Hungary’s full-blown malaise

András Tóth, László Neumann and Hortenzia Hosszú

1. Introduction

At the end of 2007, we noted that Hungary was in a state of malaise and uncertainty concerning whether the country was on the right development route (Neumann and Tóth 2009). Four years later, Hungary is suffering from a full-blown malaise. Although Hungary is entering the sixth year of the economic crisis provoked by the accumulation of debt by the state and the private sector, it seems that the worst of the ordeal still lies ahead. The signs of this malaise are everywhere. More and more Hungarians are losing their faith in political parties, institutions, democracy and even the market economy. Opinion pages in newspapers are arguing that Hungary has become a colony of international finance. The far right is on the rise and a new exodus of Hungarians in search of a better future in rich Western European countries has begun.

In this chapter we argue that Hungary – and indeed many of the new member states in Central and Eastern Europe (CEE) – has had no luck at all. It escaped too late from the iron cage of Soviet-style socialism and the grip of the Soviet Union. The short period of growth after the destructive years of the post-socialist crisis was not enough to bring about more generalised growth before the outbreak of the debt crisis.

At the same time, the expectations of the population were too high, partly induced by the (comparatively) high standard of living in the old EU member states and partly by the illusions created by EU accession. The rising tension between high expectations and uneven development undermined political stability and opened the door to political populism around 2000. The special conditions of the early 2000s, when easy money led to a build-up of debt, allowed illusionary economic growth boosted by populist expansionary government policies. The accumulation of both government debt and private debt masked the problems being
generated by an unsustainable economic path. The debt build-up sent distorted signals to the political sphere and the population and created a rosy illusion. From 2000 onwards, half a decade of debt creation fuelled illusionary growth, which ended in 2006. Since 2006, Hungary has been stumbling from crisis to crisis.

The debt-induced crisis of the real economy began in Hungary well before the advent of the credit crunch. Unfortunately, the home-made crisis coincided with the outbreak of two major crises at the end of the first decade of the 2000s. First, the debt crunch in autumn 2008 and the following Europe-wide crisis induced by similar debt build-ups and political illusions about the common monetary system. Second, the ongoing employment and demographic crisis – highlighted by the debt crisis – which calls into question the sustainability of the welfare state model that Hungary adopted. These interrelated crises are feeding each other and pushing the country deeper and deeper into a whirlpool.

The turning of the tide caught an inattentive society by surprise. The long and ever deepening crisis has crushed the illusions of the transition period. The dreams related to the European social model and a globalised market economy are in ruins for a very large segment of Hungarian society. Illusions have been replaced by disillusion. Hungary, again, is in a new transition process after the transition from socialism towards a new model.

The aim of this chapter to analyse how these factors have coincided and fed the accumulation of causes of the crises and to describe the direction in which Hungary is heading.

2. The hope and demise of the Hungarian model

Hungary escaped from the iron cage of Soviet-style socialism and the grip of the Soviet Union in 1989. Had the change of system occurred some time in the mid-1970s, when Spain and Portugal turned towards democracy and slowly opened up their economies, Hungary would have had time to adapt in a more piecemeal manner to the competition between open markets within Europe and, indeed, to the emerging globalisation. But this was not to be. The transition took place as the world was entering the triumphant years of globalisation and the dominant discourse was
Hungary’s full-blown malaise

A triumph of failed ideas – European models of capitalism in the crisis

in praise of unfettered competition. For Hungary this took the form of a policy imperative to open up the economy and to demolish customs barriers. During the political transition in 1988–89, most domestic actors did not foresee the coming destructive force of globalisation. Instead, it was hoped that emerging small and medium-sized enterprises, emerging from the micro-entrepreneurial seeds of the Kadarist semi-marketised socialist system, would quickly make use of the freeing of the economy from state control and create a flourishing economy. It was hoped that this domestic SME-based economy would be similar to that of Germany’s Mittelstand. It was hoped that such a development would allow the phasing out, step by step, of the state-owned industrial sector and would make possible a new development path without too much social conflict.

Reality turned out to be different. State-owned domestic industry, which was accustomed to the monopolistic internal market of the Soviet bloc, was technologically outdated and work organisation and business practices were hopelessly uncompetitive as companies produced for non-competitive monopolistic markets. In 1990, Hungary was exposed overnight to the ruthless competition of a globalised world. The impact of unfettered competition was exacerbated by the collapse of the monopolistic Soviet markets. The passing of a very strict bankruptcy law made things worse and speeded up the collapse of state-owned companies. Thus, opening up, in the first instance, was a destructive force in Hungary (Lorentzen, 1995). State-owned large-scale domestic industry was practically wiped out. Only those companies survived the ‘great extinction’ which were bought by strategic foreign investors or served the more closed niche markets dominated by government procurement. The disbanding of agricultural cooperatives induced a similar job crisis in rural Hungary. The great extinction of large companies and cooperatives was also a major social catastrophe. In the first years of the transition more than 1 million jobs were destroyed out of 4 million. Large segments of society were pushed out of the labour market into welfare dependency, especially older generations, Roma or the under-skilled rural population. The newly emerging strata of welfare recipients formed a new burden on the state budget.

