FOREWORD BY THE EDITORS

The Hungarian Labour Market Yearbook series was launched in 2000 with the support of the National Employment Foundation (OFA). The yearbook presents the main characteristics of Hungarian employment policy and each year features an indepth analysis of a topical issue. The editorial board has striven, from the beginning, to provide up-to-date results of labour market research and useful information on the Hungarian labour market tendencies as well as the legislative and institutional background of the employment policy of the GO and NGO organizations of the public employment services, local governments, the public administration, educational and research organisations and – last but not least – for both the press and the electronic media. This year we have also created a clearly structured and easily accessible volume that presents the main characteristics and trends of the Hungarian labour market on the basis of available statistics, conceptual research and empirical analysis. Continuing our previous editorial practice, we selected an area that we consider especially important from the perspective of understanding labour market trends in Hungary and effective evidence-based policy making. The book has four main sections.

The Hungarian labour market in 2011–2012

The economic recovery from the crisis slowed down in the middle of 2011 and by the start of 2012 the performance of the Hungarian economy – similarly to the other European countries – once again declined. In addition to the unfavourable long-term economic prospects, demand for labour also persistently declined, thus the employment rate is below its pre-crisis level. As a result of government measures aimed at increasing activity, the activity rate reached a level unprecedented since the early 1990s. Another related issue is that people who become unemployed are least likely to exit the labour market and that keeps the rate of unemployment high in an unfavourable economic environment. Although this is worrying, it is a more favourable situation than, for example, expanding the possibilities of retirement. The increased intensity of public works programmes in the past two years helped to prevent the further growth of unemployment although it could not reduce it. There is no reliable information on the impact of recent changes in public works programmes, namely the lengthier employment opportunities, on entry into the open labour market. There were also considerable regional disparities in the development of employment. At the beginning of the crisis, the situation of the central and Transdanubian regions which had been characterised by higher economic activity deteriorated relatively quickly and

the unemployment rate stabilised at a much higher level than the average of previous years. Public works programmes aimed at alleviating the further deteriorating situation of the Northern and Eastern regions that had been affected by high unemployment even prior to the crises.

Companies adjusted to the low economic output of previous years not only through levels of employment but also through wages. The dynamics of gross average wages in the business sector slowed down, and the level of less rigid real wages stagnated over recent years. At the same time the public sector was forced to cut wages and non-salary benefits. There were significant changes in the tax burden on labour in recent years. In 2012 the personal income tax effectively became dual-rate, which increased the tax burden on those earning less than the average wage, while it reduced the burden on those earning above the average wage: to offset the net loss of income among the low-paid, the Government increased the minimum wage by 20%. To date there is insufficient information on the impact of tax realignment on labour supply because further changes are expected in labour taxation in 2013.

In Focus

This year's *In Focus* consists of two parts. *Part I* focuses on the impact of taxes and transfers on the labour market. Although the primary purpose of taxes and transfers is to create revenues to fund public expenditures and redistribute income, their impact on the labour market is also crucial because they influence, and in some cases jeopardise, the sustainability of the system. Therefore it is very important to understand these effects as much as possible. Current Hungarian research in this area – building on our rich heritage of labour economics research – produced some interesting findings and perspectives and generated exciting debates. An important development has been that this was not limited to academic circles, but there have been also numerous attempts to communicate the results to policymaking and to emphasize the importance of evidence-based policymaking.

Meanwhile there has been a boom in the international literature on public economics – inspired by the works of Raj Chetty and Emmanuel Saez. The fifth volume of the *Handbook of Public Economics* provides a detailed overview of this process. This exciting period – when a "new consensus" is emerging on the empirical assessment of the elasticity of labour supply to taxation – also brought normativity, optimal tax rate and tax system considerations back into the picture. It certainly involves serious debates – mostly about the taxation of the top 1% of the income distribution, or that of capital income. We would like to make this diverse, innovative and active literature more widely known in Hungary. The chapters in the first part of *In Focus* provide further references and a starting point for this.

The first, introductory chapter – written by the editors, Péter Benczúr and László Sándor – sets out the common conceptual framework of this section, with particular focus on the role of transfers and taxes in the static model of labour supply and demand. In addition it provides a detailed and comprehensive overview of the recent

empirical literature on labour supply elasticities. The second part of the introduction reviews the main results and the open questions of international academic research on income taxation drawing heavily on reviews in the *Mirrlees Review* and the forthcoming fifth volume of the *Handbook of Public Economics*. The *Appendix* (by Mónika Bálint) provides a description of Hungarian databases that are used in the impact assessment of taxes and transfers, to date less well-known in labour market research.

