.

"There have, of course, been made investigations of the expected impacts. They revealed that if the new law on bookkeeping (accountancy) were introduced in 1992 at one go, the deficit of the budget would grow huge. This is why we decided that a modern system of depreciation cannot be introduced at one go. In establishing the tax base, a compromise has to be struck, so that both the state should fare well and also the enterprises should have some money left with them. It is first of all the depreciation allowance accountable on new assets that can be raised to a realistic level, and thus more sources will be available to the firms" (From an interview with Mihály Kupa, Minister of Finance, published in Figyelő on July 4, 1991.)

But one cannot know what will bring about an improvement of the economic situation, if the expected after-tax profit of the firms is by far not enough for investments accelerating evolution and the structural changes. True, in the case of newly established firms, if the investment is indeed new or, similarly, with investments implemented through direct import of capital, the raising of the depreciation rates will have more advantageous impacts. But this is not sufficient even here as, because of fast inflation, investors might fare badly in consequence of the new linear rates. Much depends thus on the development of inflation.

The taxation of personal incomes has justly been criticized, because if only "sizes" the incomes of wage earners, the progression is too steep and the marginal rate of the PIT is too high. All that puts a brake on initiatives. According to the proposal on the changes in the taxation system, and correctly progressiveness should be mitigated and the marginal rate of the PIT should be reduced to the official rate of the general profit tax, that is, 40 %. But, because of the grave position of the state budget, this can

only be achieved through abolition of the wide favours, thus "widening" the tax base. Only "personal favours" (exemptions), uniform for every taxpayer, involving favourable treatment of the costs of living in the taxation system, and allowance for dependent children can deducted from the tax base, while the family allowance received has to be added.

According to the proposal, with 1992 also small sums received (those below Ft 2000) will have to be added to total income, the 65 % favour of authors' fees will cease, and so will the tax exemption of incomes from abroad and tax will have to be paid also on the interest on deposits in foreign exchange. Benefits in kind will have to be imputed according to determined norms. (E.g. if cars are given for personal use to employees, or if someone lives in official quarters free or at a low rent).

Pensions will be engrossed and thus pensioners will pay taxes after their marginal incomes above their pensions according to higher rates. Nor will the price receipts of small farmers below annually Ft 500000 be tax free. Thus, in spite of the reduced PIT rates and lower marginal rates, they will fare much worse, and their actual tax liabilities may significantly increase. This will obviously be a source of tensions, particularly if we consider that the groups quickly enriching themselves increasingly withdraw their incomes from taxation. And, as regards political tolerableness, the idea of the proposal is simply unacceptable that, beyond a certain limit, the rate of PIT should be degressive.

The indication is missing from the proposal how the tax brackets have to be adjusted to inflation. Because of the grave position of the budget this is likely not to happen, or only to unsatisfactory degree. Nor is there any indication of the taxation of incomes from compensation received.

## Approximative raising

It is the equilibrium requirements again that dominate the changes in the GTT. The approximation to each other of the rates is correct, but it is uncomfortable if this is coupled with a raising of the general level of GTT: the zero rate will be raised to 10 %, and the 25 % rate will be reduced to 20 %. This will entail an about 2.5 % rise in the consumer price level, bringing a revenue of Ft 30 thousand million for the budget. The justification is that revenues from GTT have been growing more slowly than expected, as demand has shifted towards products and services with a zero rate, satisfying mostly basic needs. This shift may be considered as an effect of declining real wages and of economic recession in general, but, quite obviously, it also played a role that the zero rates allow a lower consumer price. Public finance wishes to make up for this loss and, in addition, in a way that the zero rates should be abolished earlier than the reduction of the 25 % rate to 20 % rate takes place.

Considering the actual position of public finance it is difficult to attack the intention of raising the GTT. The raising of the tax could only be avoided if expenditures could be adequately reduced, but no sufficiently sound proposals can be made for the latter, either. Facts remain facts. There is every likelihood that the GTT will be raised, and this will have an inflationary impact which will not benefit evolution.

