

Schwerpunkt Ungarn

Analysen Positionen Essays

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Growth, Crisis Management and the EU: The Hungarian Trilemma

Summary

The paper addresses the challenges of the Hungarian economic strategy in the post-2010 period. It analyzes the constraints and options, as well as the reaction and interaction of various players on the international arena that have shaped outcomes.

Beyond the discussion of the 15 months of futile negotiations with the IMF, issues of how Hungary fits, with its unorthodox economic policies, in the changing architecture of the European Union moving towards ever more federalism in its crisis management.

László Csaba

Growth, Crisis Management and the EU: The Hungarian Trilemma

■ The current paper attempts to provide an empirically based overview of economic developments in Hungary in the period from 2010 to 2013. It highlights one specific angle, that of international embeddedness, and we consciously omit a number of issues – hotly debated domestically – abroad, from constitutional amendments to the way of addressing indebtedness of households in forex (foreign exchange).

In adopting the bird's eye view we shall analyze the following paradox. While in the 1987-2007 period Hungary tended to be the frontrunner of systemic change to market capitalism, it was also a darling of the international community (EU and capital markets alike). This situation had dramatically changed by the end of the mandate of the second Orbán administration. Hungarian domestic issues – more recently the fourth amendment of the Constitution in 2011 – invited public debates in the Congress of the United States of America and the European Parliament alike. Measures clearly aimed at a domestic audience, such as decreasing the maintenance cost for housing and banning the use of totalitarian symbols, have triggered angry international reactions.

Even such initiatives which are either natural – such as nominating a new governor of a central bank – or applying arrangements, which have earned praise elsewhere – such as the flat tax in the Baltics, Russia and Slovakia – have stirred angered criticism. In a way, Hungary is under siege, and the Prime Minister has gone as far as accusing Brussels of lasting use of double standards and taking sides against the government's fight against vested interest groups. And while the litany of complaints lodged by international players against the center-right Hungarian government can hardly be numbered – nor can the counter-accusations – the popular standing of the government remained unusually high, especially among those able to formulate party preferences.¹ This is absolutely unusual, as governing parties tended to lose

1 According to Median opinion research center, 45 percent supported Fidesz, 24 percent the socialists and 17 percent the radical rightwing Jobbik. In: *Heti Világgazdaság*, 4 April 2013.

about half of their support by the midterm of their mandate. Furthermore, with the increasing majoritarian elements in the new electoral law, these results would translate into a replication of the unprecedented two-thirds majority (of seats, not votes!) for the governing parties.

In short, this is a most unusual mirror image – of a bad guy from the outside, and of a good guy from the inside. All the more so, since the economic performance of Hungary was ambiguous at best. A former Governor of the Central Bank writes about the loss of perspective, especially for the younger generation, "true, this is largely an all-European phenomenon".² – How did we get there? How did the government, with a solid majority and elected on a definitely pro-growth, supply side platform, get stuck into a series of improvisations? How come that structural reforms remained slow, growth, if any, was sluggish, and the boom of the small business sector and related employment never materialized? On the other hand, we may revert the question: how come that a country, whose doomsdays were forecast by financial analysts by the week, has remained resistant to tremors, while many other former darlings of capital markets, and even prestigious European Member States, as Greece, Spain, Portugal, Ireland and more recently even Cyprus, have fallen victim to the new contagion, like a series of dominos?

The Socialist Legacy

Let us recall an earlier account³ proving in detail the following paradox: While Hungary had been an uncontested winner of the transition race, it fell behind already from 2005 on. In other words, lacking major institutional reforms and wasting much of the opportunities of easy global financing, Hungary could not really make use of the *additional* chances and opportunities provided by its accession to the European Union. EU membership was undoubtedly beneficial – not only for being a structural net recipient of EU funds – but even in the broader perspective of being upgraded as a safe haven for international investors of various kinds. In order to anchor those improvements, introducing the single currency could have been the easiest bet. And indeed, the first deadline, set by the first center-right government was 2006, which was later extended to 2008, 2012, and since the financial collapse of October 2008 no deadline exists. More recent pronouncements by cabinet members were tentatively speaking of the range of 2020, i.e. way beyond anything practical for policy-making.

In reality, it is exactly the *largely unexpected, if perhaps inevitable continuity of drifting*, which has characterized Hungarian economic policies ever since the peer

2 Bod, P. Á. (2013): Crisis after crisis – any lessons learnt? In: Hungarian Review, vol. 4, no. 2, pp. 18–28, here: pp. 24–25.