Chapter 2 examines the intensive margin of labour supply, more precisely the elasticity of taxable income (written by Péter Benczúr, Áron Kiss and Pálma Mosberger). First, it gives an overview of the international literature on the subject – in greater detail than other overviews already available in Hungarian – focusing on aspects relevant from the perspective of economic policy. Then the chapter presents the findings of two previous studies that used data from Hungary to estimate the elasticity of taxable income. Finally, it demonstrates the use of estimated elasticities in "optimal tax rate" model simulations.

Chapter 3 looks at employment, more precisely: the labour market participation decision, also known as the extensive margin of labour supply (authors: Gábor Kátay and Ágota Scharle). It considers two main issues: on the one hand it examines the impact of the tax and transfers system on decisions about labour market participation based on the findings of a recent empirical study. And on the other hand it summarises how the system of unemployment assistance encourages or deters efficient job search and job take-up.

Chapter 4 presents the utilization of a heterogeneous household microsimulation model for assessing the impact of the tax and transfer reforms on the economy (authors: Dóra Benedek, Gábor Kátay and Áron Kiss). It starts with a brief overview of the application of microsimulation methods abroad and in Hungary. Then it briefly presents a microsimulation model developed in the Magyar Nemzeti Bank (the central bank in Hungary) that can be used to assess the long-term employment and macro-economic impacts of hypothetical and real changes in taxation and transfers.

Chapter 5 shifts the focus from labour supply and employees to employers and labour demand. Following a brief general introduction (written by Árpád Földessy and Ágota Scharle) it gives an overview of previous findings and experiences related to the impact of wage subsidies (authors: Péter Galasi and Gyula Nagy), and then presents the results of a recent study on the impact of the "START card" wage subsidy scheme (authors: Zsombor Cseres-Gergely, Árpád Földessy and Ágota Scharle). The fourth sub-chapter explores another large area of state intervention – minimum wages (authors: Ágota Scharle and Balázs Váradi). It summarises the potential impact of the targeted reduction of the minimum wage as a tool to increase employment based on Hungarian and international literature. The final, fifth sub-chapter reviews the international literature on the long-run equivalence of employee and employer contributions (by Árpád Földessy).

The final chapter, *Chapter 6* of *In Focus – I* analyzes the issue of labour market related tax avoidance and evasion (authors: Dóra Benedek, Péter Elek and János

Köllő). Following a brief conceptual introduction to the international literature on the prevalence of the shadow economy and undeclared work, the chapter goes on to examine undeclared employment and tax evasion among businesses in Hungary using detailed micro-level data. Finally, the last sub-chapter analyses the income redistribution aspects of tax evasion using micro-level data. The chapter also contains three special topic boxes: István János Tóth and Mihály Fazekas preview their recent results from a survey on envelope wages, providing a first evaluation of the impact of the crisis on income underreporting. Mirco Tonin reviews his earlier research results on the link between minimum wage regulation and tax evasion. And finally, Árpád Földessy and Ágota Scharle analyze the impact of temporary employment booklets (alkalmi munkavállalói könyv) on black and grey employment.

In Focus – Part II provides a summary of studies exploring the impact of company characteristics on workers' wages and employment opportunities. The introduction briefly discusses potential reasons why company characteristics can influence workers' wages. Then it presents the main methodological features of databases suitable for the analysis of this topic and finally presents the subject of the chapters: collective agreements, participation in international trade, foreign ownership and privatisation.

Chapter 1 on collective agreements (by Mariann Rigó) shows that the unconditional wage gap between workers in companies with or without collective agreements is relatively large (over 20%) and it is not reduced substantially if individual differences are taken into account. However, controlling for observed company characteristics significantly reduces the wage gap to 3–3.5%. If unobserved company characteristics are also controlled for then this is further reduced to 2–2.5%.

Chapter 2 (by John Sutherland Earle and Álmos Telegdy) examines how workers' wages change following the acquisition of a local business by a foreign company. Foreign-owned companies pay 46–60% higher wages to their workers, however if observed and unobserved characteristics are controlled for, this effect is halved. The effect is heterogeneous: younger and skilled workers receive higher pay increases than their less skilled colleagues; nevertheless wages go up for all categories of workers following acquisition.

