GROWTH, CRISIS MANAGEMENT AND EU: THE HUNGARIAN TRILEMMA

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ABSTRACT: T his paper addresses the challenges of 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.

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The current paper is perhaps the first academic attempt to provide an *empirically based overview* of economic developments in Hungary in the 2010-2013 period. This is done under one specific angle, that of international embeddedness, and we consciously ommit a number of issues hotly debated domestically abroad, from constitutional amendments to the way of addressing indebtedness of households in forex. The big picture is undoubtedly one dominated by the trilemma, highlighted in the title. We also refrain from offering a round-up, lacking a historic perspective on an open-ended process.

Thus we are entering a slippery slope with this attempt. In adopting the bird's eye view we shall analyze the following paradox. While in the 1987-2007 period Hungary tended to be not only a – sometimes undisputed, sometimes less convincing – frontrunner of systemic change to market capitalism, but also a darling of the international community/EU and capital markets alike/, this

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situation has dramatically changed by the end of the mandate of the second Orbán administration. For good or bad, Hungarian domestic issues – more recently the fourth amendment of the Basic Law – 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 mainatance cost for housing and banning the use of totalitarian symbols, have triggered angry international reactions, and not only from left-leaning mass media. Even such initiatives which are either natural –as nominating a new governor of a central bank when the mandate of his predeccesor expires – or applying arrangements, which have earned praise elswhere –as the flat tax in the Baltics, Russia and Slovakia – have stirred angered criticism, in otherwise restrained partners, such as the IMF or the European Central Bank.

In a way, Hungary is under siege, and the Prime Minister has gone as far as accusing Brussels of lasting use of double standards, subjectively intepreting even basic economic facts, and taking sides against the government's fight against vested interest groups and their political clientelism. And while the litany of complaints lodged by international players against the center-right 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.[2] This is absolutely unusual, as governing parties tended to lose 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 voltes!/ 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 the country was ambigous at best. A former Governor of the central bank, and one of the most seasoned observer, a formative personality of center-right thinking speaks not only of the growth, which is yet to come and has no early indications of doing so, but also about the loss of perspective, especially for the

[2] According to Median opinion research center, 45 pc supported Fidesz, 24 the socialists and 17 pc the radical rightwing Jobbik. In: *HVG,* 4 April, 2013.

younger generation – true this is largely an all-European phenomenon/Bod,2013,pp24-25/. It might be of interest to a broader readership to raise the question: how did we get there? How did the government, with a solid majority, and elected on a definitely pro-growth, supply side platform, got stuck into a series of improvizations, re-baptized as ’unorthodox economic policies”? How come that structural reforms remained slow, growth, if any, was sluggish, and the boom of the small busines 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 prestigous EMS members, as Greece, Spain, Portugal, ireland and more recently even Cyprus, have fallen victim to the new contagion, as a series of dominos? How come that Hungary never experienced the drying out of capital markets, which have shaken much stronger economies, as the ones listed above?

In short, any balance must be ambigous, depending on the standard we, as analysts, apply. The glass is half full, if we take the angle of financial markets and fiscal prudence, just unlike in the entire long preceeding half of a century, i.e the 1957-2008 period. On the other hand, the glass is half empty if we adopt the broader socio-economic perspective, one which has been traditionally cultivated by the intellectuals having rallied among the new bloc of center-right forces ever since 1995.

Preliminaries: the Heritage of the 2006-2010 Period

Let us recall – rather than reproduce – our earlier account/Csaba, 2013/ 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 entry in the European Union. While EU membership was undoubtedly beneficial – not only from the economic perspective, and 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 pronouncement by cabinet members were tentatively, non-committingly speaking of the range of 2020, i.e way beyond anything practical for policy-making.

The period of drifting, as richly documented in our previously cited chapter, has started way before the change of the guard. On the contrary, the landslide victory of the Right was, to a large deegree, due in 2010 to the overall feeling of being fed up with drifting and improvizations, and a preference for strong and efficient governance. It must be stressed, if for no other reason, that radical critics of the center-right government have a tendency of depicting the status quo ante, i.e also the 2005-2010 period as one of normalcy, reforms, financial equilibrium and structural change – which holds at the level of declarations of intent only, not born out by any statistics.[3]

In reality, if we – like many common people in Hungary – are surprised, when taking stock of the period of 'electoral revolution', as the official parlance goes, it is exactly the *largely unexpected, if perhaps inevitable continuity of drifting,* which has characterized Hungarian economic policies ever since the peer pressure of the EU ceased. 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 EMU, but also in many other areas, from environmental protecion to social policies – were usually saved as unnecessary overstretching by the successive governments, basically ever since 2003, i.e in 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

[3] Perhaps the most articulate representative of this view is Professor Péter Mihályi/2012/ of the Univerity of Pannonia, Veszprém, a former member of several center-left administrations in charge of pension and health issues. Many other public figures formulate similar views, without however the sophistication and attention to detail, peculiar to Mihályi.