## Optimistic forecast

Inflation has a direct impact on the balance of the state budget, on taxation – the development of burdens – and on the possibilities of evolution. In my opinion, however, the proposal is too optimistic in forecasting merely a 21 % rate of inflation for 1992, with a 3 % growth of the GDP – a similarly optimistic forecast. The makers of this proposal expect this rate of inflation with an about 20 % increase of nominal wages, a 25 % nominal increase of pen-

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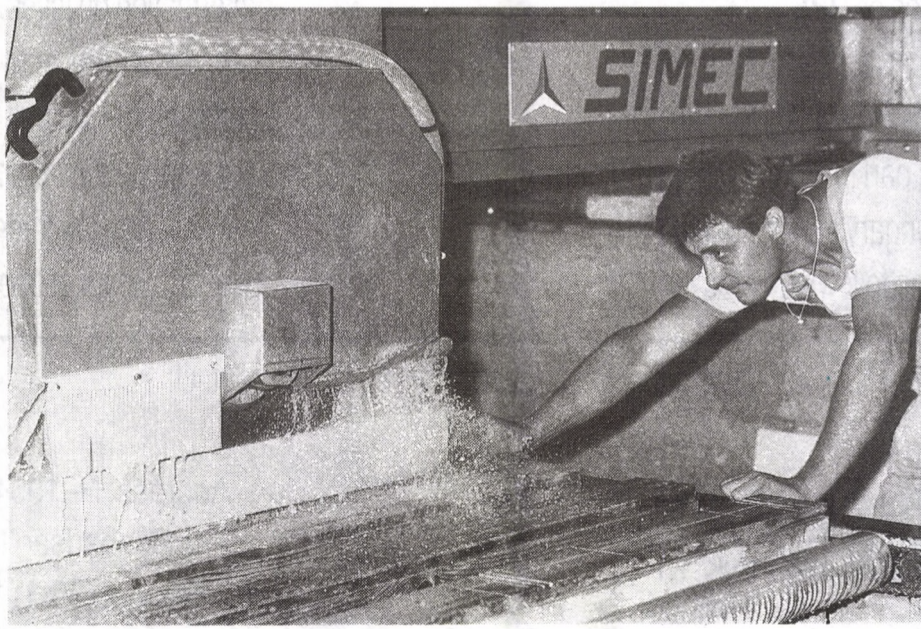
rium, push the requirements of competitiveness and economic evolution into the background.

Enterprises may justly have a grievance that the real burden of the profit tax is too high, since the depreciation allowance calculable as cost is lagging far behind the real replacement needs. Thus, not only the profit, but also the depreciation allowance is taxed, and all the more so the more lasting and faster inflation becomes. According to the proposal on the changes in the tax system, on investments implemented after January 1st, 1992 the depreciation rates can be increased: on newly invested machinery a rate of 12.5 %, on computer equipment 33 % and on vehicles 20 % can be applied. In the case of buildings, if the construction is completed after the date mentioned, the proposed linear rate of depreciation allowance is 2 %, that is, the period of writing-off would be 50 years instead of the now valid 100 years. In one version of the computations, the changes would allow the saving of Ft 4 thousand million in taxes.

## "Protection" of the tax base

Thus, progress is extremely modest, if we can speak at all about progress. The new rates affect, namely, but a fraction of fixed capital, the system of writing-off is not degressive, that is, a much greater part of the capital cannot be written off initially than in later years, even in the case of newly invested capital, thus the new rates do not provide adequate protection against inflation. Thus, the real rate of the profit tax will

MARBLE PLANT IN DEBRECEN.



The Austrian company Tissot and Agrokor founded a JV for marble processing of Carrara, Portuguese, Austrian and Hungarian marble-blocks. Their most valuable product is a 7 mm thick marble sheet which can be applied as tile, too. Agrotiss sells primarily to Western customers.

