

Constitutionalism, Economic Transformation and Europeanisation: the Case of Hungary

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This article attempts to apply a constitutional political economy approach to a subject that has rarely if ever been analysed from this perspective. While the systemic change following the collapse of the Soviet Empire has provided social scientists with the opportunity to refer to constructivist insights on the holistic transformation of the social order, the application of related theories has been meagre. The following analysis presents an outline of how constitutional development influenced economic change in one of the new EU member states during the past two decades, and formulates suggestions on how insights from the above line of thought might be operationalised to improve the given institutions and policies.

Der vorliegende Artikel sucht einen konstitutionenökonomischen Ansatz auf einen Gegenstand anzuwenden, der nur selten – wenn überhaupt – aus einer solchen Perspektive untersucht wurde. Zwar bot der Systemwechsel, der auf den Zusammenbruch des sowjetischen Imperiums folgte, Sozialwissenschaftlern eine Gelegenheit, auf konstruktivistische Erkenntnisse über eine gesamthafte Transformation der Gesellschaftsordnung zurückzugreifen; die Anwendung entsprechender Theorien blieb jedoch eher dürftig. Die folgende Analyse untersucht die Frage, wie die Verfassungsentwicklung in einem der neuen EU-Mitgliedstaaten den wirtschaftlichen Wandel während der vergangenen zwei Jahrzehnte beeinflusst hat. Dabei werden einige Vorschläge formuliert, inwiefern Einsichten aus der benannten Denkschule operationalisiert werden könnten, um die bestehenden Institutionen und Politiken zu optimieren.

One peculiarity of the social sciences is the researchers' inability to agree upon the meaning of even basic analytical concepts. This is hardly astonishing, especially in the light of constructivism and other post-modern approaches, which highlight the focal role of discourse in constituting both reality and our perceptions of actions relating to the former. For this reason and contrary to the Anglo-Saxon tradition, it matters which name we attach to individual processes or phenomena. It also matters how we structure our axioms and arguments, as this, especially in the more formal approaches, prejudices the type of outcomes we may and do expect from performing academic exercises on empirical materials or models.

I. Why Does Constitutionalism Matter for the Economy?

Against this background it may not come as a surprise that economists, even from within the same line of thought, tend to disagree on concepts and their meanings just as much as other social scientists do. In law, for instance, the more traditional approach¹ takes constitutionalism to be the broad understanding of the history and practice of constitutional arrangements *in toto*. In the post-communist environment, by contrast, an equally influential line of reasoning emerged that defines constitutionalism in terms of *limiting the state, primarily the executive*.²

This line of thinking underscores the relevance of checks and balances in a much broader way than is customary in political science, meaning the division of powers between the legislative, executive and judicial branches. It has its equivalent in the contemporary representatives of the Freiburg School or constitutional political economy.³ This approach, following the political philosophy of *F. A. Hayek*,⁴ lays great emphasis on the quality of the constituting components of economic order or, to put it more simply, the *framework for the macroeconomic processes*. From this perspective, two momentums may be considered decisive:

- to save the market from its imperfections and self-destroying failures by regulatory agencies and procedures that keep the open economy and thereby the free society in operation, and
- to save mass democracy from itself, including its inherent tendency to overspend and disregard those broader concerns that do not fit into the myopia of media-led politics or maximizing votes.

Given that post-communist change has been one of wholesale *social engineering* where all rules of the game, formal and informal, have been re-written, it could have been an extraordinary opportunity to test those theories. Moreover, the accession of post-communist countries to the European Union, which has been a top strategic priority for all domestic elites from the very outset, also included a fair dose of social engineering because the Maastricht Treaty and its successors have been gradually transforming the former trade bloc and customs union into a political community. Since the Amsterdam Treaty omitted the possibility of “opt-outs”, new member states have become, willy-nilly, “110-percent

1 Cf. recently *Vorländer, H.*: Europas multiple Konstitutionalismen, in: *ZSE*, 5/2 (2007), 160–180.

2 Most prominently in *Sajó, A.*: *Limiting Government. An Introduction to Constitutionalism*, Budapest/New York, 1999.

3 Cf. the major books by *Buchanan, J.*: *Constitutional Economics*, Oxford, 1991, and *Vanberg, V.*: *The Constitution of Markets*, London, 2001.

4 *Hayek, F. A.*: *The Constitution of Liberty*, Chicago, 1978.

Europeans” in their attempts to transplant existing EC/EU arrangements, irrespective of their salience. As the Commission has been entrusted to check progress in these areas in detail and on the spot, this commitment could not remain pious in intention only.

Therefore from the very outset, *transformation* has been much more than its economic backbone, commonly referred to by the English acronym SLIP, i.e. stabilisation, liberalisation, institution-building and privatisation. This process has entailed the parallel restructuring of the economic, social and political order, formal and informal institutions alike. As a large-scale social engineering experience, it has provided a potential for implementing the related insights, all the more so, because systemic change, at least in the frontrunner countries, has been taking place in the context of Europeanisation.