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 in a negative spiral, bringing about negative synergies across the factors of growth.

How can such a negative synergy come about? Usually – and this applies to the Hungaran case as well – 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. East Asian countries, following the crisis of 1997-99 continued to implement gradual but sustaining, irreversible changes in their financial system and industrial organization, and re-gained their lost growth momentum soon. In sum, this is a feasible proposition, contrary to the currently dominant view of rational choice , which takes the rule of vested interest and the ensuing poilcy laming as given.

In Hungary reforms were clearly running out of steam ever since the accession to EU was formlized in December, 2002. It seemed, not being overzealous is an innocent ommision 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. The drift between discourse and reality – *Dichtung und Wahrheit* – has perhaps never been so great as in this period. 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 until distrust in institutions, and notoriously in political parties, who should be the agents of incremental, peaceful and professionally managed change in any open society.A recently published collection of papers/Muraközy,ed, 2012/ single out this component as formative for lack of savings, investments, innovations and generally speaking, forward looking action.[4]

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 pc in the period until 2006, however the slowdown starting in the second half of 2006 was already secular. The dream of automatic catchup to the EU living stabdards has not materialized – this explains to a large degree the rise of the radical right/Buzogány, 2011/, which was an unprecedented feature in postwar political history of the country/though fully in tune with the rise of the wave of dissatisfaction in all across Europe, from the Netherlands to Finland, i.e in countries with a track record of tolerance and disregard for right wing extremism/.

Balanced analyses of the Hungarian economy/OECD, 2012/ 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 non-party member left wing Premier of Péter Medgyessy in August,2004 by his own coalition, was largely due to the feeling, that he is unable to mobilize and manage for change. The new PM, Ferenc Gyurcsány was of the opinion, that the time of 18 months left until the 2006 elections is too short for any major reform. He subordinated everything to winning a popular mandate – in order to accelerate change in the next legislative cycle.

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

[4] Authors include a former member of the first Orbán government, Academician Chikán, and to the general manager of TÁRKI Social Research Institute, György István Tóth, convened by Péter Felcsúti, longtime Chair of the Hungarian Banking Association.

split over major changes, rendering those impossible on the ground.[5] This split was made open by the leaking of the unfamous 'lie speech' of Mr Gyurcsány in mid-September, 2006, four months after it was delivered, but about the time when fundamental reform projects were about to be legislated. The tone and the style of the speech was such, that it hurt most of Hungarian society, and triggered six weeks of demosntrations – yet another unprecedented phenomenon in the whole Hungarian democracy since 1848. However, the Premier and his party was sticking to power. The raw was finally calmed down by the opposition, calling for referenda on the socially most sensitive issues by March,2008.

This development has made the deep division in Hungary open, the administration remained much of a lame duch. The opposition had an easy run to win the plebiscite with 85 pc of the vote, since questions were targeted against fee payments in education and health care. However, this move has also pushed the center-right into a hardly managable situation. On the one hand, their image was – especially abroad – one of irresponsible populists, ready to sacrifice exconomic rationality for gaining votes. On the other hand, this image alone was a warrant for the center-right having to act in an ultra-conservative manner on economic issues once in government.

The Left – and the remnats of the once prominent Hungarian Democratic Forum – were so hopelessly sticking to power to the very last minute, that this created a bent for a sea change. While Fidesz and their allies were clever enough not to spell out any specific program during the elction campaign on economic matters/as disticnt from emotional and legal issues, such as dual citizenship and a call for a new Constitution/, the undercurrent message was that of imminent and major change. Alas, economic theory also is of the opinion that discontinuing malpractices is immediately welfare enhancing, thus the popular expectation was not without foundation.