The Ministry of Finance worked out a proposal of almost 200 pages for the modification of the taxation system.

The author, member of the consultative body of the minister, says, the study proves that the burdens of the country are grave indeed and also internal political fights prevent forces from being actually concentrated on the liquidation of the crisis. Thus, the real tax burden of the population will anyway increase.

One can in many respects agree with the tax policy proposals of the Ministry of Finance. The tax base has to be widened, as this will help reduce the marginal rate of the personal income tax (PTA). To this end, however, – as other sources are missing – the scope of subsidies and exemptions has to be reduced radically. The rates of the general turnover tax (value added tax – GTT) have to be brought nearer to each other. Pensions have to be engrossed so that the tax burdens on marginal incomes of pensioners should be the same as with active earners. In the interest of increasing the tax base and reducing the marginal rates the tax exemption of benefits in kind should be abolished. The effort at making the tax system uniform, at its simplification and at a more equal judgement of different sectors and forms of property (ownership) are similarly welcome.

But the proposal is decisively imprinted by the effort at preserving internal and external equilibrium. As a matter of fact, the grave burdens weighing down the country appear in concentrated form in the state budget. This is why – as can be read from the proposal – the scope of manoeuvring of the firms is hardly expanded by the changes in taxation, the weight of taxes does not diminish, in fact a rise of certain taxes may be expected. Even so, the deficit of the state budget will expectably rise to 94 thousand million forints, although – according to the agreement made with the IMF – the deficit ought to be reduced from Ft 78 thousand million planned for this year to Ft 50 thousand million in the next. And this sum does not yet include the burdens of the budget deriving from the compensations to be paid, from the returning and operation of church immovables, the organization of the World Exhibition, the restoration of damages caused by the building of the Bős-Nagymaros power station (already cancelled) as well as from certain unavoidable wage policy measures. In addition, even further tax rises cannot be excluded beyond the steps outlined in the proposal, that is, the domestic economy is threatened by an even stronger restriction.

## The greatest evil

The proposals contained in the proposal are all too optimistic. The tax burdens are likely to be greater than those conceived of, while the revival of the economy is not likely in 1992. Inflation will probably grow faster than thought by the makers of the proposal, while investments and personal consumption will develop more advantageously than forecast. The external and internal equilibrium positions will remain critical, and the profitability of the enterprise sector – mainly of state enterprises – will be low, among other things as a consequence of the too high tax burden.

The greatest evil is that a proper transformation of the taxation system and the easing of the tax burden are not just matters for decision making, the burdens hamstringing the country do not allow this. On reading the proposal it can be found at every turn that the fiscal points of view, forcing the improvement of short-term equilib-

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The high official of the Pentagon visited the Gödöllő Engineering Factory on July 19, accompanied by a delegation of politicians and experts. His host was General Manager of the company Colonel-Engineer Árpád Adorján.

tion save money for fear of the deterioration of the living conditions, at the same time proves the temporary character of the trend. Any deterioration in the political and economic situation may reverse this trend at any moment.

In 1991, however, this development has already eased the tension which had arose from the overexpenditure of public finance in general, and that of the budget, in particular. Last year the public finance was in a net saving position, but now it has a net borrowing requirement of Ft22 billion.

It is highly visible also in other fields that the ways of influencing the monetary sphere are changing. One and a half or two years ago the National Bank of Hungary set a goal to cut the share of refinancing credits extended to financial institution among banking resources. This goal has been achieved partly because of the stagnation of

the refinancing credits with a maturity time longer than one year and also because short term credits are increasing much slower than the inflation.

In the meantime, another credit arrangement, introduced in the second part of last year, became dominant, namely the refinancing credits granted against the currency deposits of the banks. Currently, two thirds of short-term credits are extended in this form. Nowadays the financial institutions have lots of currency deposits, so the commercial banks have an easy access to resources. In the opinion of some experts, due to this, money fuelling inflation will stream into the economy. That is why the central bank has decided recently to be more rigorous than before, and to raise or adjust the interests of these refinancing credits to those of the 90 day discount treasury certificates. (f. l.)