The latter term has a variety of meanings,⁵ but for our purposes we understand Europeanisation as *interaction of domestic and EU policies and institutions*, rather than mere copying of EU institutions or the quasi-coercive use of EU policies by the new members. In so doing and in line with the research on West European experiences with integration, we stress the relevance of active feedback processes. The more we do so, the more we may think about the pivotal importance of constitutional change as the supreme and final level of formalising institution-building and political commitments alike. First, policy diffusion has been shown to have a major impact in all OECD countries, even in the old EU member states.⁶ Second, a properly designed and EU-oriented constitution-building has been shown by recent econometric evidence to be a forceful commitment device, signalling both elite commitment to sound policies and accountability, thereby improving the credibility of and public support for large-scale (and oftentimes costly) market-oriented reforms.⁷

In this way we might assess constitutional progress in terms of *new political economy*, i. e. to test if, and to what degree, constitutional changes that have been taking place in a frontrunner transforming country and by now EU member state have contributed to economic improvement in one way or another. The case of Hungary might be illuminating in order to highlight the – limited, though relevant – role of history and the responsibility of those taking decisions that culminate in constitutional change. Finally, we turn to the intriguing question of *if*,

5 Cf. the broad overview in the special issue of the ZSE, 4/3 (2006).

6 Pitlik, H.: A Race to Liberalization?, in: *Public Choice*, 132/1–2 (2007), 159–178.

7 Desai, R./Olofsgaard, A.: Constitutionalism and Credibility in Reforming Economies, in: *Economics of Transition*, 14/3 (2006), 479–504.

and how, constitutional change may contribute to fiscal consolidation. Since this last question has been one of the oldest topics that triggered the work in the area of constitutional political economy, the test may be worth a run.⁸

II. From Form to Substance and Disregard of Economy

A characteristic specific to Hungarian “Goulash Communism” as practised under *János Kádár* from 1956 to 1989 was its pronounced respect for formalities. This served, *inter alia*, the purpose of dissociating itself from the disgraced *Rákosi* regime as well as from other communist countries, such as Romania or East Germany. Stepping into the footprints of the Soviet Constitution of 1936, which is known to have declared universal freedoms (including the right to secede from the Union), formal arrangements in Hungary have always been kept legally impeccable.

Although this kind of legalism has not immediately influenced policy outcomes, it has been important in a number of ways. First, the legal tradition based on German law going back to the interwar and earlier periods was sustained. Second, following the gradual liberalisation of the post-1962 period, legal forms allowed for actual – economic and personal – freedoms to evolve. Examples of this are the Enterprise Law of 1977, allowing for major decentralising reforms in the 1980s, the liberalisation of the second economy in 1982 or the Transformation Law of 1988, allowing for the spontaneous privatisation of assets. Finally, those in power developed a sense of being constrained by legal forms and procedures.

This state of affairs differed greatly from that in other communist countries. Supported by the small freedoms of Kádárism, such as the relatively liberal travel arrangements or the respect for privacy, this paved the way to what was later termed the “negotiated revolution” in the 1989/90 period.⁹ It also allowed for the National Round Table Talks during this period, which resulted in a complete regime change without adopting a new constitution.¹⁰ For this reason, Hungary did not receive a new basic law, but rather it had to be content with the revised and improved edition of the 1949 version.

⁸ See, among others, *Buchanan, J.*, op cit., *Vanberg, V.*, op cit., as well as *Persson, T./Tabellini, G.*: The Economic Effects of Constitutions, Cambridge/London, 2003.

⁹ *Tőkés, R. L.*: Hungary’s Negotiated Revolution, Cambridge/New York, 1997.

¹⁰ Cf. in more detail *Bozóki, A.* (ed.): The Roundtable Talks of 1989. The Genesis of Hungarian Democracy, Budapest/New York, 2002.

It is very telling that both the old and the new constitutional arrangements that key features of the political order such as the guarantee of property rights, personal freedoms and the multiparty system could be incorporated into what many still consider a “Stalinist” construct. On the other hand, the Hungarian political elites have obviously missed the window of opportunity to act as Founding Fathers and lay the basis of a free economy and free society for the decades to come. The “negotiated” transition has also contributed to the lack of catharsis among both common people and the political class. The switch to democracy and a market economy was conspicuously non-violent, almost “everyday-like”. Therefore the petty work of political and economic transformation, including the launching of painful reforms, could not be compensated for by the euphoria about regained freedoms.

For the early period this remained a seemingly negligible circumstance since the outgoing regime had already legislated much of what was needed in terms of property ownership and privatisation. The independence of the Central Bank could be created by a mere amendment of the Law on the National Bank in 1991 and via a minor modification of the Law on Financing Public Debt in 1997 (that practically prohibited the monetisation of fiscal deficits by interdicting direct financing of government imbalances). However, as soon as the policy consensus of the 1990s gave way to left- and right-wing populism without a “*Stabilitätskultur*” having materialised within the economics profession or in the broader public, the practice of doctoring statistics and creative accounting proliferated.¹¹

It is common knowledge that several of the “old” EU member states have also been found guilty of “creative accounting”, from France to Greece and, notoriously, Italy. However, references to the malpractices of others do not exempt us from the consequences of our own misdeeds. The Hungarian public has been ill-informed about the actual state of affairs and has thus not been able to make deliberate public choices. Investors have been misled too. And last but not least, the well-known crowding-out effect of public deficits has triggered a slowdown in growth, irrespective of contemporary accounting tricks.

