## Sustainability and the emergence of economic-social development in Hungary's competitiveness

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### The fiscal effects of the COVID-19 pandemic

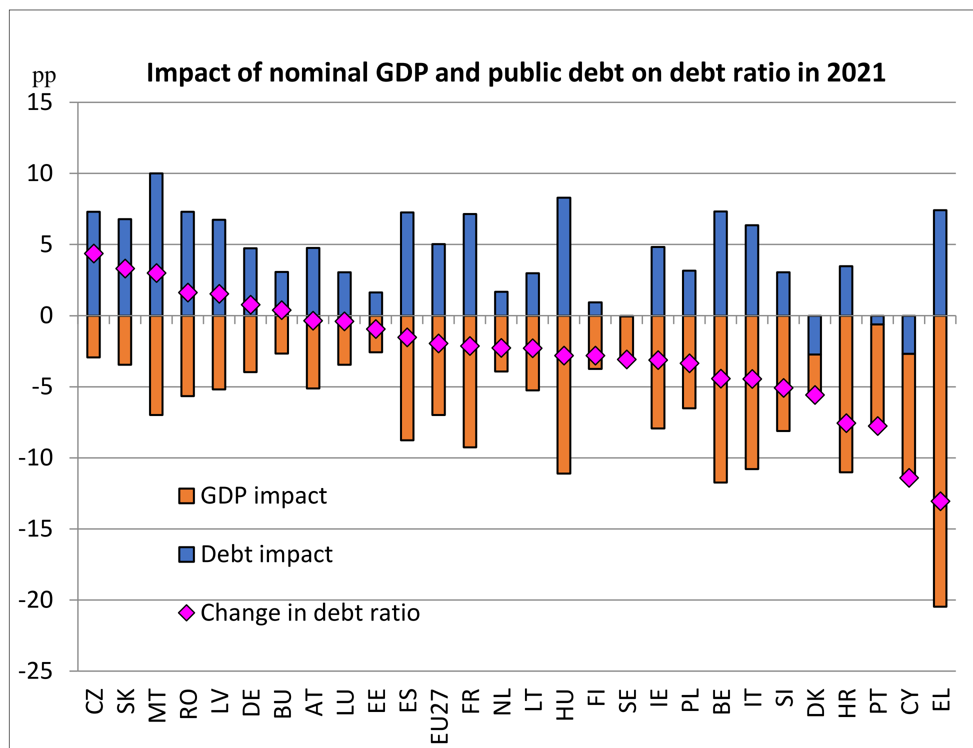
The COVID-19 pandemic has caused considerable economic damage in all EU Member States, not only in for households and in the business sector, but also in all segments of public finances. Adopting an active economic policy, governments resorted to measures that expounded state spending.

In the year of the pandemic, the debt-to-GDP ratio rose to 6.7% on average in the EU from 0.6% in 2019, but eased back to 4.7% in 2021. Despite this improvement, budget balances of all Member States were worse than in 2019.

Since 2021 most EU Member States ran consolidation plans, but a visible decline in debt-to-GDP was only produced by a few countries (e.g. the Netherlands, Denmark). It is especially difficult to curb deficits in south European countries that are heavily dependent on tourism, as 2021 was not exactly the best year for tourism, despite a notable pickup from the plummeting of the previous year. Among the Visegrad countries, Poland is unlike the others, in that it has pushed its public deficit to below 2% in 2021. In countries that have pursued stringent fiscal policies already before the crisis, a rise in public deficit stayed more modest in 2020 and recovery took a faster path. But the countries that were more relaxed about their deficits before saw stronger deficit increases during the crisis, and -- despite their deficits undoubtebly falling somewhat -- their budget gap stayed well above 3% in 2021.

After the huge growth of 2020, debt-to-GDP ratios fell back somewhat in all EU27 countries in 2021. A fall in debt-to-GDP was primarily induced by the nominal growth of GDP, as public debt at current prices continued to rise for all countries with only a few exceptions. The nominal rise in GDP was mainly propped up by the high price index (GDP deflator). It is whether the nominal GDP was higher or lower than nominal debt increase that made a difference among various countries. There were only a few Member States that could cut their nominal public debt (Denmark, Portugal, Cyprus), while debt continued to grow in all other countries. However, a rebouncing economic growth could still reduce debt-to-GDP ratios in most Member States, despite rising nominal debt.

The flip side of this picture is that it is mainly rising inflation that had contributed to this process, which in turn has blown up GDP at current prices. Further, as incomes are inflated away, and economic trends connected with tax revenues are fouled up already in the medium term, it is hard to see that any of the above would support debt consolidation for longer than the immediate short term.