## Effects of Hungarian – Soviet trade relations on the monetary sphere

Last year it was the developments in the Soviet-Hungarian relations, which, among others, geared monetary tensions. Instead of a planned commercial deficit, a more than Rb 1 billion surplus in merchandise trade with the Soviet Union has occurred since the middle of the last year. As a result, the value of the Hungarian claims against the Soviet Union, together with the value of previous debts unpaid so far, has approached \$ 2 billion calculated at the new exchange rate of the rouble to the dollar, approved in principle last spring. And there is hardly any hope that the Soviet will pay.

Only for this reason, an additional inflationary Ft 30 billion was added to the money supply last year. The companies applied in most of the cases the form of prompt cash in their rouble-accounted exports, which also meant that they got their money very fast. This improved their liquidity far more than the hard currency export, which is nonetheless much more preferable for the country. (The bank paid the exporters

promptly against shipping documents – Editor's note.)

This year "dollar-accounted trade practically does not work or works scarcely", says a government report. In the first part of the year the Soviets opened letters of credit for a mere \$ 163 million. The government predictions for 1991 had calculated with a 30 per cent decline, i.e. with an export of \$ 2,6 billion. But after analyzing the situation at the end of the first six months – before the Soviet coup attempt – the Ministry of Foreign Trade considered that the Hungarian export to the Soviet Union would not exceed \$ 1 billion, which implies a 60 per cent decrease, even if we take into account the export in transferable rouble at the beginning of the year.

This decline causes further trouble in the budget, as it will increase the deficit by Ft 10 billion compared to the deficit planned before. According to the calculations of the Ministry of Finance, due to profit taxes, tariffs, import duties and the additional demand of the unem-

ployment fund, a further deficit of Ft 18–20 billion can be expected. On top of this, it is very likely that a sales tax revenue of Ft 10 billion will fall short. Apart from the budget, the social security will suffer losses in the first place, which has already an overdue claim of Ft 30 billion.

Companies which supply their goods mainly to the Soviet market have been full of tensions for years. In 1990, companies realizing more than a third of total rouble export of the country suffered losses for their entire activity. The total value of their losses was as much as Ft 33 billion. There are highly different views within the government in respect of the possible impact of a 60–70 per cent fall in export to the Soviet market on the unemployment. The Ministry of Agriculture and the Ministry of Industry expect an unemployment of 130–140 thousand in the agricultural sector and that of 100 thousand in the industrial branches as a result of diminishing Soviet market deliveries. According to the Ministry of Finance it is unlikely that the number of the unemployed will rise by more than 70 thousand, even if the export falls 70 per cent.

## A BUDGET DEFICIT OF Ft 100 bn?

On the basis of facts and statements made known to the public this year, the likely budget deficit can only be estimated very roughly. It is sure, however, that the deficit will exceed the originally planned 78 billion forint. At the end of the second quarter its value was Ft 51 bn, and at the end of July Ft 61 bn.

The uncertainty has already begun at the time of the balancing of the last year's budget. At the end of the last year companies paid unexpectedly huge profit taxes or dividends on state assets. Thus, the last year's deficit of only Ft 1,4 billion was far less than it had been expected before. Early this year it turned out, however, that the companies had considerably surpassed their payment obligations and claimed back approximately 15 billion forints.

### Tensions

However, this sum reclaimed by the companies is, rather particularly, charged to this year's budget, which means that it will automatically increase the budget deficit. At the same time this example shows the calculation uncertainty which characterises both the budget and the monetary sphere as a whole. The taxes reclaimed by the companies deserve special attention, as they arose from allowances which could only be precisely calculated at the end of the year. Last year the value of allowances linked to the various profit taxes paid by the companies exceeded 20 million forint, which is more than one fifth of the actual payment.