For this reason one could have argued for introducing fiscal rules along the lines of the practice that was spreading in a number of developed and developing countries in the second half of the 1990s.¹² Introducing fiscal rules alone may or

11 Csaba, L.: Between Transition and EU Accession: Hungary at the Millennium, in: *Europe-Asia Studies*, 52/2 (2000), 805–828.

12 See Kopits, G.: Fiscal Responsibility Framework: International Experience and Implications for Hungary, National Bank of Hungary, MNB Occasional Papers 62, Budapest, 2006 (available online under www.mnb.hu).

may not be conducive to more disciplined and sound public finance. Without getting into the nitty-gritty of this issue let us note that anchoring sound policies in the constitution, as in Poland, might be a rather resolute way of tying the hands of politicians and ensuring that inevitable controversies do not derail the fundamentals of economic policy. In this regard, the speaking silence of the Hungarian Constitution could perhaps be seen as omission at least, and shortcoming at worst.

Even fragmentary evidence for the democratic period may be indicative of the relevance of this issue. First, recurring attempts have been made, primarily, though, by no means exclusively, originating within the Hungarian Socialist Party and intellectuals close to it, to create a new constitution. It would have implemented two major changes:

- First, regressing to the idea to set up a bicameral system which was discussed by the National Round Table but overtaken by the political processes culminating in the free parliamentary elections of 1990. Adherents to this institutional option perceive it as a counterweight to what they consider as “partocracy” and to the majoritarian structure of the lower house.
- Second, creating a safeguard for social rights, seen by many as being threatened by marketising reforms. The latter can, in fact, lead to an ever-exploding budget, since rights not covered by revenue intakes might be relegated to a formality. If enforceable via courts, these never allow the fiscal stance to be restrictive.

The political relevance of these abstract considerations has been shown through the rulings of the Constitutional Court. This body has actually taken over the role of an upper house, counterbalancing the tyranny of the 50 percent plus one vote in the legislature. This role perhaps started with the ruling against “serving historic justice” in 1991, not allowing for retroactive legislation to purge the ex-communists from public life. More importantly from the economic perspective was the ruling against restitution of property, which had been the major agenda point – if not the single issue – of the then governing Smallholders’ Party. By enforcing financial compensation instead of returning confiscated property, the Court directly meddled in shaping political institutions and policy choices. Likewise, the 1993 ruling on municipalities that declared these to be fully-fledged property owners has made any centralisation of state administration impossible. It also pre-empted the attempts to leave the local municipalities without assets in the process of privatisation, and has therefore had important implications for the outcomes of this process. Last but perhaps most conspicuously, the Constitutional Court, through a series of rulings, revoked the structural reform components of the *Bokros* adjustment package of 1995, thereby setting clear limits to what the

parliamentary majority of the day and the executive can deliver in terms of systemic change by a mere fiat.

While the activism of the first Constitutional Court (1990–1999) was perhaps inevitable since the nature of the Round Table Talks and the hectic pace of the events tended to overtake everybody, improvisation, ad-hoc legislation and the resultant incoherence among the various economic subsystems as well as between the economy and society could not be avoided either. The Court has assisted in spelling out the spirit of the Constitution through interpretations. And although it would be hard to deny that judges have – sometimes changing – political preferences, in the long run this gradual and continual evolution of constitutionalism has basically been a plus in creating an open economy and an open society.

However, the rulings on the *Bokros* adjustment package already underlined the paradox we are trying to address here. While by 1995 the immediate transformation of a reform socialist economy into a market economy had basically been accomplished, as reflected by Hungary's admission to the OECD (an organisation precisely checking this quality), it would have been premature to state that the new market order in all of its finesse had already been created. Therefore, one could argue both in favour of and against the adjustment package introducing structural measures going way beyond what is needed by any version of stabilisation. Adherents of the *Bokros* package have rightly emphasised the economic component, i.e. that only structural reforms allow for the sustainable adjustment of economic processes.¹³ These imply changing rather than protecting the *status quo ante*, in social and economic terms alike. By contrast, opponents of the package, including the strong majority of the Constitutional Court, formulated equally weighty criteria about stability, predictability and transparency as being fundamental principles of rule of law in general and in and for the economy in particular. Arguing along those lines, the Court, in a series of rulings in 1995–1997, basically revoked most of the structural measures, such as tuition fees for universities and the payments for health services, and it curbed a number of social transfers, including pensions.

In short, given the parsimonious wording of the Hungarian Constitution on economic matters, which was due to the conditions of its inception, it has allowed not only for competing, but positively conflicting interpretations. It has not anchored any clear set of policies to be conducted, such as price stability or social

13 See Kornai, J.: Adjustment without Recession: A Case Study of Hungarian Stabilization, in: Zecchini, S. (ed.): Lessons from the Economic Transition, Dordrecht et al., 1997, 123–152; Antall, J.: A kiigazítás- ahogy én látom [The Adjustment Programme as Seen by an Insider], in: Közgazdasági Szemle, 44/2 (1998), 97–122.

rights. For this reason, as we have tried to indicate in the sketchy list of major rulings by the Court, it has not become an obstacle to systemic change, as was the surviving Soviet Constitution for Russia in its first period of stabilisation (1991–1994) when such support would have been most needed. Meanwhile, it has also not precluded the regress to policies that were oriented towards the *status quo* rather than towards developing a mature and competitive market order.