Let us note, that in February, 2009 finally MrGyurcsány was forced to resign and give way to his former Economy Minister, Gordon Bajnai. A technocrat and

[5] A nice account of a participant observer of these sabotage, published before governmental change, is found in/Mihályi, 2008/.

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 corrections, in terms of personnel as well as in terms of policies, reverting Hungary from the doldrums. While his mandate was restricted, in part lacking legislative majority, in part owing to the conditionality attacked to the 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 euro-zone, the contagion spreading from Greece to other countries, and the EU being late in its reactions to market panic. Owing to the inadvertant fiscal policies of the Socialist government, and their disregard for the ramifications of the collapse of Lehman Brothers in September 18, 2008, Hungary was on the verge of bankruptcy. The latter could be avoided only by a last minute rescure 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 bn euros in a mere 5 days to bail out the coutry from speculative attacks on the Forint.[6]

The stand-by agreement – like any of its kind – 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. No matter how rational or legitimate those changes might be, these can be taken only by a government with full parliamentary legitimation and strong popular mandate. Mr Bajnai was clearly lacking both.

[6] In the following pages we shall refer to EU-IMF rescue package, although the World Bank, the ECB and several other players were involved. The loan was jumbo, if we measure it not against the mammoths of the later Greek and Spanish and Irish packages, but against the annual budget of the EU, which was in that year slightly over 120 bn. The liquidity for Hungary alone would have absorbed a sixth of total EU funds, had these not already been committed for other purposes, as agricultural and cohesion spending.

Therefore by the time of the electoral victory of the center-right, a paradoxical situation emerged. Similarly to 1989-90 the outgoing Socialist administration already started to implement those changes, which were needed to fiscal balancing and improving market coordination. On the other hand, the coalition of the Right was composed of series of forces adhereng to different economic ideas, interests and platforms. For shorthand, we may talk about an employee and small business wing, represented basically by city mayors and local party bosses in the post-2010 legislation, calling for more state intervention, market protection and price controls. On the other hand, given the dismal record of the Socialists, the business class as well as the middle income players, persons working in the transnationalized sector and EU related projects, generally the better skilled, tended to favor a more mainstream European conservative line along that of Angela Merkel and David Cameron/not being the same/.

Caught in a Mediterranean Storm

Formation of an economic strategy as concieved in 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 – the first time together with national ones – was irresistable. Thus the first attempt to form a proper strategy over and above elctoral promises started only in November, 2010.[7] But by that time the Greek crisis and its /mis/management by the European Union has been emerging in its full complexity, with the much unforseen ramifications for both the EU as an institution and its members, large and small alike.

We may reconstruct the original project of the governing coalition by references to the limited, scarce and barely authoritative sources to our disposal. Even being a participant observer on occasion does not guarantee the solidity and clarity of insight, usually required for being able to form an opinion over what has happened, when, how and why so. Thus our reading of events is one of the competing ones, allowing for a larger dose of uncertainty than ussual in academic

[7] Various semi-official documents, such as a platform signed by 500 intelelctuals, articles and chapters by future and prospective members as well as former members of the Government served as points of orientation. These have all proven to be poor indicators of actual events, indeed.

discourses. Furthermore, even if –as now – the issue is open ended thus the currently unforseen outcome may change the entire interpretation we now consider sound and earnest. Government plans – especially fiscal plans, but also many others, including ideas on structural reform and those related to EU – tended to change quite frequently, thus conventional area studies analysis making regular references to governemtal documents, decrees and statements do not seem to be productive in our case.

With the benefit of hindsight two sources may be singled out as authoritative. For the 'small business' approach it is the book by the architect of Fidesz economic views, György Matolcsy/2008/. This blames the one-sided emphasis on fiscal issues and especially austerity for stagnation, much in line with what currently Francois Hollande explains. The other book is by business people/Fodor-Járai-Parragh,2008/ which 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.

As the government was composed basically of persons known from their moderate views – e.g Economy Minister Tamás Fellegi, Minister of Justice, Deputy PM Tibor Navracsics, Foreign Minister János Martonyi, the chief of staff of the PM, Mihály Varga – 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 in order to please both IMF and the EU. 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 new and new negotiations.[8] 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. Skelentons abounded in the cupboard. 2. Fiscal rigor, promised in exchange for new and new injections of money, have barely been put in practice. Regular and

[8] For a good summary cf Visvizi/2012/.

systematic official dodging the promises, especially the crucial ones, in the most extreme manner has come to the limelight.