Early this year the Hungarian government moderated its original plans again and made different concessions to certain groups of the population. The most significant item amounting to 15 billion forint comes from the government decision to postpone energy price increases and to pay compensation for them. It can't be neglected that 87 percent of the planned subsidies on consumer goods was paid in the first six months of the year.

Due to other budget tensions, additional resources or a redistribution of available funds would be necessary. According to many experts, this year the social security system will show a deficit, which, under the existing rules, must be financed from the budget. The half-year deficit of the social security system stood at 6,5 billion forint. The budget gave a guarantee to cover the deficit of the social security system, provided that the outstandings of the latter do not rise during the year. But, as the outstanding debts of the social security system rose to 32 billion forint by the end of August, theoretically the budget guarantee lost its validity. Nevertheless, in the present political situation in Hungary it is unimaginable that the budget would not cover, in one way or another, the deficit of the social security system.

There are considerable tensions in the economy of both the central institutions and the municipalities. At the same time the additional preliminary commitments have already exceeded the Ft 7 billion reserve fund planned for this year.

According to released information, even so the administration has managed so far to keep a firmer hand on its expenditure than in the previous years. The trouble is that though the social security services are wastefully managed, any further expenditure cut in several fields and at the expense of several social strata would produce unbearable tensions. At the same time the transformation of these services has just begun, and there is neither professional nor social consensus on the trend of the transformation.

### New state bonds

There are huge tensions on the revenue side, too. With an economy under restructuring and an increasing number of market participants, the previous tax system, which relied on large state-owned enterprises, is robbed of its revenues. According to a malicious remark made by a well-known economist, Hungarians have succeeded in privatizing only one thing so far: the budget revenues. But the changes in the tax system will not make their impact before next year. The official statements predict that this year the budget deficit will exceed the originally planned deficit by Ft 10 billion, and they say there is no need to adjust the budget. The IMF has changed its expectations, too: according to the modified agreement, it now accepts a deficit of Ft 86,5 billion.

To cover the deficit the Parliament has approved central bank credit of Ft 60 billion and capital market resources of Ft 15 billion raised by issuing state bonds and has increased the value of the stock of treasury certificates by Ft 3,7 billion. But the financial administration has lagged behind almost six months in issuing state bonds, and the likely deficit has also increased. That is why they have passed beyond the permitted limit of the stock of treasury certificates and want now to add 3 million forints to the central bank credits. The floating of state bonds Ft 15 billion with an interest 2 per cent higher than that of discount treasury certificates is to begin in September. Some experts fear this higher interest will limit the possibilities to raise credits in other sectors.

On the other hand, financial experts close to the government consider that unless the administration takes restrictive measures, the deficit will exceed its originally planned value by 18–20 billion forint. They must be optimists. Tensions arising from the collapse of trade with other Eastern countries may result in a further deficit of several billions. Hence, the government must act. (f. l.)

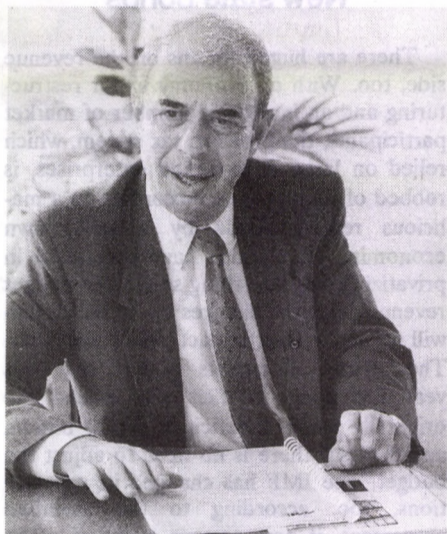
# TIPS, a Matchmaker for the Business World