III. Europeanisation – the Overrated Promise

One commonplace to be found in the academic and policy analyses of the 1990s and early 2000s has been the belief, developed into an axiom, that Europeanisation is likely to represent a fundamental moulding factor for all countries engaging in systemic change, but particularly for new EU member states. This top-down approach tended to put the emphasis on the leverage of the Union, highlighting the various dimensions of influence the old members had on new ones.¹⁴ Furthermore, much of the literature on the then candidate countries interpreted the EU attempts to transplant their arrangements and check institutional quality, both during *acquis*-screening and accession talk, as a quasi-colonial attempt to restrain the freedom of choice for new democracies from among the “varieties of capitalism”.¹⁵

Against this background it might be surprising to see the resurgence of populist policies in the new member states in the first few years of the 21st century and their relapse into policies that were thought to have ended with the EU accession process. This applies to assertive Polish foreign policy stances as much as to Hungarian laxity and its lagging behind in the economic arena. The latter will now be our subject for analysing the impact of constitutionalism.

Dovetailing supranational legislation with domestic traditions of EU member states has never been an easy task. The Karlsruhe ruling on the Maastricht Treaty and many other judgments indicated that old members also have their troubles in managing the interaction. For the new member states, a number of specificities have emerged.¹⁶ Furthermore, the coordination process has become even more

14 This view was emphatically expressed by Schimmelfennig, F./Engert, S./Knobel, H.: *International Socialization in Europe: European Organization, Political Conditionality and Democratic Change*, New York, 2006.

15 Dyson, K. (ed.): *Enlarging the Euro Area: External Empowerment and Domestic Transformation in East Central Europe*, New York, 2006.

16 See Vörös, I.: *Legal Doctrine and Legal Policy Aspects of EU Accession*, in: *Acta Iuridica*, 44/3–4 (2003), 141–163.

complex because of the political stalemate within the EU-15 that emerged by the time accession became politically feasible. Some of the most important items include the boycott of Austria in 2001, the disagreement about Afghanistan and even more about Iraq, the meagre deal in Nice, the equally minor results of the Constitutional Convention and finally the rejection of the Constitutional Treaty in 2005 and its planned replacement by a Treaty in 2008; all these events indicate that the implementation capacity of the EU, i.e. the most important feature of any institution,¹⁷ has been severely constrained by issues that do not relate to enlargement and the related distributional conflicts. As a result, the idea of the “supremacy” of EU law has been replaced by a reference to its “primacy” over national law, rendering it a contested domain. As a consequence, the top-down controlling and guiding functions of EMU arrangements could not exert their influence either in law or in fiscal policy.

Let us address the major areas where Europeanisation could have brought about a breakthrough in the more recent past. First and foremost the entire constitutional order, primarily major components of the legal system, could and should have been adjusted with an eye to deepening. The *acquis communautaire* started to develop in an unprecedented manner following the Maastricht Treaty and the evolution of the three-pillar system. Also the silent, covert but continuous evolution of Community legislation, arising partly from the actions of the European Commission as policy entrepreneur and partly from policies of various pressure groups, often without explicit authorisation, resulted in the establishment and gradual implementation of a wide variety of policies at the EU level.¹⁸ The fields that have emerged over the past 15 years include legislation relating to society, the environment, the defence arm of the EU with extraterritorial peace-keeping missions and, more recently, energy.¹⁹

These developments could not have taken the new members by surprise because the structured dialogue, launched at the Essen Council of 1994, already involved all ministries besides finance and foreign affairs in the consultations. While the educatory impact of this intergovernmental dialogue could hardly be overestimated, *legal harmonisation* has not led to that level of congruity and forward-lookingness that one could optimistically have expected. In short, it has not been only about economic and other vested interest, but about broader con-

17 See North, D.: *Institutions, Institutional Change and Economic Performance*, Cambridge/New York, 1990.

18 Cf. Wallace, H./Wallace, W./Pollack, M. (eds.): *Policy-Making in the European Union*, 5th ed., Oxford/New York, 2005.

19 On the latter cf. *European Commission: Green Paper on Market-based Instruments for Environment and Related Policy Purposes*, COM (2007) 140 final of 28.03.2007.

cerns. Despite the two separate rounds of *acquis*-screening and accession negotiations in 1998–2002 and beyond, the influence of EU arrangements has remained partial, and *anticipatory adaptation* of domestic rules and policies has remained fragmentary at best.

One of the reasons for this has been the technical and substantial difficulties involved in the complex process of legal harmonisation.²⁰ This has to do with the very nature of the EU, which both at the constitutional and the political level (*Verfassungswirklichkeit*) continues to be much more an association of compound states²¹ than a federation with central powers to enforce any legal norm. While the latter might well be derived from the basically (though by no means exclusively) intergovernmentalist structure of the EU, the evolution of policies is indicative of the presence of the contrary processes as well. However, without reference to the political stalemate and the ensuing implementation deficit referred to above (that has nothing to do with Eastern enlargement, having preceded it in the old member states during the period from 1998 to 2004), one could not convincingly interpret the foot-dragging observable in the new members.