This explains why Viktor the Victorious, the new PM, 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 cristal clear, that they do not tolerate a laxer fiscal stance, even in exchange for major structural reforms. Meeting the fiscal targets were set to be the single standard against which the solidity, loyality and credibility of Hungary as a partner will be measured against.

We do not discuss the economics behind the reasoning. It has become axiomatic therefore *for a government, built on fighting austerity, that fiscal stringency is a supreme maxim,* else endless reschedulings and marginalization is a very real threat. By the same token experimenting with supply side reforms, which generated huge deficits even under Ronald Reagan and George W.Bush, was simply not an option. The more seriously we believe that any major reform is likely to incur cost at first, before it breeds results, the more serious this circumstance weighs..For if lack of reforms in 1997-2009 were at the root of the erosion of both potential and trend rates of growth, fiscal excellence on its own is unlikely to help overcome the doldrums, engines of growth are not mobilized by these virtues.

One of the reasons which may explain why the Orbán governent 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 eg in the Europe 2020 strategy, or in the Employment and Growth Pact of June, 2012[9] – in reality the Commission adopted an intransigent stance on fiscal retrenchment. By contrast, the French-led IMF, the Lagard-Blanchard duo seems to have been more forthcoming to reflating

[9] Question marks over 120 bn Euro EU ’growth pact’. Euractiv, 2 July, 2012/accessed on 13 April, 2013/.

policies and thus more willing to tolerated 'good deficits' from Japan to Greece[10]. This is exactly the opposite to the view of the Commission.

Therefore 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 sacrosaint deficit targets*, have subordinated much, if not most, of the substance of economic governance.* While the government – in a typical vein for conservative administrations – went out its way to expand on emotional and legal issues, that are formative for a right leaning electorate, from elementary education to the prohibition of totalitarian symbols and ensuring 'balanced media', the economy remained much of an orphan. It sqeeezed out a lot of attention, but this was mostly involuntary, forced, thus haphazard and ad hoc in nature.

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 longest serving Polish minister of finance – and CEU economics Professor – Jacek Rostowski has harvested its fuits. Poland was allowed to deduce pension related defictis 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 indicator for fiscal solidity.[11]

Nationalizing private pensions – a stock of 3 thousand billion Ft or 10 pc of a year's GDP - was not the sole improvized measure of fire fighting. The

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

[11] Deficit in 2010 was -7,9 pc of GDP, followed by -5.0 pc in 2011 and -4.0 pc in 2012, with debt ratios accounting for 54.8 pc in 2010, climbing to 56.4 pc by 2011 and declining – despite new defitits – by 2012 to 55.9 pc, 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 ahrsh and automatic measures already from 60 pc debt/GDP ration, thus the fiscal cliff, currently reigning US debates, could easily erupt also in Poland, save the improved accounting techniques.

government introduced crisis taxes, levied on energy, banking, retailing and telecommunications firms. It has since been a subject of emotional debates if this was neccesitated 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, Mihály Varga. The revenue loss in both readings of events runs around 500 bn Ft or 1.5 pc of GDO or 3 pc of expenditures. Most of the crisis taxes and restrictions were criticized as discretionary and distortive, both by the IMF and the EU Commission, as well a sby a large part of domestic analysts, which is a point hard to dispute. However no serious alternative of revenue raising was proposed. And in a stagnant economy- growth accounted for a mere 1.2 pc in 2010 – only major revenue cuts could have replaced those. But the latter were not a realistic option in a government taking over at the middle of a calendar year, and expenditure items, in their bulk, anchored in laws/as on pension, on public transport, on education and health care/.[12]

2011 was a truly experimental year. Relying on the ’windfall’ of private pensions the government allowed for some fiscal stimulus, in the range of 5 pc of total expenditures, hoping to revive the economy. This was in my view a blunder, since the Hungarian economy *never reacted to fiscal stimuli over the past 30 years,* at least not in a sustainable fashion. However, the overall feeling was that the Greek crisis is finally over, the establishment of the EFSF, the standing bailout fund of 400 bn euros will do the trick, and the global and especially the EU economy will re-gain its role as a locomotive for Hungary. In this perspective the government provides just the first push, and the rest will be taken care of by the economy itself. This view has proven to be plainly wrong.