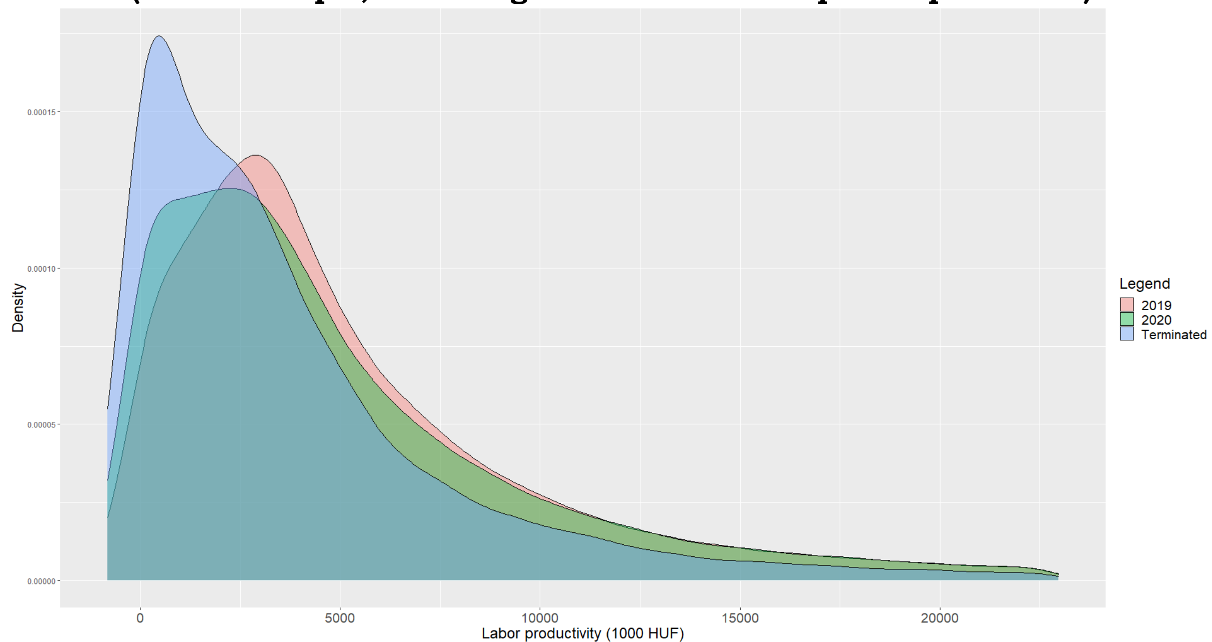



*Source: Eurostat*

**Characteristics and profitability of Hungarian businesses, change in 2020**

The profitability and main demographic indicators of businesses have changed in 2020, more on unfavorable terms, but not nearly as severely, as one would expect after a period of recession so deep as unseen since World War II. Certainly, the number of functioning businesses has dropped in all sectors, altogether by about 13,000. From the point of view of risk of closure, the tourism sector was not worse affected by the crisis than any other sector, on the contrary, for some other sectors performing services with higher added value, a risk of shutting down was slightly even higher. About a quarter of businesses that have closed were five years old or younger, a half of them were 5-10 years old, while the share of companies aged 10 years or older was 25% among companies that had to shut down.

**Labor productivity and density in terminated businesses, 2019, 2020 (nested sample, excluding bottom 5th and top 95th percentile)**




*Source: NAV*

In 2020 profitability had not been favorable, as expected from the circumstances, but the situation was not dramatic. In 2019 among some 200,000 businesses examined, 15% were making a loss, which corresponds on average to about HUF 500,000 in loss on assets. One year later the share of loss-making companies rose to 22%, and the average return on assets hovered around HUF -800,000.[1]

A fall in profitability affected nearly all sectors, but mainly construction, accommodation services and catering. Agriculture, the energy sector and financial services were the only three sectors where a median profitability grew, albeit only slightly. Although the largest losses were invariably suffered by the tourism and the arts and entertainment sectors, it is apparent that companies that were not helped by the government's sectoral wage support scheme also suffered significant losses of profit.

The Hungarian corporate sector has made use of the preferential low-interest loan and grant opportunities, investment-boosting programmes offered during the pandemic. Consequently, a slight rise in debt can be seen among companies that have hardly ever had any long-term liabilities before.