In short, the bad example of the old members has proven much too easy to emulate. As long as the political class uses European forums as a theatre for their respective domestic electorates rather than focusing on visions and modalities of managing future challenges, it is perhaps overambitious to expect, as the present writer tended to, new members not to follow suit but to adopt the stance of the Founding Fathers and focus on issues that might be solved only through common effort. In this concept the unwillingness of the Hungarian Constitutional Court to give up its gatekeeper function and quasi-automatically condone the primacy of European law over domestic²² is rather the expected outcome. All the more so since, in the earlier phase, the well-known lawyer, *Barna Berke* already won a precedent case in the late 1990s. In that ruling, the Court declared that, contrary to the political atmosphere of the day, the process of legal harmonisation should *not* lead to the automatic adoption of EU competition norms in the pre-accession period. While in both cases the major argument was the need to retain the internal coherence of domestic legal arrangements, which is *per se* valid, a different viewpoint emerges from the economic perspective: that of the missed opportunity to import a set of rules which already perform relatively well and with a

20 See in more detail *Vörös, I.*, op. cit.

21 *Blankart, C.*: The EU: Confederation, Federation or Association of Compound States?, in: *Constitutional Political Economy*, 18/2 (2007), 99–106.

22 *Sajó, A.*: Learning Cooperative Constitutionalism the Hard Way: the Hungarian Constitutional Court Shying Away from EU Supremacy, in: *ZSE*, 2/3 (2004), 351–371.

credibility and enforceability way beyond any local arrangement, not least owing to the practice of the European Court of Justice in Luxembourg.

A second area where Europeanisation could have been expected to have immediate influence is monetary policy. Ever since Maastricht and the implementation of the EMU, monetary policy has been centralised in the hands of the European Central Bank. Because the new members were precluded from the option of opt-outs by the Amsterdam Treaty of 1997, they acceded with the commitment to join the Monetary Union. In a way the conditions applying to them are stricter than those for Britain or Denmark.

Here again, theoretical assumptions and policy considerations have been clashing. In short, economic theory is unequivocally in favour of any small open economy joining a monetary union. The more we realise the pre-eminent role of fiscal flows in setting exchange rates and interest rates in a global interaction of markets operating 24/7, the less meaningful we find the conventional terms “exchange rate policy” or “interest rate policy”, implying a major deliberative component on the side of policy makers. The reign of the bipolar view in financial economics, considering either monetary union or free floating as the only viable and sustainable long-term alternatives, renders further discussion at this point superfluous. By implication, giving up two non-instrumental policy tools does not count as a major sacrifice for any small open economy.

It follows that it was only logical that Hungarians and foreign investors alike expected the speediest possible adoption of the euro. This would have required fiscal consolidation and the copying of the monetary arrangements of Community law. In reality, a different story emerged, and formal professional opposition to the considerations outlined above was demonstrably negligible. First, the independence of the National Bank of Hungary (NBH), though guaranteed by the 2001 edition of the law on central banking, has not been anchored in the Constitution, unlike the status of the ECB that has been enshrined in the successive EU treaties. As a consequence, the practical meaning of this independence has been open to interpretation. As long as successive governments adopted an increasingly populist line, central bank independence remained a nuisance. For this reason, a series of measures were passed, especially in the 2003–2006 period, leading to a narrow interpretation. First, with reference to the legal status of the Bank as a corporation, a supervisory board was established. Second, fiscal policies that were out of line with the inflation-targeting regime adopted by the NBH have been continued. Increasing VAT rates in 2004, decreasing them in 2005 and re-increasing them in 2006 were only the tip of the iceberg. Third, policy disagreements between fiscal and monetary authorities went public, with the pro-government press conducting a series of unfounded attacks on the political mo-

tives of the NBH. Fourth, as a consequence, in 2004 the supreme decision-making body of the Bank was expanded to include experts close to the government line. While these mishaps are being corrected in the 2007–2008 period, this is an outcome of selecting a highly esteemed commercial banker to the post of the Governor, a person who also has an extremely cordial relationship with the Premier. In other words, the rituals of the EU, including public interventions of the ECB, have not proven to be instrumental in pre-empting derailments.

It is an important technicality that, contrary to the ECB, the National Bank of Hungary has been sticking to the regime of inflation-targeting (IT), while the ECB adheres to its two-pillar strategy.²³ IT is in line with the fashion in financial economics, although clear IT regimes are being practised in countries like Britain, Chile and New Zealand, who are currently not aspiring for EMU membership. Inflation targets, constantly 3 percent per annum, have been regularly missed, and there are no chances of meeting it before 2009,²⁴ which is a poor performance of eight consecutive years.

As a consequence, and after a series of postponements, Hungary was forced to give up the original entry date to the euro by mid-2006. In short, EU membership has not armed the NBH to withstand fiscal policy fluctuations and thus enhance the expected credibility. Therefore, financial markets reacted to this astounding move rather condoningly, reflecting the credibility problem mentioned above.