3 Csaba, L. (2013): Hungary: the Janus-faced success story of transition. In: Fosu, A. (ed): Development Success: Lessons from More Advanced Countries. Oxford-New York: Oxford University Press, pp. 254–277.

pressure of the EU ceased in December 2002. While taking over the common regulatory frame, the *Acquis communautaire*, had been a precondition for accession, additional efforts – not only in order to converge to the European Monetary Union EMU, but also in many other areas, from environmental protection to social policies – were usually saved as unnecessary overstretching by the successive governments, basically ever since 2003, i.e. for a decade by now! If we just take the economy, minimalism in institutional and structural reforms of the past decades may explain, to a large degree, the secular trend of lower potential and actual GDP growth in Hungary. The latter is not attributable – as many financial analysts do – to cyclical or policy factors, since the potential rate of growth is not directly influenced by policy actions or mishaps, even if these were of a tsunami or an earthquake. Potential growth and also the trend rate of growth declines only if fundamental factors of growth, such as investments, labor inputs, innovation, financial intermediation, research and development and foreign direct investment interact.

How can such a negative synergy come about? Usually it takes a relatively long period of time, a decade or more, for individual factors of growth to be eroded. For instance, the political economy of policy reforms globally advocates reforms to be sequenced and introduced step-by-step. First simpler, later more complex measures are to be taken, and this should create, in a best-case scenario, a self-propelling process of continuous reforms. We have experienced such reforms in the Baltics, but also in a number of countries of Latin America, including Chile, Ecuador and Brazil in the 2000s.

In Hungary reforms were clearly running out of steam ever since the accession to the EU was formalized in December 2002. It seemed that not being overzealous was an innocent omission with little or no consequences for the trend rate of growth, and convergence to the per capita GDP levels of EU-15 was taken as a given. These policies were drifting, and amidst vociferous activities of producing reform projects of various sorts, especially in the 2004-2009 period, very little if anything of those projects actually materialized. This drift has contributed to the emergence of an exceptional degree of *mistrust, featuring Hungarian society*, at all conceivable levels, from the interpersonal via trust in contracts and legal arrangements up to distrust in institutions, and notoriously in political parties. A recently published collection of papers⁴ singles out this component as formative for lack of savings, investments, innovations and, generally speaking, forward looking action. Let us highlight: These unfavorable tendencies all evolved in the 2002-2009 period, not least owing to the growing discrepancy between official discourse and actions / reality / outcomes. The rate of economic growth was though 4.6 percent in the period until 2006, however the slowdown starting in the second half of 2006 was already secular. The dream of automatic catch-up with the EU living standards

4 *Muraközy, L.* (2012): *A bizalmatlanság hálójában: a magyar beteg* (Caught in the web of mistrust: the Hungarian patient). Budapest: Corvina Könyvkiadó.

has not materialized – this explains to a large degree the rise of the radical right.⁵

Balanced analyses of the Hungarian economy⁶ highlight the fact that the Hungarian economy – not having undergone any serious structural reforms since 1997 – has started to run out of steam already by 2004. The removal of the left wing Premier Péter Medgyessy in August 2004 by his own coalition was largely due to the feeling that he was unable to mobilize and manage for change. The new Prime Minister, Ferenc Gyurcsány, was of the opinion that the time of 18 months left until the 2006 elections was too short for any major reform. He subordinated everything to winning a popular mandate.

Uniquely in post-1989 history, the Left could earn a second victory in 2006, in theory enabling them to major changes. In reality, the Socialist party was deeply split over major changes, rendering those impossible on the ground.⁷ This split was manifested by the leaking of the infamous 'lie speech' of Mr. Gyurcsány in mid-September 2006 – four months after it was delivered, but at the time when fundamental reform projects were about to be legislated. The tone and the style of the speech were offending, thus hurting most of Hungarian society, and triggered six weeks of demonstrations – yet another unprecedented phenomenon throughout the Hungarian democracy since 1848.

This development made the deep division in Hungary plain, and the administration remained much of a lame duck. The opposition had an easy run to win the plebiscite on social issues in March 2008 with 85 percent of the vote, since questions were targeted against fee payments in education and health care. However, this move had also pushed the center-right into a hardly manageable situation. As a matter of fact, their image was – especially abroad – one of irresponsible populists.

The Left – and the remnants of the once prominent Hungarian Democratic Forum – were so hopelessly sticking to power to the very last minute, that this created a bend for a sea change. While Fidesz and their allies were clever enough not to spell out any specific program during the election campaign on economic matters, the undercurrent message was that of imminent and major change.