As far as the SME sector is concerned, it quickly became clear that the 40 years of the Soviet system had left a population short of the capital and business knowledge necessary for the endogenous building up of a
successful market economy based on starting up firms from nothing. The rebirth of a domestic small and medium-sized enterprise sector, which began to flourish after 1989, was only a partial success. Although hundreds of thousands of SMEs were set up, most were micro-enterprises serving the domestic market at a very low productivity level. A large segment of this sector could survive only by operating at least partly in the shadow economy, employing partially or fully undeclared workers and evading taxes. Estimates suggest that the share of the shadow economy could be as high as one-third of the total economy.

It was left to foreign direct investment to export capital, modern technology and best practice business models into Hungary. The FDI-based development route was especially feasible as the semi-open character of the Kadarist regime had allowed some contact with the Western world from the 1970s onwards, which laid the foundations for Hungary to develop an FDI-based renewal of Hungarian industry. Hungary was also in dire need of external capital as the country inherited a 90 per cent debt level from the previous regime. It was an absolute necessity to induce export-oriented development through FDI to avoid bankruptcy. Hungary, which turned to FDI almost alone in Central and Eastern Europe just after the transition, was extremely successful in attracting foreign investors in the 1990s. Hungary became the favoured destination of FDI in Central and Eastern Europe: in 1997, per capita foreign investment in Hungary was three times larger than in Poland or the Czech Republic. Manufacturing FDI by strategic investors was a very important part of the incoming investment stream. As a consequence of FDI-based manufacturing renewal, Hungary was successfully turned into a manufacturing base for export-oriented manufacturing. Largely, due to this export-oriented FDI, the Hungarian economy became interwoven with the European economic area. Already in 1997 two-thirds of Hungarian exports and imports were with Europe. Nonetheless, one of the by-products of the large inflow of capital was that certain economic sectors became dominated by foreign owners. Also, most of the flagship companies of the Hungarian economy became foreign-owned firms. This foreign dominance also led to a political backlash: the FDI-based economic strategy was politically vulnerable in times of crisis.

After a short recovery in 1993, which followed a crisis provoked by the collapse of the Mexican peso, and after two years of painful reforms, Hungary returned to sustained growth in 1996, which lasted uninterrupted
until 1999, when the effects of the Russian crisis hit Hungary and again slowed down the economy.

The FDI-based recovery of the economy also had positive political implications. The economic upturn and the success of economic integration into Europe strengthened pro-European sentiments and contributed to the consolidation of Hungarian democracy. Rapid integration and the harmonisation of Hungarian institution-building with that of Europe led to EU accession in 2004 (Agenda 2000).

The economic slowdown of 1999/2000, however, coincided with significant changes in overall trends. Hungary lost its prime destination status and had to accustom itself to the slowdown of FDI inflow around the turn of the millennium. This slowdown had a number of reasons. One very important factor was that the emergence of Hungary as a possible FDI location coincided with the emergence of China as one of the world’s major manufacturing hubs. Low-cost Chinese competition posed a serious challenge in many labour-intensive assembly-type branches. Also, there was a change in Hungary’s situation in the late 1990s compared to other Central and East European countries. While in the early 1990s Hungary was almost alone in pursuing an economic policy based on attracting FDI in the region, in the mid-1990s neighbouring countries began to follow suit. Thus new competition emerged in the region for FDI projects, capital, technology and jobs. Some of the new competitors had considerable advantages over Hungary. Poland, for example, had a very large internal market, while Slovakia and Romania competed for FDI with considerably lower wage costs (Sass 2004). In the short term, this new found competition had a negative effect on Hungary. FDI inflow into the region became more dispersed, and FDI inflow into Hungary and Hungarian economic growth slowed down.¹

The slowdown coincided with and contributed to a turn in Hungarian economic policy. The root of the change can be found in the changing sentiments of the population following years of rapid growth and the