The third area in which Europeanisation has had an impact is fiscal policy. In any monetary union, but especially in one constructed without prior political integration, fiscal policy is by definition a matter of common concern. Economic debates preceding the adoption of the euro amply demonstrated this point, leading to the famous non-bailout clause in the Maastricht Treaty and its successors. This means that tolerating fiscal laxity is by no means an option since this would trigger reactions from the financial markets or translate into higher inflation in non-trespassing countries. While the efficiency of these arrangements has proven to be questionable in practice since financial markets failed to punish obvious non-compliance in old and new EU members alike in 2004–2007, this does not invalidate the objective existence of the interrelationship. This is the rationale of sustaining the various processes of policy coordination and control, including the convergence and stability programmes and their assessment by the Commission and the Council (Ecofin), the regular analyses from ECB and the involvement of the Council in debating economic matters and measures.

²³ Issing, O./Angeloni, I./Gaspar, V.: *Decision-Making in the European Central Bank*, 2nd ed., Cambridge/New York, 2004.

²⁴ MNB [*National Bank of Hungary*]: *Inflációs jelentés-frissítés* [An Update on the Report on Inflation], Budapest, August 2007 (available online under www.mnb.hu).

From this perspective, the application of the common fiscal framework, i.e. the Stability and Growth Pact, could have been seen as legitimate and practical, even following its re-interpretation in March 2005.²⁵ In short, two overlapping considerations may be advanced. First, conducting sound fiscal policies by avoiding the explosion of public debt is simply common-sense economics conducted not for the sake of gaining approval from any external agency but for its own virtue and uses. Second, being a candidate for the single currency immediately implies that efforts for compliance arise from the country's own efforts rather than only from external pressure.

It is of course true that precisely in the period immediately before and after Hungary's entrance into the EU, large countries were regularly flouting the Stability and Growth Pact (SGP). As long as they could get away with it without even the famous "naming and shaming", governments were given the incentive to drift into populist economic policies and the precedent was created. Observing the mismatch, insightful analysts called for complementing the joint framework of SGP with national fiscal rules.²⁶ These have indeed been effective in a number of countries, such as Sweden, but they have remained non-existent in most new members except Poland, where a constitutional amendment in 1999 contained a provision about the automatic measures and procedures to be taken if public debt were to exceed 50 percent of GDP. However, in the case of Hungary, no such rules exist.

It might be legitimate to object that fiscal discipline is an outcome of a broad socio-economic process, in which the culture of fiscal soundness, transparency and trust among major players are formative in ensuring the outcomes.²⁷ In this line of reasoning, one may well get away with or without rules. For instance, in the 2000s Romania has conducted sound policies without formal rules. By contrast, elaborate procedures in Germany could not stop the country from non-compliance with Maastricht in a series of years.

From the perspective of the literature on Europeanisation, one could have expected that constitutional modifications would anchor sound public finances in the basic law of the country. This also seemed to be possible given the fact that in 2000–2002 public debt was way below the line of 51–53 percent of GDP, and deficits were also in the range of 5 percent.²⁸ Since growth was also around 5 per

25 A more detailed analysis can be found in *Csaba, L.*: *The New Political Economy of Emerging Europe*, 2nd, revised and updated ed., Budapest, 2007, Chapters 8 and 9.

26 *Buti, M./Franco, D.*: *Fiscal Policy in a Monetary Union*, Cheltenham/Northampton, 2005.

27 *Gyórfy, D.*: *Democracy and Deficits*, Budapest, 2007.

28 Current reporting and final numbers often do not overlap, and the difference was significant until this practice was discontinued in August 2006. There was also a cleaning-up procedure in both election

cent, this could, in theory, have been the ideal time for fiscal adjustment. Reference to EU accession and the ensuing need to regularise fiscal affairs could have been a handy argument, and the “EU consensus” among various elite factions was widespread. Moreover, fiscal adjustment, if implemented under conditions of liberalising markets and social cooperation, does not necessarily imply costs in terms of production and employment. Although comparative analysis has indicated that the growth-generating/expansionary effect could not be proven, the contractionary effect can unambiguously be excluded under Hungarian conditions.²⁹

However, if anything, the opposite of the normative view has happened. Between 2001 and 2007, governments were involved in populist redistribution policies. Therefore, the adoption of fiscal rules seemed anything but urgent to them. This applied to the post-election time of 2002 and 2006 and to the historic opportunity of May 2004 when accession, after 15 years of laborious efforts, finally occurred. Meanwhile, the Law on Public Finance was re-interpreted so that none of the corrective measures of its stipulations, such as the obligation to submit a supplementary budget to the legislation, ever needed to be applied. For instance in 2002, when the reported current deficit exceeded 9 percent, a re-interpretation of the Law made the formal submission of a supplementary budget obligatory only if the difference between planned and actual figures exceeded 5 percent of expenditures. Given that the majority of the day is always ready to accept a modification of fiscal targets during the year, even as late as in November, it would require an extreme exigency, such as an earthquake or a war on the territory of the country, for this to happen. Ex-post evaluation of the fiscal target and performance by the State Audit Office is normally conducted with empty rows of seats in Parliament. No politician or official has ever suffered from the consequences of the often sweeping criticism of the office, which has been public all the time. As a final consequence, general deficit ballooned to 9.6 percent by 2006 and 6.4 percent by 2007, and public debt reached 71 percent of GDP by 2007, with very gradual improvements possible in the years to come due to increasing international rates of interest.³⁰

years, when misreporting of preceding years were discontinued. Although the latter may evoke the impression of a political business cycle (*Nordhaus, W.*: The Political Business Cycle, in: *Review of Economic Studies*, 42/1 (1975), 169–190), it is not the case. Deducing those one-time items deficits in the range of 6 percent in 2002 and 7 percent for 2006 remains, whose average is just equal to the consolidated average for the 1991–2006 period.