Let us note that in February 2009 finally Mr Gyurcsány was forced to resign and give way to his former Economy Minister, Gordon Bajnai. A technocrat and businessman, Bajnai interpreted his role much as of a caretaker government, as he enjoyed no direct and unconditional support in the legislation. He introduced a series of improvements, in terms of personnel as well as in terms of policies, reverting Hungary

5 *Buzogány, Á.* (2011): Soziale Bewegung von rechts: Der Aufstieg der national-radikalen Jobbik Partei in Ungarn. Südosteuropa Mitteilungen, vol. 51, no. 5-6, pp. 38-51.

6 *OECD* (2012): Economic Surveys: Hungary, 2012. Paris: Country study series.

7 *Mihályi, P.* (2008): Miért beteg a magyar gazdaság? (Why is the Hungarian economy ill?). Budapest: HVG Kiadói Rt.

from the doldrums. While his mandate was restricted, in part lacking legislative majority, in part owing to the conditionality attached to the IMF-EU-World Bank stand-by of October 2008, signed by his predecessor, the trick of averting the crisis did work.

This was not an easy task at all during the escalation of the crisis of the Eurozone, the contagion spreading from Greece to other countries, and the EU being late in its reactions to market panic. Owing to the inadvertent fiscal policies of the Socialist government, and their disregard for the ramifications of the collapse of Lehman Brothers in September 2008, Hungary was on the verge of bankruptcy. The latter could be avoided only by a last minute rescue operation, which included an institutional innovation. It was not only the European Commission, but also the IMF and the World Bank who secured the jumbo loan of 20 billion euros in a mere five days.

The stand-by agreement included a series of conditionalities, which severely restrained the room for manoeuvre for the Hungarian government. On the one hand it stipulated long overdue changes, such as raising retirement age and severing disabilities, cutting unemployment benefits. On the other hand, as any structural reform, these measures were intruding deeply in the social model of the country.

The task was to be completed by the coalition of the Right from 2010. It was composed of a series of forces adhering to different economic ideas, interests and platforms. In short, we may talk about an employee and small business wing, calling for more state intervention, market protection and price controls. On the other hand, the business class as well as the middle income players, generally the better skilled, tended to favor a more mainstream European conservative line along that of Angela Merkel and David Cameron.

Caught in a Mediterranean Storm

Formation of an economic strategy as conceived in the textbooks on economic policy and political sciences has never taken place. This was due to a series of circumstances. Domestically, the lure of winning the municipal elections was irresistible. Thus, the first attempt to form a proper strategy over and above electoral promises started only in November 2010. But by that time the Greek crisis and its (mis)management by the European Union had been emerging in its full complexity, with the much unforeseen ramifications.

We may reconstruct the original project of the governing Hungarian coalition by references to the limited, scarce and barely authoritative sources at our disposal. For the 'small business' approach it is the book by the architect of Fidesz economic views, György Matolcsy.⁸ This blames the one-sided emphasis on fiscal issues and especially

8 *Matolcsy, Gy.* (2008): *Éllovasból sereghajtó* (From a frontrunner to the laggard). Budapest: Éghajlat Könyvkiadó.

austerity for stagnation, much in line with what currently Francois Hollande explains. The other book is by business people⁹ and is more conventional/orthodox in its economic views, in line with the continental – not the American – conservatives in terms of calling for fiscal prudence, smaller state, de-regulation and a series of supply side measures.

The expectation was that of slow and incremental change. All the more so, as the country was still under the IMF standby and the quantitative targets adopted by the Bajnai administration. Sensing the expectations, the government aimed at an easing of the strict deficit and debt targets. But – lacking credibility – this was a non-starter.

All the more so, since the Greek crisis erupted in full by March 2010, indicating the whirlwind of changes, restrictions, bailouts and ever new negotiations.¹⁰ Creditor governments were first confronted with two painful insights. (1.) Government financial statistics have been doctored for a decade, and in much more profound ways than the Greek authorities were willing to concede. Skeletons abounded in the cupboard. (2.) Fiscal rigor, promised in exchange for new and new injections of money, has barely been put in practice. Regular and systematic official dodging the promises, especially the crucial ones, in the most extreme manner has come to the limelight.

This explains why the new Hungarian Prime Minister has encountered an unprecedented degree of rigidity by his partners already upon his first visit to Brussels and Berlin in May 2010. On both occasions, President Barroso and Chancellor Merkel made it crystal clear that they would not tolerate a laxer fiscal stance, even in exchange for major structural reforms. Meeting the fiscal targets was set to be the single standard against which the solidity, loyalty and credibility of Hungary as a partner would be measured against.