The more we see the structural, institutional, qualitative and psychological factors behind the economic lull, elaborated above, the less we tend to believe in old-fashioned textbook Keynesian discourse. It was conducted basically outside the profession of economists, primarily in the mass media, which attribute stagnation

[12] It borders with the absurd when some commentators dispute the right of any government to re-distribute costs of public dues across the social strata, especially if this is around 3 per cent of total expenditures, which is less than the half of the improvised overspending that followed both the 2002 and 2006 lelections.

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*. Thus pushing down the rate of interest is though nominally possible, however it is likely to trigger two devastating consequences: a/the depression of the rate of exchange. While not under direct control of the central bank, the rate of exchange is highly sensitive to the rate of interest. b/ The international appetite for Hungarian bonds may decline, unless their profitability is above average, compensating for the many adverse news and the resultant uncertainty over the yields and liquidity position offered by the country.

Instead of becoming the year of a turn for the better, as stipulated by the Széll Kálmán Plan, published in March, 2011 was a combination of two major thursts. 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 pc in 2010, followed by 1.4 pc in 2011 and contracted by -0.6pc in 2012. The German economy slowed from 4.2 pc in 2010 to a mere 0.7 pc by 2012, Italy turned from + 1.7 pc in 2010 to -2.4 pc by 2012, and France from +1.7 pc in 2010 to 0.0 pc by 2012/according to ECB: op.cit.p40/. The Greek drama intensified rather than ebbed out. By August 2011 the collapse of yet another rescue package has 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.[13] This has proven to be a clever 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 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[14]- 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. One faction of the government indeed was banking on buying time/i.e the Turkish, but definitely not the Argentinian, card was to be played/. However the other faction considered this to be brinkmanship with potentially dire consequences for external finances, to the point of insolvency.

Oddly enough the problem solved itself, over and above the heads of major players. While substantive negotiations broke down already on 16 December, owing to IMF objections to the new draft Law on central banking, enahncing governmental leverage over the National Bank of Hungary, Hungarian bonds were selling well on the markets. Among skyrocketing CDS and prophecies of collapse, Hungarian bonds sold under Italian and Spanish counterparts. Markets never dried out, as for Cyprus or Latvia. And amongst a harsh six months' long controversy with EU Commission, the first half of 2012 was one of return to the position of darling of the financial markets. From this moment onward, the Hungarian government has clearly *lost any serious – immediate – material*

[13] This surprised the party newspaper and the government media most, since these tended to be most hostile to the IMF in the preceding months, using an antagonistic rhetoric of earlier periods.

[14] Perhaps most eloquently by NYU Professor Iván Szelényi/2012/ attributing a conscious policy of denial – de facto playing for reschaduling, rather than for agreement – to the Orbán government. In a subsequent public debate at CEU he could not substantiate this claim, and expressed his view of the need to 'talk out in the open' the doubts what the assertive style of the government, reminescent of Argentina, a notorious maverick, could do.But the Hungarian track record on debt, as well as all other conditions were other than equal, so was the outcome.

incentive to go back to a standby,[15] which would have constrained its freedom of manoeuvre for experimentation and micromanagement of affairs, both of which it felt important to keep processes under its own control.[16]

Yet another round of substantive negotiations took place in the third week of July, 2012. But those talks on nuts and bolts never resumed. With Hungary floating yet another series of government bonds in the range of 2.5 bn euros in Febnruary, 2013[17], the raison d'etre of the negotiations was over. The IMF declared the close of the talks, ant the minister in charge of those was relocated to the Ministry of Finance.

If only we look at the financial indicators, Hungary does qualify as a success story. Deficit in 2012 was kept at 2.1 per cent, against 3.9 pc in the eurozone and 4.4 pc in the EU according to latest available data,[18] despite repeated doubts voiced publicly by the EU Commission. Debt to GDP ratio in end June 2012 stood at 78.6 pc of GDP, against 90 pc of the eurozone.[19] Very few EU countries could improve their debt/GDP indicator, also few of them –even those under IMF supervision – manage to control public deficits[20]. Inflation started to come down in 2013, and so could interest rates, from 6.75 to 4.75 pc in a single year. This strenous fiscal stringency is all the more surprising, as fiscal profligacy has long historic roots and institutional components, and has rightly been described – somewhat mockingly –

[15] While the Hungarian government was after a flexible credit facility, along the Polish lines, the IMF never seriously considered this option, owing to its critical assessment of the sustainability of Hungarian policies.