29 See *Benczes, I.*: *Trimming the Sails. European Fiscal Reforms from a Hungarian Perspective*, Budapest/New York, 2007.

30 *MNB*, op. cit.

In short, a series of other policy areas could have been immediately affected. These include the rule of law and the spread of law-abiding behaviour. In reality, the latter has not happened, and the state, as exemplified by fiscal policy, has been one of the major actors in setting the bad example. Improvisations on granting or not granting concessions to foreign investors, delaying the payment of the 13th-month wage for public-sector employees and the 13th-month pension to pensioners, the two accounting for about 4.2 million persons in a country of ten million, are just the best known examples. Continuous and incoherent changes in taxes, public dues and other items of regulation, such as employment and safety conditions, together with red tape, non-transparency and allegations about corruption are among the major hindrances that limit the growth of the new private sector, i. e. small and medium firms.³¹ Recent attempts to conduct “patriotic economic policies” along French, Spanish and Italian lines, protecting through a special law “strategic” firms from takeover by those disliked by the government,³² in open defiance of the basic principle of the single market, also do not bode well for the spread of law-abiding behaviour.

Likewise, recurrent tendencies of the governmental majority of the day to reinterpret any legislation in their own favour, especially those regulations that would constrain the majority’s freedom to manoeuvre, are reasons for concern. Nominations for the organs overseeing public media, non-nomination of persons to positions where they could exert restraining influence, such as the post of ombudsman, judges of the Constitutional Court and even of the attorney general, are rather well publicised cases in point.

In matters of environmental policy the introduction of Community legislation has been slow, partial and delayed.³³ This sector’s share of total public expenditure has been constantly decreasing since 2002 when accession negotiations were concluded. Despite a government’s avowed good intention, its spending is the way to measure its actual priorities. And while private-sector involvement in building waste-processing works or even supplying water has been an established practice, this only mildens lacking public sector involvement.

Finally, the influence of Europeanisation in social affairs has been limited. While the EU in general has no significant competences over social matters, discursive elements, policy evolution and rulings of the European Court of Justice have created a field for interaction. In the case of Hungary, social legislation tends

31 Cf. the extensive analysis published recently by the *Ministry of the Economy and Transport (GKM): A kis- és középvállalatok helyzete, 2005–2006. Éves jelentés.* [Annual Report on the State of Small and Medium Enterprises, 2005–2006], Budapest, August 2007.

32 See more on that in the editorial of the business weekly *Figyelő*, 36 (2007).

33 The Urban Waste Water Directive will be fully employable only after 20 years, i. e. 2022.

to be lax and labour market regulations liberal. However, in recent years a number of new regulations emerged, such as the higher compulsory minimum wage for university leavers, limiting the opening hours of supermarket chains, or the fight against illegal employment. These changes have usually followed domestic policy considerations rather than any immediate influence of European forums, be they consultative or formal.

IV. Balance Sheet and Perspectives

What we have seen until now provides at least partly unexpected answers to the question raised in the title of this contribution. First, constitutionalism has not proven to be a formative idea in Hungary, despite the rather strong neo-liberal traits of the social science literature and even policy discourse in the nearly two decades of systemic change. This is a finding that may be generalised, with the usual caveats, to other new EU members as well. Second, Europeanisation, especially its top-down component usually (over-)emphasised in the literature in general and on Eastern enlargement in particular, has also proven to be a largely toothless lion. The availability of EU funds – the material component – or the enthusiasm for overcoming the uncertainties of the post-1920 period and joining the great work of European construction – the ideational component – have both had insufficient impact on the conduct of actual policy-making. The latter component followed – so our third insight – its own closed, self-referential logic, rather than the norms of economics, law or political science. In matters of fiscal policy and law-abiding behaviour, it even failed to follow the basic interest of an acceding country.

Fourth, as a consequence, economic change has proven to be much less of a success story than it could have been expected. Although this finding cannot be generalised, it is not entirely surprising. Notoriously lax fiscal policies inevitably lead, as we have seen, to the crowding out of private investment. Increasing the role of the state in terms of expenditure leads to efficiency losses and limitations to the bottom-up development of the private sector and the supply side in general. Giving up the entry date to the Eurozone has opened the drift in policy-making. It has also left reform deliberations without a macroeconomic anchor and a time frame. The choice has thus been clearly counterproductive, especially seen in the broader context. Both sustainable high rates of growth and financial stability could only have benefited from an early adoption of the single currency. EU arrangements have proven to be inefficient to counteract the drift coming

from domestic policies. While the final, fifth insight is by no means peculiar to new EU member states, its ramifications are perhaps weightier for those in need of a better quality regulatory frame for their global competitiveness.

On balance, the competences and the practice of the Hungarian Constitutional Court has not followed the ideas of the new political economy cited at the outset. The Court has continued to meddle in a variety of current affairs, while it has proven unable to strengthen the basic features of the socio-economic order against the political cycle to the ideal degree. This applies especially to monetary and fiscal institutions and the enforcement of the idea of the rule of law.