¹ Nonetheless, in our opinion, the recovery of the region as a whole and the emergence of cross-regional manufacturing networks do offer Hungary positive long-term prospects and reinforce the basis for specialisation by the region and, within it, Hungary as a base for a manufacturing hub within the European economic area.
palpable possibility of EU accession after joining NATO in 1999. Hungarians wanted to experience the dividends of growth in a rapid elevation of living standards and wages, converging with Western European levels. ‘Real harmonisation’ was the key word in public debate after institutional and legal harmonisation in the course of adopting the EU’s *acquis communautaire*. FIDESZ, which was elected in 1998, had pursued a prudent economic policy under the leadership of Viktor Orbán. In 2000, however, the government, reeling from a loss of public support following the slowdown of the economy, turned to Keynesian-style state financed economic development by boosting consumption. It was hoped that growth in domestic consumption would kick-start the Hungarian economy to resume growth and would also help to regain political support for FIDESZ. Various measures, such as a 60 per cent increase in the minimum wage between 2000 and 2001 in two steps, a 75 per cent wage increase for civil servants within a short time-span and a generous mortgage support programme to boost flat construction marked this new policy.

This policy change was not successful in securing electoral victory in 2002 for FIDESZ, but it definitely put Hungarian economic policy onto a new track. In the heated 2002 election campaign, MSZP, the major opposition party, campaigned with the slogan ‘welfare system change’ and outbid the governing FIDESZ by promising large-scale welfare and other measures, such as a 50 per cent wage increase for public sector employees, a thirteenth-month pension payment to all pensioners, abolition of income tax for low wage employees and an ambitious road construction programme. Winning the election in 2002, MSZP implemented all the headline pledges made in the election campaign. Expansionary state spending returned Hungary to rapid economic growth, but at a price: a high budget deficit and accumulating debt.

In 2003, the MSZP government led by Péter Medgyessy tried to reduce the budget deficit and the rising debt. The policy change was also influenced by the EU. The accession agreement stipulated that Hungary would join the Eurozone and Hungary was obliged to comply with the thresholds established by the European Stability Pact (ESP) for a low budget deficit, inflation rate and debt level. This imperative required an economic policy aimed at reducing the state budget deficit and overall debt level. Economic measures initiated in 2003 to redress imbalances in the state budget, however, led to a rapid loss of popularity for the govern-
ment. FIDESZ, the major centre-right party in opposition, led by the charismatic Viktor Orbán, increasingly embraced a populist and nationalistic tone and opposed any state-budget consolidation efforts. FIDESZ campaigned for a strong development state model, which supposedly would ensure the welfare and well-being of Hungarians. In autumn 2004, facing the possibility of losing the election in 2006, MSZP opted to change the head of government and nominated Ferenc Gyurcsány, a young, more charismatic figure. Although the European Commission repeatedly asked the Hungarian government to follow a prudent economic policy, Gyurcsány, aiming to win the 2006 election, adopted a populist tone and returned to debt accumulation to finance the rapid increase in domestic consumption spurred by the state budget measures. This government policy was made possible by the special conditions of the early 2000s, when abundant cheap credit inundated the world. Easy debt seemed to allow Hungary to follow an economic policy based on an expansionary state budget policy. This process facilitated a boom in construction and the launch of large-scale infrastructure projects. On the other hand, rising prices undermined the economy’s ability to attract manufacturing FDI.

Populism was on the rise on both the left and the right. In the run-up to the 2006 elections both camps campaigned on ever increasing welfare measures and promised large-scale state development projects. In a last ditch effort to ensure electoral success, in late 2005 the government implemented new expansionary measures which sent the budget deficit north of 10 per cent in 2006. Creating the illusion of never-ending growth by means of expansionary policies was the order of the day. The large public deficit and rising debt, however, were criticised several times by the European Commission. The Commission demanded a more prudent economic policy in accordance with the ESP. After several warnings, the Commission rejected Hungary’s 2005 Convergence Programme, submitted by the Gyurcsány government, and made it clear that after the elections, in autumn 2006, the Hungarian government would have to put forward a new convergence programme.

MSZP easily won the 2006 campaign, painting the picture of an ever-growing ‘Pannon puma’ and a rosy future for all. After winning the election, however, Gyurcsány had to meet the EU’s demand to come up with a realistic Convergence Plan, which entailed a severe cut in budget spending after the fiscal profligacy of 2002–2006. The government’s
András Tóth, László Neumann and Hortenzia Hosszú

sudden U-turn was a bolt from the blue for most Hungarians. Things were made worse by the leaking of a speech given by the Prime Minister in autumn 2006, in which he admitted to a closed meeting of the MSZP’s parliamentary faction that the government had lied during the election campaign, did not govern properly and had forged statistical data to mislead the electorate in order to win re-election. The leaking of the speech led to an eruption of protests throughout the country. FIDESZ accused the government of winning the election under false pretences and demanded a new election. The Gyurcsány-led government, however, refused to accede to the demands of the opposition. It hoped that a sharp correction and rebalancing of the budget would cut the recession short and lead to growth from 2008 onwards, thereby hopefully restoring the government’s fortunes.