One of the reasons which may explain why the Orbán government expelled the IMF and suspended the standby in June 2010 might have been exactly in the hope of the EU allowing for more flexibility. However, as it turned out by the time of writing, *the EU and the IMF adopted reverse roles in this play*. While the EU, in theory being in favor of growth – as e.g. in the Europe 2020 strategy, or in the Employment and Growth Pact of June, 2012¹¹ – in reality the Commission adopted an intransigent stance on fiscal retrenchment. By contrast, the French-led IMF, the “Lagarde-Blanchard duo”, seems to have been more forthcoming to reflating policies and thus more willing

9 Fodor, I. / Járjai, Zs. / Parragh, L. (2008): Túl az idők jelein (Beyond the signs of times – interviews conducted by Kovács, L. P.). Budapest: Éghajlat Könyvkiadó.

10 For a good summary cf. Visvizi, A. (2012): The Eurozone crisis in perspective: causes and implications. In: Visvizi, A. / Stepinski, T. (eds): The Eurozone Crisis: Implications for Central and Eastern Europe. Catholic University of Lublin, Institute for East-Central Europe, Yearbook, vol. 10, no. 5, pp. 13-32.

11 Question marks over 120 bn Euro EU 'growth pact'. Euractiv, 2 July 2012 (accessed on 13 April 2013).

to tolerate "good deficits" from Japan to Greece.¹² This is exactly the opposite to the view of the European Commission.

Therefore, the lack of co-operation with the IMF, and also the frequent mishaps in communication between the Orbán government and its foreign partners (from the business community to the European Parliament) created a situation – when attaining the repeated corrections of fiscal accounts in order to secure the sacrosanct deficit targets – that subordinated much, if not most, of the substance of economic governance.

For instance, when negotiations over accounting for implicit debt in the pension funds seemed to have come to a halt in November 2010, the government decided to nationalize private pension funds. Meanwhile, the more enduring negotiating tactic of the longest serving Polish minister of finance – and Central European University economics Professor – Jacek Rostowski had harvested its fruits. Poland was allowed to deduct pension related deficits from general government number – an accounting innovation introduced by France in 1999. Thus Poland could avoid the consequences of deficit spending for its debt / GDP ratio in 2010-2012, which is the single most important political indicator for fiscal solidity.¹³

Nationalizing private pensions – a stock of 3 thousand bn Forint or 10 percent of a year's GDP – was not the sole improvised measure of fire fighting. The government introduced crisis taxes, levied on energy, banking, retailing and telecommunications firms. It has since been a subject of emotional debates if these were necessitated by the revenue loss from incremental tax cuts and family allowance increases, or were a leftover of the outgoing government, as claimed by the 'clean hands' committee headed by former and future Minister of Finance (2000-2002, 2013-2014), Mihály Varga. The revenue loss in both readings of events runs around 500 bn Forint or 1.5 percent of GDP or 3 percent of expenditures.

2011 was a truly experimental year. By relying on the 'windfall' of private pensions the government allowed for some fiscal stimulus in the range of 5 percent of total expenditures thus hoping to revive the economy. This was in my view a blunder, since the Hungarian economy *has never reacted to fiscal stimuli over the past 30 years*, at least not in a sustainable way. However, the overall feeling was that the

12 Extended period of low interest rates can rekindle financial risks. IMF Survey online, 11 April 2013, available at: www.imf.org.

13 Deficit in 2010 was -7.9 percent of GDP, followed by -5.0 percent in 2011 and -4.0 percent in 2012, with debt ratios accounting for 54.8 percent in 2010, climbing to 56.4 percent by 2011 and declining – despite new deficits – by 2012 to 55.9 percent, showing the results of improved cosmetics. Source: ECB Statistics Pocket Book, April 2013, p. 46 and p. 47 (available online). Let us note, that the Polish Constitution stipulates a harsh and automatic measures already from 60 percent debt/GDP ration, thus the fiscal cliff, currently reigning US debates, could easily erupt also in Poland, save the improved accounting techniques.

Greek crisis was finally over, the establishment of the European Financial Stability Facility EFSF, the standing bailout fund of 400 bn euros would do the trick, and the global and especially the EU economy would regain its role as a locomotive for Hungary.