Future options contain partial though potentially important improvement in the two major problem areas, fiscal and monetary policies. In fiscal policy the years of procrastination, the growing burden of debt and the despair of markets about being able to join the safe haven of the Eurozone any time soon have made the need for regularising public finance an imperative. There is a need for broader insights into the need for transparency and for rules guiding fiscal decisions in the course of the daily ups and downs of democratic politics.³⁴

In September 2007, the President of the Republic convened all parties represented in Parliament in order to agree upon introducing fiscal rules, new institutions and legislative procedures meant to ensure the coherence of fiscal planning and avoid recurring public debt and overspending. In order to attain this, modifications to the Constitution are being discussed that would provide the fiscal authority and planning process with the anchor that has been missing up to now. However, the first public statements made by those participating have already raised doubts about the viability of the entire project in bringing about major and sustainable improvements in public finance. These improvements are a must if the single currency is ever to be introduced under the existing criteria.

The government's original proposal of July 2007, as published on the website of the Ministry of Finance,³⁵ is a mere compilation of existing alternatives, without prioritising any of the available options. Following the announcement of the Premier in April 2007, an Office of the Budget modelled on its American counterpart is being created to help create consistency in fiscal plans. However, it is well known that the fiscal performance of the USA was dismal in 2000–2007, leading to the greenback losing half its purchasing power against the single currency in the period under scrutiny. The Congressional Budget Office is not even meant to create a counterweight to the improvisations of the administration and of the legislature, the major sources of fiscal imbalances in any democracy.

³⁴ *Cosidine, J./Duffy, D.*: Partially Sighted Persons and the Public Debt Elephant, in: *Constitutional Political Economy*, 17/4 (2006), 237–249.

³⁵ See www.pm.gov.hu.

While experts have advocated the introduction of stiff quantitative and procedural norms to streamline the budgeting process,³⁶ actual policies seem to have moved in a different direction. Not only is the new institution toothless, but also no other institution will be in a position to crosscheck the consistency of fiscal plans with medium-term targets. Setting these targets in a continuous updating of the EU convergence programmes remains basically disconnected from the annual fiscal planning and its ongoing modifications. Neither the State Audit Office nor the parliamentary committee on fiscal affairs has the right and the expertise to control *ex ante* the coherence of fiscal plans. Their opinion is by no means binding on the governmental majority.

In terms of monetary policy, the correction of previous misdeeds is in the making. At the time of writing, a joint committee of the Bank and the Ministry of Finance has even been set up to elaborate the trajectory and technicalities of introducing the euro. Quite tellingly, the Minister of Finance also stressed that the government continues not to set a fixed date for introducing the single currency.³⁷ This might be a problem insofar as the crux of the political economy of the euro is to gain credibility through timing and calculable actions that trigger those reforms and adjustment that are needed to qualify.

In light of the improvements reported above it is instructive to see the evident impact of Europeanisation, as Hungary does not dare to be left out of core EU policies. That is, the possibility to shape decisions is at least as significant as the reverse influence, that of the European fiscal and monetary framework on domestic arrangements. It is important to observe that flouting the SGP has not led, as many feared, to its disintegration. On the contrary, in 2006 and 2007 France, Germany and Greece adopted measures to ensure gradual compliance with the fiscal targets. By the same token, Hungary also faced the core options, i.e. being left out or adjusting to the common goals.

In the other fields listed in the previous section, the impact of Europeanisation also remains significant and favourable, especially if complemented by domestic efforts. Among these efforts, the ongoing activist stance of the Constitutional Court deserves special appreciation. Through a series of its rulings nullifying improvisational policies of the government, the Court continues to develop what many consider an unwritten constitution. In so doing, the judges follow the insights from new political economy³⁸ that highlight the enormous relevance of

36 Kopits, G. (ed.): *Rules-Based Fiscal Policy in Emerging Economies*, New York, 2004; Romhányi, B.: *Reforming Fiscal Rules and Institutions in Hungary*, in: *Public Finance Quarterly*, 52/2 (2007), 341–376.

37 As reported in: *Világgazdaság*, 13 September 2007.

38 *Genmaidi, N./Shleifer, A.*: *The Evolution of Common Law*, in: *Journal of Political Economy*, 115/1 (2007), 43–68.

case law even under continental systems since rulings create trial-and-error processes, whereby legislation that is able to meet public preferences may and does emerge.³⁹

Also in other areas, such as competition policy, environmental policy and social policy, the slow, evolutionary change and the possibility to rely on the European Court of Justice as final arbiter allows for the continuous improvement and harmonisation of Hungarian institutions and policies. The higher the probability of overcoming the political impasse that culminated in the Dutch and French rejection of the Constitutional Treaty, the more palpable these results might be in the non-economic areas in the years to come. And the better the quality of institutions and policies, the bigger the potential gain, both for Hungary and the Community, in terms of competitiveness, growth and welfare. In this way, the objectives on which the entire process of systemic change has been focused could be realised.

³⁹ The authors term this as *Cardoso law*, referring to the Brazilian case in which a series of politically biased rulings have finally added up to legislation of a much better quality than before.