## Digitalisation and competitiveness

Since 2014, the European Commission has monitored Member States' digital progress and published annual Digital Economy and Society Index (DESI) reports. Whereas Hungary ranked 21st among the EU28 over the past two years in the survey, it fell to 23rd place among 27 EU countries in 2021. There are only very few areas where Hungary performs above the EU average. Some of the areas where Hungary performs well are overall fixed broadband take-up and at least 100 Mbps fixed

[1] Assets are the sum of intangible assets, tangible assets and fixed assets.

broadband take-up. At the same time development of mobile networks remains below the EU average. 5G coverage grew by 11% in 2021 compared with the previous year, but it is still at only 18% compared with an EU average of 66%.

Hungary performed below the EU average in most of the sub-indicators on human capital. Only 49% of Hungarians had at least basic digital skills and other indicators also showed relatively low levels of digital skills.

In terms of integrating digital technologies Hungary ranked 26th, and was placed among the worst performers in the EU for all indicators on adopting and using modern technology. A majority of Hungarian businesses still does not pay adequate attention or makes sufficient effort to transform its production, marketing and organisational processes in a way that fits the needs of a modern age.

Hungary's rating on the digitalisation of public services is mixed. The country ranked 25th on this dimension, which is a commendable achievement largely to do with the relatively high number of e-government service users. However, it is less flattering for the country's competitiveness that Hungary had one of the lowest values in the EU for open data.
In sum, Hungary has made considerable progress in investments, completed developments and integrated systems, but the use of services - both in the case of businesses and private individuals - has only become popular where the state made it compulsory.

It seriously impedes Hungary's chances of reducing its digital development gaps that other Member States are already using the community funding made available by the Recovery and Resilience Facility (RRF), which can be used on the condition that at least 20% of allocations are spent towards developments aimed at digital transformation. Most Member States have gone even further. Overall, 26% of the approved developmental expenditures are aimed at digital goals, but in Germany or Austria, more than half, in Luxembourg, Lithuania and Ireland, nearly one-third of allocations are spent on digital developments.

The key to Hungary's competitiveness -- and digitalisation is no exception -- is in the development of the education system. In order to tap on the advantages offered by digitalisation, the government and businesses must take immediate steps to train, retrain and further educate the current and future labor force.

In addition to the traditional school system, a strong further education system should be set in place with incentives (tax breaks, repayable and non-repayable assistance), so that the adult population, the current workforce, could have the opportunity to aquire digital competencies that will be needed in the workplaces of the future, in the companies undergoing digitalisation; and so that they should not drop out of the labor force due to the appearance and increasing spread of robotisation and automation. Not only employees but also companies should be motivated, offering incentives for them to improve their employees' digital skills in the interest of raising their own competitiveness.

**An evaluation of the EU's climate strategy with a view to Hungary**

Over the past few years there have been several milestones in the EU's climate strategy: the European Green Deal (EGD) at the end of 2019, and the Fit for 55 package introduced in mid-2021. Under the EGD and the related European Climate Law, the European Union should become climate neutral by 2050. The Fit for 55 plan has put in place stricter medium-term targets for 2030, thus is aimed at achieving a faster green transition.

Based on the main targets set by the Commission and approved by the Council, the EU must reduce its greenhouse gas emission levels by at least 55% by 2030 (the current target is 40%), while raising the share of renewable energy in the overall energy mix to 40%, including 29% in transport and 49% in the energy supply of buildings. A binding target approved for industry is to raise the share of non-biological renewable energy sources (e.g. green hydrogen) to at least 35% by 2030 and to 50% by 2035.

In this framework the Hungarian government is fundamentally set on maintaining stability, taking advantage of opportunities arising through the green transition while avoiding disruptive changes as much as possible. An implicit aim of the Hungarian strategy is that the country should remain an attractive target for industrial investments with relatively high raw material and energy needs. However, as seen from its reactions to the energy crisis, the government is ready to respond to the sudden and obvious emergency situation by taking strong steps, yet its approach is still not really climate-centered. One sign of this is the dependence on the use of firewood.

In the longer term however, the EU climate strategy is likely to deal with the question of how realistic are suggestions that the economy after the green transition will be very much like today's economy, only in a greener and more digitalised version. While the aim is to avert a climate catastrophe, by now it is more realistic to talk about a partial aversion. According to projections, the weather conditions weighing down on Europe this year will become the new average in 15 years. In addition to this, global politics is starting to face changes, a sign of which is the ongoing Russian-Ukrainian war. Decisions have been made to quickly change the current European energy mix in wake of the war. At the same time, Hungary, which has placed nuclear energy and the expansion of solar power in the center of its green transition strategy, continues to build on the idea that a Russian connection (import of uranium) and a Chinese connection (import of solar panels) can still be reckoned with in the foreseeable future.