In early 2008, the Hungarian economy seemed to return to growth after an anaemic 2007. However, in autumn 2008 the credit crunch hit. The ensuing financial crisis forced Hungary to turn to the IMF and to begin a new round of drastic economic austerity measures to reduce the budget deficit. At the same time, the export-led engine of the Hungarian economy came to halt: 2009 saw a 6.7 per cent fall in GDP, mainly due to the worldwide recession. The collapse of the Hungarian economy was especially deep as the state, after years of pro-cyclical spending drift, had to continue to cut budget spending instead of initiating Keynesian-style anti-cyclical measures to lessen the impact of the recession in the real economy.

The crisis also shed light on the unsustainable employment and demographic trends of Hungarian society. Hungary, after the collapse of the state-owned industrial sector, emerged as a country with a substantial inactive population, partly due to the relatively generous early pension and disability schemes, which allowed older people to opt to be welfare recipients instead of being unemployed. A huge segment of the Hungarian active population is unable to find work due to health problems related to age, but also poor education and living in remote rural areas. The rapid aging of the society made things worse. The Hungarian population, and that of the working age population, is both shrinking and greying. This parallel process is increasingly imposing an unsustainable burden on the welfare budget, especially as far as pension payments and health costs are concerned (Hugh 2007; Fazekas, Cseres-Gergely and Scharle 2008).
The new round of the crisis has used up the gains of the rebalancing efforts of the 2006–2008 period and sent the economy into a new decline. This negative turn completely undermined the political credibility of the government and of MSZP in particular, which was already in a deep legitimacy crisis due to the economic U-turn after the 2006 election and the leaked ‘we were lying day and night’ speech. Finally, the outbreak of a series of corruption scandals further eroded public support for MSZP. The relentless opposition of FIDESZ also hindered the government in making it clear that some of the reforms were necessary and not merely government malevolence.

The 2010 elections were won by FIDESZ by an overwhelming majority, while Jobbik (from the party’s original name Jobboldali Ifjúsági Közösség or Right-wing Youth Association), the far right party, won 16.7 per cent of the votes with an economic programme directed against the market economy. The MSZP, which four years previously had easily won the elections, gained less than 20 per cent of the votes.

3. The crisis and the ‘conservative revolution’

The misguided economic policy of the early 2000s also sent false signals to the population. It seemed that sustainable and rapid economic expansion, the rapid increase of living standards and the ongoing ‘real’ harmonisation with more established EU member states would ensure an ever growing income stream for Hungary. The first Orbán government of 1998–2002 initiated a lavish mortgage subsidy programme to boost the construction industry after it had decided to boost the economy by expanding government spending in 2000. In 2001, it allowed banks to offer foreign currency mortgages and loans for Hungarian citizens. Austrian banks pioneered this technique in Hungary and had begun to offer Swiss franc-based loans to Hungarian citizens to gain market share. Until 2003, the share of Swiss franc-based loans was minimal compared to forint-based loans. Nonetheless, around 2003, four factors changed the state of play. After the elections, the Hungarian National Bank (MNB) initiated a policy of raising the base interest rate of the Hungarian forint in response to the government’s public spending-based expansionary programme in order to reduce inflationary pressures. As a consequence, the price of Hungarian forint-based loans shot up, while the value of the forint strengthened against the euro and the Swiss franc. Additionally,
András Tóth, László Neumann and Hortenzia Hosszú

A triumph of failed ideas – European models of capitalism in the crisis

in 2003 the Medgyessy government, as part of the budget stabilisation programme, terminated the subsidisation of forint-based mortgages launched by the Orbán government. Moreover, after EU accession in 2004, there was a consensus among the political parties that Hungary should join the Eurozone as soon as possible, but not later than the end of the decade. The possibility of rapid accession to the Eurozone also made foreign currency-based loans seem relatively safe. As a consequence, such loans expanded rapidly from 2004 onwards. Despite several warnings, the Gyureságy government, possibly fearing the recessionary impact of the drying up of credit flows, did not change the law. Thus, the build up of debt in Swiss francs in the private sector went on uninterrupted until the outbreak of the credit crunch in late 2008. The volume of private sector debt in foreign currency reached 20 per cent of GDP.