By Ted Prittie

As Hungary's economy transforms into a modern market based system, the need for, and interest in, foreign involvement has increased rapidly. Thus far, one of the main problems has been how to successfully match foreign firms and investors with Hungarian companies. As the largest commercial bank in Hungary, Magyar Hitel Bank Rt. (Hungarian Credit Bank Ltd.) is presently working to alleviate these problems to better serve its clientele. MHB was the first commercial bank established after the creation of the two-tier banking system in 1987. At MHB, the General Director of the Division for International Business Relations and Marketing, Dr. György Gonda and his colleagues, have over the past year put together a specialized unit to tackle the problem of the integration of foreign investment in Hungary. The result is TIPS, an acronym for a service specializing in this field. With the bank's clients accounting for approximately 55 % of the GNP and 60 % of exports, MHB is surely a key player in Hungary's transformation and its successful integration into the world economy. Recently we talked with Dr. Gonda to discover more about TIPS and their involvement in foreign investment in Hungary.

**What does TIPS stand for and what is the mandate of the organization?**

TIPS stands for Trade Investment Promotion Services and is a specialized division of the International Business Relations Department of the bank. It was established one year ago to aid in the facilitation of joint-ventures, industrial cooperations and other business opportunities involving clients of the bank and foreign interests. Basically, due to changes in the economy, more and more companies are realizing the need to involve foreign capital and/or know-how in their organizations to become more competitive in Hungary and abroad. This is where TIPS can be of great service, by providing a medium for our clients, through which they can access information and assistance related to foreign participation in their companies.



Dr. György Gonda, worked in many areas relating to foreign trade and joint ventures, including First Commercial Secretary of the Hungarian Trade Office in New York, before joining the Magyar Hitel Bank in 1989.

**Are the services strictly for clients of the bank or are they open to the general public and do you have a method of including the whole country in this service?**

Clearly the bank wishes to work with its clients, but let me point out that TIPS is open to any person or company that is interested in our services. As far as the whole country is concerned, through the bank's eighteen regional directorates outside of the capital and the nationwide branch network, TIPS is able to reach and service businesses throughout Hungary. This is a key element of the bank's policy and is especially important to the success of TIPS and the bank's clientele.

**Does TIPS work both ways, that is to say, firstly, can foreign companies interested in Hungary approach TIPS with questions and/or proposals and secondly, where do you look for the foreign participants and how do you attract their interest?**

Through our experience we have discovered that there is a lot of interest in Hungary and that the service works most efficiently if we open the door to both sides of the potential cooperation. To answer your first question, we welcome any foreign company who is interested in Hungary to contact our office and we are presently and have been in the past contacted by companies with requests for information and assistance related to cooperation. Secondly, TIPS puts together information packages based on consultations and questionnaires completed by Hungarian companies. This information is sent through various channels abroad, including banks, chambers of commerce and selected foreign companies. Some of the current ventures which we are working on, involve spa and hotel reconstruction projects.

**Once the contact between companies has been established, what is the subsequent involvement of TIPS and the Magyar Hitel Bank?**

The service was once referred to as a liaison between capital and entrepreneurs, but I feel TIPS is really more than just a liaison. The service continues after the initial contact has been made with the specialists of the department's ability to provide assistance to see the success of the cooperation become reality. Regarding the involvement of Magyar Hitel Bank, if the business venture created through TIPS is interesting to the bank, MHB may take part in the joint-venture with its own capital. This involvement is up to a maximum of 25 per cent as stipulated by Hungarian Banking Law.