[16] It is a completely different claim that the government never had an intention to agree/KarsaiG, 2013/ . Interestingly, critics of the government supported a standby not because of its inevitability, but precisely for the disciplining effects they expected from it.

[17] Bonds were denominated in greenback, and 3.25 bn USD was floated/with demand exceeding 12 bn/ for a spread of 3.25 pc, with 5 and 10 years maturity. The spread was in the low end of the offer. Cf: *portfolio.hu,* 12 Febr., 2013.By April Forint bonds were floated at 4.25 pc, with inflation runningat 2.2 pc, a remarkable decline in both.cf: *napi gazdaság,* 23 April, 2013.

[18] ECB: *Statistics Pocket Book,* April, 2013, p.46/available online

[19] ECB: op.cit.p.47. By the end of the year the Hungarian number declined to 77.1 and the Eurozone number increased to 91.3 pc, according to preliminary estimates.

[20] It is an important qualification if we consider the nationalization of private pension funds, in the range of 3 thousand bn or 10 pc of GDP. If for no other reason that wealth was used for covering current outlays, and the implicit debt – burden of the future generations – proportionally increased.

as part and parcel of the Hungarian „corporate culture” in public finance, dating back to the last decade of goulash Communism/Benczes, 2011/[21].

However, this is not the whole story. Growth, employment and exports do not recover, no sign – even in offical documents – of Széll Kálmám Two, published in March, 2012. The one million new jobs remain a dream- even if 240 thousand jobs were created in public works. But those are not productive, fulfilling, enterprising jobs, what Europe 2020 would stipulate and society would approve.

Glass Half Empty or Glass Half Full?

It is perhaps inevitable that any ongoing process invites ambiguous assessments. It seems, this time is different: ambiguity is more legitimate than on average. Let us attempt to provide a summary assessment!

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 authors/Kornai, 2012/ 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 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 lack of transparency and incapacity to get things implemeted reached an unprecedented degree. Governmental decrees were changed often during the week. Some centralization of decisionmaking was though warranted.

It is a different story – and outside the scope of the current short overview – to assess if, and to what degree, *the actual extent of centralized decision-making*

[21] It is interesting to note that fiscal conservatism had been a feature of both Austro-Hungarian and independent Hungarian governments, until the exigencies of the late 1970s triggered a change, both on inflation and government deficits. This reflected the weakness of the subsequent governments and the easy ways of inflating away the ’pork’ distributed on political grounds, i.e of buying the appeasement of the population with declining living standards. The latter has seriously undermined the legitimacy of the Kádár regime, more than democratic movements or changes in international political arena.

was adequate in scope. Many partial insights indicate of an overdose of zeal, a propensity to decide whatever conceivable at the highest level – just opposite to the EU theory and practice of subsidiarity.[22] 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.*[23] On the one hand, the transnationalization of Hungary and the embeddedness in EU institutional infrastructure, the large role of TNCs and the crowds of persons working abroad, the free media altogether exclude any such possibility. Also it is ahrd to see a series of improvizations as a system of any sort, which deserves this academic term. As we know from Walter Eucken/1952/ the regularity of improvizations, or the sustaining ad hoc decisions – what he termed as *punkltualistische Wirtschaftspolitik* – is exactly the opposite to what the term systemic interventions/*Ordnungspolitik* stands for. We do not have the liberty of changing the meaning of established economic terms.

Second, the upgrading of foreign trade continued/Antalóczy, 2012/. 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 for the long run. True, this is a discretionary arrangement.

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 Basic Law, and of more economic issues, which is our concern. In the EU Council deal of March, 2013 continued drawing on cohesion and agricultural funds is ensured – this seems to be perhaps the most important funding for public investment in the country. In the debates on the fiscal and banking union the country could avoiud isolation, but also eschewed a very real threat of drifting into supranationalism, where non-elected organs decide over macroeconomically significant expenditure items and bank resolutions/Csaba, 2012/. While the relationship to the Barroso

[22] More on that in the insightful volume of Colombo, A.ed/2012/, with applications on new EU members.
[23] Desire and reality should not be mixed up.

Commission have 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, without aspirations to become a king-maker in any areas of Community policy.[24]

So far, so good. The questzion is more about the future perspectives. *To what degree had the Orbán government lain 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 an overbroad 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, and if yes, on waht grounds for the second Orbán administration?

