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Hungary's premier challenge

By Simon Taylor

With the incumbent Socialist Prime Minister Ferenc Gyurcsány looking likely to win a second term in office following the next round of voting in Hungary's elections on 23 April, the main questions facing the government are when and how it will tackle the country's swollen budget deficit.

The latest official estimate of the deficit is 6.1% of gross domestic product (GDP) but revised data due this week put the figure at 7.1%. The European Commission is currently preparing its third recommendation to Hungary to reduce the size of the hole in the country's finances under the EU's excessive deficit procedure.

A spokeswoman for Economic and Monetary Affairs Commissioner Joaqu'n Almunia said: "We have been following the electoral campaign and promises very closely in view of the fragile state of Hungary's finances."

She added that the government which emerged from the elections "knows what our expectations and those of the Council are with regard to the budgetary situation".

But planned tax cuts already announced by the government are expected to add 3.5% of GDP to the deficit, although Budapest claims this will be more than compensated for by a reduction in debt levels.

EU finance ministers have also asked Budapest to prepare a new convergence programme setting out the country's preparations for joining the eurozone by September this year. They said that the Hungarian government should identify "concrete and structural measures" on how it was going to reduce the deficit. In particular, the ministers expressed concern about the debt-GDP ratio which was close to the reference value of 60% of GDP and commented that the sustainability of public finances was at "high risk" given the costs of an ageing population.

But both Gyurcsany's governing MSzP and the opposition Fidesz party of former prime minister Viktor Orbán have campaigned with promises of tax cuts, new jobs and increased pensions payments. Gyurcsany's campaign promises have been costed at 5.4 billion euro and Fidesz's at 14.6bn euro.

While Hungary has performed well on other main economic indicators, reducing inflation to 3.6% and showing growth of over 4%, the size of the deficit is causing concern among investors. The central bank is expected to raise interest rates from the current level of 6% over the coming months. The forint's value against the euro has dropped to around 267, after trading for a long time around 250 forints to a euro. The fall coincides with fears that the deficit may hit the country's plans to join the euro in 2010. But fears of a full-blown currency crisis are overstated.

The first round of voting in Sunday's elections failed to produce a conclusive winner although Gyurcsány's MSzP won 43.2% of the votes with its coalition partners, the liberal MSZP, getting 6.5%, clearing the crucial 6% hurdle to be in parliament. Fidesz won 42% and the smaller conservative party MDF 5%.

But MDF President Ilboya David instantly ruled out riding to Orban's aid by refusing to contemplate entering a coalition with Fidesz.

Orban announced on Wednesday (12 April) that he was withdrawing as Fidesz's candidate for prime minister. Whether the move will be enough to entice MDF's David into considering a coalition is still unclear. If Gyurscany emerges as the winner in the second round of voting on

23 April, this would hand the Socialist prime minister the distinction of being the first post-Communist government in Hungary to win a second term.

Although Gyurcsany has campaigned on pledges of tax cuts and more money for pensioners, political analysts believe that he will take action to reduce the public deficit. László Csaba, professor of international economics at Central European University in Budapest, believes Gyurcsány's success is due to a spending spree which has benefited workers in the country's large state sector and pensioners.

If Gyurcsany is elected for a second term, said Csaba, the prime minister "may not do everything I would like him to as an economist".

Nevertheless, the Socialist premier, who is also a very rich entrepreneur, is "too much of a businessman" to do nothing about the deficit, Csaba argued.

"Some reforms and budgets will be forthcoming," Csaba predicted, which could cut around 2.5% of GDP off the budget deficit. "The question is does he have the courage to do it in the first 100 days?"

Provided he gets a second term after the 23 April round, Gyurcsany will have four years to take steps to address the deficit, enough time for voters to forget the pain when they choose their leader again in 2010. Whether the millionaire who models himself on Tony Blair will have done enough to secure Hungary's entry into the eurozone is another question.