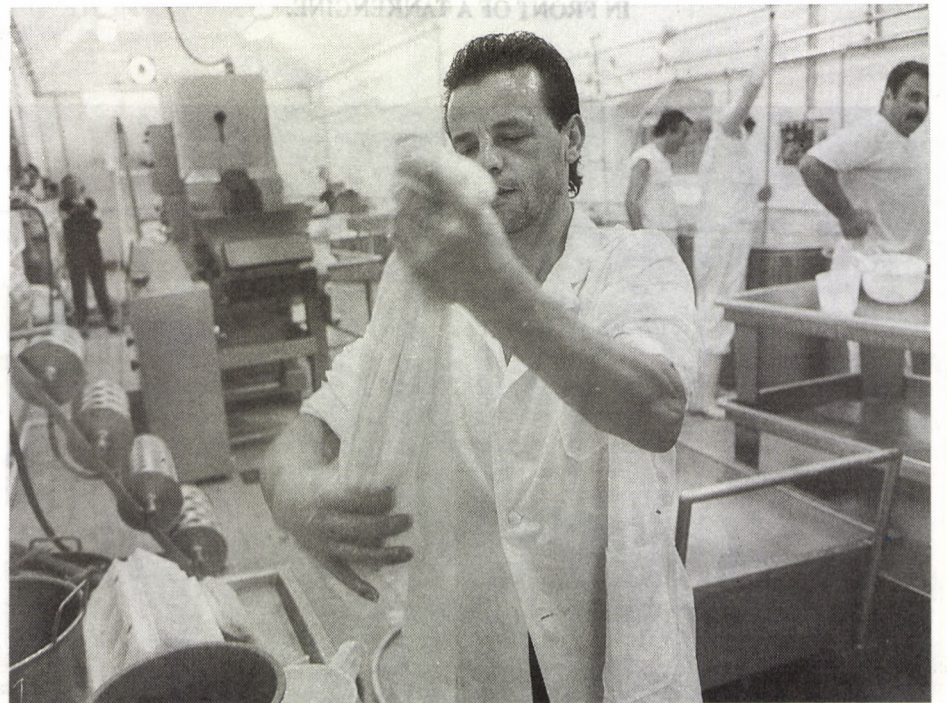
**Could you possibly provide a few examples of cooperations established with the assistance of TIPS?**

Last year, among others, we established a joint-venture between an American company, Concorde, and MOM, the Hungarian Optical Works, to produce cameras in Hungary. As well, the company A-Tech was established with MHB and DEGEM of Israel to sell educational systems in Hungary. Finally I would like to say, that we are optimistic about the successes of TIPS in the future and would like to invite any interested companies or investors to contact our offices.

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## ITALIAN CHEESE-SPECIALITIES AT ÖRMÉNYKÚT.



A PLC with Italian and Hungarian participation has been formed at Örménykút. Preserving the vital biologically important ingredients of fresh milk, they are producing in 6 hours cheese sold in the shops of county Békés.

# JOINT VENTURES

## Hungarian-British-Canadian investment-trade PLC formed

The Győr-based Duna-Lajta Trade Company has formed an investment and trade PLC with the participation of the British investment company John Govett and the Canadian firm Global Holding.

The new JV, called Global TH (Trading Hungary), was launched last month in Győr. Initial capital of 1.03 billion forints (13 million USD) is shared equally between the Hungarian company and the foreign investors. Officials hope to expand the company's range of products and number of outlets.

## Hungarian-Italian manufacturing JV founded

A new JV, called MEC-2 MOM Electronic, Ltd., has been set up to assemble electronic parts for IBM and Olivetti computers and to manufacture spectacle frames.

Headquartered at Zalaegerszeg in western Hungary, the company has an initial capital of 58 million forints (763,000 USD). It is shared equally between the Hungarian and Optical Works (MOM) PLC, of Budapest, and Montaggi e Collandi 2 in Elettronica SNC, of Udine Italy.

The company seeks to produce 200,000 frames next year.

## HIGH-TECH MANUFACTURING OF ROBOTS.



Mikromatika Robot - Automatika, a limited liability company, has been founded on Oct. 31, 1990 by Miromatika Holding (51 %), German companies (30 %), the employees (72 persons) with 19 per cent. The initial capital was HUF 80 million. The diversification of Mikromatika (in existence since 1981) made it necessary to create a holding for autonomous, profit-oriented limited liability companies. Robot-Automatika came into being throughout this process, inheriting a team of specialists in automation with experience since 1981. Serving customers at home and in Eastern-Europe, they specialize in building industrial, assembly- and painting robots, producing controlling systems and using GEC, Siemens-Manutec, Nokia, DETE mechanisms.