The answer is multi-faceted, indeed. On the one hand, it is hard to dispute away the facts. While IMF and EU – as many market analysts – tended to be skeptical, the Hungarian government did sustain a degree of fiscal solidity.True, as the official parlance goes, through a fair degree of unorthodoxy, meaning non-conventional, improvized and non-sustainable arrangements, as the crisi taxes or the nationalization of pension funds. But, as Deng Xiaoping, waht matters for the market is not the color of the cat, but if it catches the mice. 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 per cent, from 70.1 pc in 2008 to 80 pc by 2009 and 90.0 pc by 2012 in the Euro-zone, from 64.2 to 82.3 pc in the EU-27, while 73 pc in 2008, 81.8 pc in 2010 and 78.6 pc in the case of Hungary /according to ECB:op.cit.p.47./ The country has remained constantly on the capital market at times of major storms. Employment grew, the rate of unemployment has not grown , unlike many other countries,

[24] Following the Hungarian press and also some international media one may wonder, if this is indeed unique. Can ithe Commission and actually any member state's government can have any other relationship than that of strains at times of hectic and ad hoc crisis management? Or at times of making a U tern as a consequence against the stipulations of the clearly intergovernmentalist Lisbon Treaty, and amidst the fight for the expenditure priorities for the 2014-2020 period? The latter were adopted in March, 2013 with a delay of nearly 6 months. One may venture to claim that the Barroso Commission's relationship to, say, Greek, Cypriot,Czech, Polish or British governments, or even with the French government on occasion has not been any better than those of Mr.Orbán.Cf also: *Handelsblatt,* 23 April, 2013.

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 from 2013. Collection of taxes and social security contributions 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 pc in 2009 to 48.7 pc by 2012 and to a forecast of 47.5 per cent by 2013.[25] The number of tax rates declined – true, from 54 in 2010 to 51 by 2013, no breakthrough.

On the other hand, fundamentals – or the real economy – continue to ail. Whatever are the reasons for stagnation, this made the expansion of productive employment, especially in small business and self-employment, the two most faqvored targets of the administration, impossible. Growth was minimal – 1.3 pc in 2010, 1.6 pc in 2011, followed by a contraction of 1.7 pc 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.

Imrpovizations 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 calucability, 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 proiority deals with big firms can hardly counteract, only milden ther unintended negative side effects. With the collapse of investments, especially in the private sector, but complemented by the contraction due to spending cuts in the public sector, and the rollback of public-

[25] ECB:op cit.p48. with the corresponding rates in the Eurozone were 51.2 pc in 2009 and 49.7 pc in 2012.

private partnership deals, together create a bleak picture for one of the basic forward looking indicator of the business cyícle – and that for the long run.

Employment and qualifications are yet another serious problems, also translating in the low level of innovations/other than survival 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 additinal revenue ratio translated into *Hungary being one of the lowest levels of labor market participation rates in Europe,* a mere 57.6 per cent 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[26].

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 complemeted 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. Moreover tax legislation remained restrictive. Unlike in the USA, charity, bequeathing or donations do not fill up the coffers of univerities, churches, hospitals or homes for the elderly, let alone elementary and secondary schools. In a way there is noone 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

[26] The OECD average at end-2012 was 65.1 pc, with Turkey 49.7 pc and Spain, 54.8 pc at the lower end, and Switzerland with 79.8 pc and the Netherlands with 74.9 pc at the top. Source: OECD: *Short Term Labour Market Statistics,* no1/2013, accessed on 13 April, 2013 at: www.oecd.org

flexible. As known from the experiences of Harz-IV in Germany, such measures take time to bite, but they do. Also revival of growth is conditioned by *all other factors of production,* not just labor. And in a small open economy the recovery of European markets is a side condition for palpable growth recovery in the medium run – a condition that was clearly not given in the 2010-2013 period.

In terms of education, quantity seems to be in line with the OECD countries in terms of enrollment structure of education, and the wage advantage provided by tertiary education/being the second largest after only Brazil in 2012 according to the OECD database cited above/. However, quantitative orientation seems to have prevailed. In short, transition did require a plethora of new skills and abilities, from accounting to communication, command of foreign languages and willingness to work under unusual conditions. This all warranted the quantitative expansion of both secondary and higher education.