Chapter 3 (by John Sutherland Earle and Álmos Telegdy) explores how privatisation alters workers' wages and the employment level of companies. This is a very important question because a widely shared view among policy makers and the public is that privatisation will lead to redundancy and lower wages. The first part of the study looks at the employment outcomes of privatisation using databases from five Central Eastern European countries (Hungary, Lithuania, Romania, Russia and Ukraine). Despite fears privatisation did not lead to substantial redundancies, at least not when they were compared to companies that remained in state ownership. The second part of the chapter focuses on Hungary and examines how wages change when state-owned companies are privatised. When the buyer is a local company, workers' wages typically decline, while if the buyer is foreign then they tend to go up. In terms of demographic characteristics, the wages of women and younger workers decline least if the

buyer is local, while foreign buyers are much more likely to increase the pay of highly qualified workers.

Chapter 4 (by Miklós Koren and Péter Tóth) examines the impact of international trade on the labour market. The authors compare the wages paid by export and import companies with wages paid by businesses that were not involved in international trade. Both export and import companies paid higher wages than businesses operating on the national market, however the effect is stronger and much greater among import companies. The higher wages paid by export companies can be explained primarily by selection: these businesses had been paying higher wages for years before they started exporting. On the contrary, higher wages paid by import companies increased gradually after they started importing. Nevertheless, not all workers benefited from the growth of trade. The analysis of Hungarian food and textile industries shows that the wages of workers whose production was replaced by imported goods declined compared to non-importing companies. The distribution of wage increases was uneven among workers, the management of the company and highly qualified employees saw higher rises.

Institutional environment of the labour market between September 2010 and August 2011

Possibly the most important change in the institutional environment of the labour market was the entry into force of the new Labour Code, which is discussed in a separate sub-chapter. Nonetheless, there other important changes too. The personal income tax system practically became dual-rate with a lower rate of 16% of the gross wage. At the same time tax credit was completely abolished. From 2012 all forms of early retirement were abolished and this marked the end of a long era that started in the early 1990s – early retirement can no longer be used to ease tensions on the labour market. Existing entitlements continue as non-pension assistance. At the same time public works employment had a further impetus. The new system launched in 2012 offers longer working hours and employment opportunities lasting for months to public workers.

The discussion of the new Labour Code focuses on the main dimensions of labour flexibility. The new law mainly facilitates quantitative changes in the workforce, in terms of labour market transitions (rules on hiring and dismissal) on the one hand, and the performance of existing employees (working time arrangements) on the other. Not only did the conditions of flexibility change but it also became less costly for employers (lower wage supplements, lower cost of dismissal) and even the financial risks associated with employing people (indemnity and guarantees) were reduced. Although the rules of employment outside the scope of the employment contract were simplified, workplace training – crucial for functional flexibility in a modern workplace – is even more marginalised in the new law than it had been before. Despite the fact that the justification of the act stipulates that the legislation would allow a greater scope for collective agreements, overall – through the revised regulation of

local trade unions and collective bargaining – it weakened the bargaining position of local trade unions, particularly in the public sector, often considered the stronghold of trade unions.

2012 was the first year when national wage negotiations were entirely conducted in the new negotiation structure, in which the Government, following consultations with social partners, decides independently on the level of the minimum wage and the minimum wage for skilled workers. Considering wages in public works, a wage-tariff type minimum wage system with four categories continued to exist. The Government also specified the "expected rate of pay increase" for low-paid workers in 2012, and provided incentives through contribution discounts and grant funding for employers implementing the wage compensation. As a result the number and coverage of company-level wage agreements is expected to decline. Although the pay freeze remained in effect in the public sector, the nominal pay of lower paid workers rose due to the wage compensation. There were larger pay increases in the health care sector where new occupational and sectoral pay scales entered into force following the action of junior doctors. A new development in social dialogue was the establishment of a new national forum in the business sector that has fewer partners than its predecessor and lacks legal guarantees in its operation.

Statistical data

This section gives detailed information on the main economic trends, population, labour market participation, employment, unemployment, inactivity, wages, education, labour demand, regional disparities, migration, labour relations and social welfare assistance as well as an international comparison of selected labour market indicators following the structure developed in previous years. As in previous years, additional data related to the topic of *In Focus* is also presented in this section. Tables 12.1–12.4 give information on time span of wage related taxes in Hungary. All tables and figures in this chapter can be downloaded in Excel format following the links provided. All tables with labour market data published in the Hungarian Labour Market Yearbook since 2000 are available for download.

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