The more we see the structural, institutional, qualitative and psychological factors behind the economic lull, elaborated above, the less we tend to believe in the old-fashioned textbook Keynesian discourse. It was conducted basically outside the profession of economists, primarily in the mass media, which attribute stagnation to the high levels of nominal rates of interest in Hungary. Let us add: In a small open economy it is always the rate of inflation, which is an independent variable, and the rate of interest is the dependent variable. Pushing down the rate of interest is thus nominally possible, however it is likely to trigger two devastating consequences: (a) the depression of the rate of exchange. (b) The international appetite for Hungarian bonds may decline.

Instead of becoming the year of a turn for the better, as stipulated by the Széll Kálmán Plan published in March,¹⁴ the year 2011 was a combination of two major objectives: For one, it contained a series of structural reforms, primarily in the labor market and social transfers, moving public finances towards sustainability. On the other hand, it contained bold growth forecasts up to a point exceeding five percentage points of GDP growth per annum (which was by no means realistic by then).

While this project helped convince investors, although its results could be expected only in years, the growth trajectory has proven to be seriously off the record. Eurozone economies were showing signs of slowdown, some of them even contracting. Eurozone GDP grew by 2.0 percent in 2010, followed by 1.4 percent in 2011 and contracted by -0.6 percent in 2012. The German economy slowed from 4.2 percent in 2010 to a mere 0.7 percent by 2012, Italy turned from +1.7 percent in 2010 to -2.4 percent by 2012, and France from +1.7 percent in 2010 to 0.0 percent by 2012.¹⁵ The Greek drama intensified rather than ebbed out. By August 2011 the collapse of yet another rescue package had become obvious. Markets were panicking and the rhetoric about 'financial contagion' and the 'vulnerability of economies on the periphery of Europe' contributed to an unprecedented de-stabilization, not warranted by the Hungarian fundamentals.

Experiencing capital flight as well as a collapse of the exchange rate of the Forint, declining from 275 per euro to 324 per euro in less than four months, while the current and capital accounts were registering a surplus, rang the alarm bells. The government returned to the much-despised IMF on 17 November 2011, without any prior consultation or preliminary communication. This has proven to be a clever

14 The Széll Kálmán Plan was the medium term plan for Hungary's economic convergence submitted to the EU.

15 According to ECB Statistics Pocket Book, op. cit., p. 40.

move, appeasing markets – domestic and foreign – without alienating the domestic electorate.

This started one of the most curious episodes in contemporary Hungarian economic history: *negotiations about negotiations*, rather than about money, credit or any other substance. The Hungarian government, in my reading of events, never had a formally approved integrated strategy. Some external observers accused the Orbán leadership of a double game, calling it the Argentinian or Turkish card – in both cases there is no intention to strike a real deal. To the degree I could observe from first hand, there was an ongoing hesitation, representing the two faces of economic policies we referred to before.

Oddly enough the problem solved itself, over and above the heads of major players. While substantive negotiations broke down already on 16 December 2011, Hungarian bonds were selling well on the markets. Among skyrocketing CDS (credit default swap) and prophecies of collapse, Hungarian bonds sold under Italian and Spanish counterparts. Markets never dried out, as it was the case for Cyprus or Latvia. And amongst a harsh six months' long controversy with the EU Commission; the first half of 2012 was one of return to the financial markets. From this moment onward, the Hungarian government had clearly lost any serious – immediate – material incentive to go back to a standby. Yet another round of substantive negotiations took place in the third week of July 2012. But those talks on nuts and bolts were never resumed. With Hungary floating yet another series of government bonds in the range of 2.5 bn euros in February 2013, the *raison d'être* of the negotiations was over.

If only we look at the financial indicators, Hungary does qualify as a success story. Deficit in 2012 was kept at 1.7 percent, against 3.9 percent in the Eurozone and 4.4 percent in the EU according to latest available data,¹⁶ despite repeated doubts voiced publicly by the EU Commission. Debt to GDP ratio in end June 2012 stood at 78.6 percent of GDP, against 90 percent of the Eurozone.¹⁷ Very few EU countries could improve their debt/GDP indicator, and few of them – even those under IMF supervision – managed to control public deficits. Inflation started to come down in 2013, and so could interest rates, from 6.75 to 4.75 percent in a single year. This strenuous fiscal stringency is all the more surprising, as fiscal profligacy has deep historic roots and institutional components, and has rightly been described – somewhat mockingly – as part and parcel of the Hungarian “corporate culture” in public finance, dating back to the last decade of Goulash Communism.¹⁸ However, this is not the whole story. Growth, employment and exports did not and will not recover in 2012-14.

16 ECB Statistics Pocket Book, April 2013, p. 46.

17 ECB, op. cit., p. 47. By the end of the year 2012, the Hungarian number declined to 77.1 and the Eurozone number increased to 91.3 percent.