Actually, detailed empirical analysis of the Hungarian labor market, conducted regularly by the Center for Economic Research of the Hungarian Academy of Sciences/Fazekas,K et al, eds, 2013/ clearly indicate, that the major problem under this angle is not the quality decline of higher education – a fact no insider would or want to dispute. *The basic problem is with persons with low or often no qualifications – about 30 per cent of school leavers* finish elementary school level only, bordering with functional analphabetism, 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 qualfications are dated, whose flexibility and willingness to acquire new skills is limited.[27] Mobilizing both groups is a gargantuan task and requires more than just diminishing social transfers. While calls for improved vocational training and re-training grown up persons abound, progress on the ground is rather 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

[27] Elaborating this point in detail Dövényi and Kézdi/2013/ higlight the role of poor health, poor/dated qualifications and not least, lack of employer demand, owing to the recession.

central European countries this relative edge simply melted/Clarke et al, 2012/..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, thus direct sales rather than floating was chosen. The Orbán government was elected on a platform of remedying the mishaps of privatization, without being specific about the meaning of both terms/objectives. In reality, this translated in a governance style which favors stae 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.* The latter is reflected in high transaction costs, weak demand for credit, overprovisioning for businesses and a general disregard for the small enterprise sector.

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. Short of the Mediterranean storm, which in theory could have erupted any time since 2003-2004, when the first major dodging of fiscal rules came in public, Hungary could perhaps have employed more relaxed, or fiscally less conservative stance. The latter could well have allowed for bolder structural reforms, more rolling back of the state and *generally more suppply-side policies,* than it happened. In a growing economy – but only one growing by 3 per cent annually and more – fiscal sustainability , as a rule, does not pose a serious challenge, provided tax collection is tight, and so are expenditures. In terms of the latter recurring reports of the Fiscal Council appreciate the exemplary discipline of the 2010-13 period.[28] But in a stagnant economy, revenue raising is inevitable in

[28] While also warning of their effects on cooling down the economy, especially already in 2013-2014. The reports are available on the website of the Fiscal Council at: www.parlament.hu/kt/legújabbdokumentumok

the short run, and thus creates disinentives to save and invest already in the medium run.

Converging to Maastricht criteria and applying the stipulations of the Fiscal Compact of March, 2012 are tasks witch are 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 sustainingly high inflation, which has fallen to 2.2 pc by March, 2013, an unprecedented low in many decades. It remains to be seen if this trend is built in the expectations, thus if it is indeed an inflexion point towards price stability. Likewise the debt ceiling, built into the Basic Law of 2011 pushes subsequent governments to prudent fiscal policies. The relative stability of the exchange rate is also a promising sign. However, not least because of the considerable – 50 pc and larger – external financing of public debt, as well as owing to the high indebtedness of households in Swiss francs *the vulnerability of the country is not yet overcome.*

While the 2013-14 period will certainly be dominated by competing political considertations – voting to national, European and municipal legislations are all due – the longer run perspectives of the country should not be assessed against the background of the electioneering typical of those times. As we have shown in this paper and elswhere, *conditions for lasting robust growth are not given.* While we do appreciate the achioevments in sustaining the financial equilibrium of the country, domestically and externally alike, this does not vouch warranty for any recovery. Economic theory as well as recent European experience – eg. 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 adress 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, improvizations and *continued micromanagement at the cost of rule of law and transparecy* *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 taxrs, 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 committment 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 improvized 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 thsoe 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. Quality of governance could and should be improved, irrespective of electoral indicators , which show the short term popularity of measures which are hardly sustainable, let alone helpful in the long run, as dictating prices and micromanaging the economy, nationalization and fiscal interventionism. In one of her memorable- oft quoted – quibbles the late Baroness Thatcher cautioned conservatives to search for the middle ground and rely too much on opinion polls, rather than on their own established principles. Rule of law, calculability, fiscal discipline via rulées-based behavior, price stability, respect for property rights are parts and parcel of the age old canon of any such movement. Treating the European Union as a common good and an accomplishment has equally been a distinctive feature of all center-right movements on the Continent/unlike in the UK/. Reviving the old merits does not require much, but would work miracles.

In so doing Hungary could be supportive of those innovations, which will make the EU more relevant to its citizens, as reseach, environmental protection and improving the institutional infrastructure, i.e the original Europe 2020 project, which goes way beyond crisis management. It may be a platitude, but *the need to move to good governance, rule of law and calculability is imminent*- and that might create conditions for return of trust of invvestors, households and firms, domestically and abroad.

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