18 *Benczes, I.* (2011): Market reform and fiscal policy in Communist and Post-Communist Hungary. *International Journal of Emerging Markets*, vol. 6, no. 2, pp. 118-131.

Glass Half Empty or Half Full?

On the one hand, it is beyond doubt, that the second Orbán government introduced a series of centralizing measures in order to be able to keep macroeconomic processes under its control. While some influential authors¹⁹ talk about an excess approximating the command economy of the Rákosi era, for me it seems to be an emotionally biased view.

First, it is beyond doubt, that the erosion of public administration has started already in 2002, with Medgyessy replacing basically across the board all personnel in public administration – a habit retained by his successors. Second, especially during the second Gyurcsány government the lack of transparency and incapacity to get things implemented reached an unprecedented degree.

It is a different story to assess if, and to what degree, the actual extent of centralized decision-making was adequate in scope. Many partial insights indicate an overdose of zeal, a propensity to decide whatever conceivable at the highest level – just contrary to the EU theory and practice of subsidiarity.²⁰ Some of the established practices of modern industrial organization, as lean hierarchies, delegation of competences, transparency and participation seem to have gone under, for reasons not always clear to any outside observer. But contrary to the claims by Professor Kornai, it does not constitute a system, let alone a vertically coordinated command economy. In fact, the transnationalization of Hungary and the embeddedness in EU institutional infrastructure, the large role of TNCs (transnational corporations) and the crowds of persons working abroad, the free media altogether exclude any such possibility. Also it is hard to see a series of improvisations as a system of any sort, which deserves this academic term. As we know from Walter Eucken²¹ the regularity of improvisations, or the sustaining ad hoc decisions – what he termed as *punktualistische Wirtschaftspolitik* – is exactly the opposite of what the term systemic interventions / *Ordnungspolitik* stands for.

Second, the upgrading of foreign trade continued.²² This is a long term and largely spontaneous, market based, FDI-led process, but it goes on, which is a good sign. The government also signed a series of agreements with major investors, which secures their presence in the long run. True, this is a discretionary arrangement.

19 *Kornai, J.* (2012): Zentralisierung und kapitalistische Marktwirtschaft in Ungarn. Europäische Rundschau, vol. 40, no. 2, pp. 59-79.

20 *Colombo, A.* (ed) (2012): Subsidiarity Governance. Houndmills/UK-New York: Palgrave.

21 *Eucken, W.* (1952/2004): Grundsätze der Wirtschaftspolitik, 7. Edition, Tübingen: J.C.B. Mohr / Paul Siebeck.

22 *Antalóczy, K.* (2012): Beágyazódás a globális értékláncokba: két évtized külkereskedelmi folyamatai Magyarországon (Integration in global value chains: two decades of foreign trade processes in Hungary). Külgazdaság, vol. 56, no. 11-12, pp. 29-61.

Third, Hungary could defend its priorities in the clashes in and with the European Union and its institutions. This holds both for broader issues, as the new Constitution, and of more economic issues, which is our concern. In the EU Council deal of March 2013²³ continued drawing on cohesion and agricultural funds is ensured – this seems to be perhaps the most important funding for any public investment in the country. In the debates on the fiscal and banking union the country could avoid isolation, but also eschewed a very real threat of drifting into supra-nationalism, where non-elected organs decide over macro-economically significant expenditure items and bank resolutions.²⁴ While the relationship to the Barroso Commission has remained constantly strained, the actual position of the country – measured by statistics and investments – is in line with the economic significance of a middle income, medium sized country. The end-May 2013 initiative to discontinue the excessive deficit procedure after nine years is a clear sign of external appreciation of the improved fiscal performance of the country.

So far, so good. The question is more about the future perspectives. *To what degree had the Orbán government laid the foundations for future growth?* To what degree may and should, indeed, we make the parallel to the *kamikaze* government of József Antall, also representing a too broad coalition of center-right forces? With the benefit of hindsight nobody doubts: They did lay the groundwork for later progress. Can we claim the same?

The answer is multi-faceted. On the one hand, while IMF and EU tended to be skeptical, the Hungarian government did sustain a degree of fiscal solidity. True, by means of a fair degree of unorthodoxy, meaning non-conventional, improvised and non-sustainable arrangements, such as the crisis taxes or the nationalization of pension funds. Not only deficit (the current indicator) but the stock of debt (the indicator with a memory and with foresight) was kept under control at a time, when EU debt/GDP ratio grew by 20 percent, from 70.1 percent in 2008 to 80 percent by 2009 and 90.0 percent by 2012 in the Eurozone, from 64.2 to 82.3 percent in the EU-27, while 73 percent in 2008, 81.8 percent in 2010 and 78.6 percent in the case of Hungary.²⁵ The country has remained constantly on the capital market at times of major storms. Employment grew, whereas the rate of unemployment has not grown, unlike in many other countries, including Poland, Slovakia and Estonia, normally invoked as role models for new EU Member States.

Structural reforms were continued, especially on the labor markets, social transfers, unemployment benefits and disabilities / early retirement schemes. The flat tax was finally introduced as of 2013. Collection of taxes and social security contributions

23 *General Secretariat of the European Council*: European Council of 14/15 March 2013 – Conclusions, available at: www.consilium.europa.eu/uedocs/cm_Data/doscs/pressdata/en/ec/136151.pdf.

24 *Csaba, L.* (2012): Revisiting the crisis of the Eurozone: challenges and options. *Zeitschrift für Staats- und Europawissenschaften*, vol. 10, no. 21, pp. 53-77.

25 According to ECB Statistics Pocket Book, April 2013, op. cit., p. 47.

were severed. The balance between social benefits plus irregular economy versus legal employment for wage has improved for the latter. Vocational training improved and state supported traineeships expanded at firms. Expenditure on GDP slightly declined, from 51.4 percent in 2009 to 48.7 percent by 2012 and to a forecast of 47.5 percent by 2013.²⁶ The number of tax rates declined – true, from 54 tax rates in 2010 to 51 items by 2013, no breakthrough.

On the other hand, fundamentals continue to ail. Whatever the reasons for stagnation are, this made the expansion of productive employment, especially in small business and self-employment, the two most favored targets of the administration, impossible. Growth was minimal – 1.3 percent in 2010, 1.6 percent in 2011, followed by a contraction of 1.7 percent in 2012 and a stagnation in 2013 – a long way from the governmental dreams of a turn to robust growth. The ensuing limitations to act on major re-tailoring of various socio-economic arrangements imply also limitations on recovery of growth.

Improvisations and quick actions were not necessarily theoretically anchored, sound or else commendable, but perhaps inevitable in the short run as fire fighting. However, in an environment already burdened with distrust, lack of transparency and foresight, not least owing to ad-hoc interventions of the administration, mostly during the calendar year, and often retroactive in their effect, all backfired soon. They made calculability, foresight and trust – i.e. some of the most important *pre-conditions for investment non-existent*. This is a general feature, and tax reliefs, selected priority deals with big firms can only soften negative side effects.

Employment and qualifications are yet another serious problem, also translating in the low level of innovations. It is common knowledge that early retirement, lax disability legislation and tolerant attitudes to earning additional income in the irregular economy, as well as the widespread continuation of employment in the formal sector – including public administration – were in a way written in the social contract of the early 1990s. Most analysts at home and abroad tended to consider these as a cost for social peace in the first twenty years of transition, thus as a given. This approach – and the resultant unfavorable work income/social benefit plus additional revenue ratio translated into *Hungary being one of the lowest levels of labor market participation rates in Europe*, a mere 57.6 percent of the 15-64 year olds, or about 8 percentage points below the corresponding Swedish number, and underperformed by Turkey and Spain only among the OECD countries.²⁷

26 ECB, op. cit., p. 48, with the corresponding rates in the Eurozone were 51.2 percent in 2009 and 49.7 percent in 2012.

27 The OECD average at end-2012 was 65.1 percent, with Turkey 49.7 percent and Spain 54.8 percent at the lower end, and Switzerland with 79.8 percent and the Netherlands with 74.9 percent at the top. Source: *OECD Short Term Labour Market Statistics*, no. 1/2013 (accessed on 13 April 2013), at: www.oecd.org.

This is not a minor or marginal issue, since it is the basic factor behind the chronic non-sustainability of Hungarian public finance. The universal provision of welfare services is not complemented by Nordic morales of taxation, nor by Scandinavian levels of wage earning formal employment, with social security contributions collected diligently. Moreover, privatization in the health, education and pension sectors tended to be limited, timid and often marginal. In addition tax legislation remained restrictive. Unlike in the USA, charity, bequeathing or donations do not fill up the coffers of universities, churches, hospitals or homes for the elderly, let alone elementary and secondary schools. In a way there is no-one to foot the bill for the theoretically free of charge public services, and there is no constraint on the demand for them.

Under this angle the Orbán government *took steps in the right direction* in severing social transfers of various sorts, creating strong incentives to work, strengthening employer positions and turning industrial relations generally more flexible. As known from the experiences of Hartz-IV in Germany, such measures take time to bite, but they do.

Actually, detailed empirical analyses of the Hungarian labor market ²⁸ clearly indicate that the major problem under this angle is not the quality decline of higher education – a fact no insider would or wants to dispute. The basic problem is with persons with low or often no qualifications – about 30 percent of school leavers finish elementary school level only, bordering with functional illiteracy, lacking computer literacy and other skills needed to be employed. The other big chunk of problems are the 50 plus persons, generations who never encountered the need for life long learning, whose qualifications are outdated, whose flexibility and willingness to acquire new skills is limited.

Financial intermediation used to be an advantage for Hungary in the first 15 years of transition. However, with the privatization and foreign penetration in other central European countries this relative edge simply melted. ²⁹ The capital market remained a sideshow in resource allocation, not least since successive governments wanted to retain leverage over sales and strategic firms in general. The Orbán government was elected on a platform of remedying the mishaps of privatization. In reality, this translated in a governance style which favors state activism, basically in all sectors of the economy. Buying back the gas stations from the German E-ON, or nationalizing waterworks in many big cities, are just tips of the iceberg. With the budget struggling to sustain tolerable deficits, *public spending could not and will not be able to replace the weaknesses of financial intermediation.*

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- 28 Fazekas, K. / Benczúr, P. / Telegdy, Á. (eds) (2013): The Hungarian Labour Market, 2012. Budapest: a yearbook published by the Institute for Regional and Economic Research of the Hungarian Academy of Sciences and the Hungarian Employment Fund PLC.
- 29 Clarke, G. / Cull, R. / Kisunko, G. (2012): External finance and financial survival in the aftermath of the crisis: evidence from Eastern Europe and Central Asia. Journal of Comparative Economics, vol. 40, no. 1, pp. 372-392.

Perspectives for Hungary in Europe

We have repeatedly highlighted the two basic features of overall assessment of the post-2010 period. *First*, the process has been open-ended and revisions of plans, forecasts, policies and practices were formative for this period, perhaps even more than in the decade before. *Second*, Hungary's future hinges upon the ways and means as well as the timeline of managing the crisis in and of the European Union. In a growing economy – but only one growing by 2 to 2.5 percent annually and more – fiscal sustainability does not pose a serious challenge, provided tax collection is tight, and so are expenditures. By contrast, in a stagnant economy, revenue raising is inevitable in the short run, and thus creates disincentives to save and invest already in the medium run.

Converging to Maastricht criteria and applying the stipulations of the EU Fiscal Compact of March 2012 are tasks within reach. Multi-annual depression of the domestic market, together with the change in governmental stance on administered prices, which were at the root of sustainably high inflation, having fallen to 2.2 percent by March 2013, an unprecedented low in many decades.

While the 2013-14 period concludes financial consolidation, *conditions for lasting robust growth are not yet given*. While we do appreciate the achievements in sustaining the financial equilibrium of the country, domestically and externally alike, still this does not vouch warranty for any recovery. Economic theory as well as recent European experience – e.g. of Italy and Portugal, to a lesser extent France – indicate the possibility of a lasting minimalism in terms of growth.

As in previous writings, in this analysis we call for a half-turn in economic policy in order to address the causes of economic lull at the root. No quick fixes exist for overcoming hibernation: Neither tax policy, nor fiscal or monetary measures, let alone the much needed structural reforms will bite immediately. Especially the latter take time to become effective, and hasty reactions, improvisations and continued micromanagement at the cost of rule of law and transparency considerations could inevitably depress savings and even more investments, especially in the private sector.

Our suggestion is a return to the established conservative economic agenda of smaller debt, smaller taxes, smaller state expenditures, more transparency and calculability, and generally a return to the rule of law, rather than continuing revolutionary governance, which is its exact opposite, i.e. rule by the law. This rather trivial turn could work miracles in restoring credibility, also enhancing governmental commitment to sound practices. Adopting a realistic deadline for introducing the single currency, say by 2017 or so, would help anchoring expectations, domestic and foreign alike. Giving up some of the improvised giant projects, such as building a new nuclear power plant, or investing formidable sums in the energy sector, should simply be discontinued.

A coordinated vision, a joint economic chief of staff – other than a narrow circle of close advisors – could help introduce revolving planning in terms established in business administration, with deadlines, responsible persons, money allocated to the tasks and controlling all those actions. In sum, well known tricks of corporate management could help revive Hungarian economic growth in the medium run, which is a possibility, but by no means a given for the rest of the decade.