The worldwide financial crisis which broke out in 2008 made it clear that indebtedness in Swiss francs was a major source of risk not only for individuals, but for the whole economy due to the rapid loss of value of the forint and the rise of the Swiss franc against the euro. The rapid loss of value of the forint against the Swiss franc created a burden on the Hungarian middle class with loans in that currency. The rapid increase in mortgage payments in forints sent consumption plunging, hurting the domestic economy, while the increasing proportion of defaults posed a systemic risk for the banking sector.

In 2008, it became clear that Hungary was under threat from a double indebtedness: of both the state budget and the population. Having to cope with two deleveraging processes created a perilous situation because each would require the opposite medicine. The recessionary impact of cutting the budget deficit in an economy in recession hurts the real economy and household incomes and causes real private debt inflation compared to private revenues. The increased mortgage payments had a negative effect on consumption, which meant shrinking state revenues, consequently inflating the budget deficit. The two parallel deleveraging processes fed each other, risking a possible debt crisis and posing a huge challenge to government policy.

Moreover, the Swiss franc-based debt burden created an economic policy Catch 22. In the context of stagnating or even decreasing domestic consumption, only growth in export-oriented manufacturing would allow Hungary to escape the debt trap. Given the loss of
competitiveness in the first half of the decade due to the strengthening of the forint against the euro and rapidly rising wages, the return to a lower exchange rate for the forint and internal wage deflation seemed necessary to restore competitiveness and make Hungary attractive to strategic investors. Household debt in Swiss francs and the strengthening of the Swiss franc against the forint and the euro in the wake of the crisis, however, effectively tied the forint to a reserve currency and means that the forint cannot fall too low and effective domestic wage deflation is not possible without risking social catastrophe and major turbulence for the banking sector.

Before 2010, FIDESZ took a populist stance in opposition and resisted any government attempt to restore budget soundness, promising a strong state and the resumption of state budget-induced growth. In 2010, however, the deepening crisis and the insistence of the EU on a low budget deficit (3 per cent for 2011 and 2.5 per cent for 2012) effectively blocked FIDESZ’s initial plans to initiate an anti-cyclical expansionary exit from the crisis. FIDESZ in government has to continue the painful deleveraging process, as the European Commission has made it clear that it will not accept any other option.

FIDESZ’s two-thirds parliamentary majority, however, ushered in a new political situation. It allowed the government to throw off constitutional constraints as constitutional amendments are possible with a two-thirds majority in Parliament. The government declared that its goal is to reorganise Hungary in a ‘revolutionary’ transformation period. The overwhelming majority enjoyed by the government parties was used, first, to create a new legal order, which aimed to eliminate checks and balances with regard to the government, which might have blocked the revolutionary transformation. The re-regulation of the media law, the limitation of the scope of jurisdiction of the Constitutional Court and the new constitution, the Basic Law, were all aimed at reinforcing the government’s grip on the country. The reshaping of the institutional order of industrial relations is also aimed at limiting the influence of independent institutions. The government disbanded the standing

2. It is widely held that the pre-crisis 2.30 forint/euro exchange rate was far too low for export-oriented industries, while the strong forint boosted imports for consumption.
tripartite body with its statutory rights and created a new tripartite-plus consultation forum, with the involvement of NGOs and churches.

It is increasingly clear that the re-organisation of the country by an omnipotent government is heading towards a new economic and societal model. The government’s stated goal is to create a new more indigenous growth model based on strong government and strong domestic economic actors following the failure of the post-transition societal model. This differs from the goal of 1989, which was a liberal democracy and a social market economy with a strong universal welfare state.

The core political idea of the new order is a kind of illiberal constitutional order based on a parliamentary majority (see Lukács 2005) which makes it possible to control the government: elections are to be held every four years.

As far as the societal model is concerned, the government intends to strengthen the position of the elite and the upper middle layers of Hungarian society in order to put them in a position to ignite a new development phase based on their capital and savings and to lessen the role of foreign actors. The introduction of a 16 per cent universal flat tax, in practice, meant a substantial reduction in the tax burden of the upper 10 per cent of taxpayers, thereby substantially increasing the tax burden on the rest of society, especially for those on the minimum wage. The recent initiative to allow the repayment of foreign currency-based mortgages in one lump sum at approximately a 30 per cent lower exchange rate than the current exchange rate between the forint and the Swiss franc or euro is also beneficial for the small segment of society with sufficient savings.3

It is the government’s declared intention to foster domestic economic development and help domestic companies to withstand competitive pressures with the help of a strong developmental state. Nonetheless, the effectiveness of such intentions is limited by the lack of state development funding, in particular since the economic crisis. The state, instead

---

3. According to government estimates, 100,000 families would have enough savings to make use of the repayment scheme out of 1 million families with foreign currency-based loans.
of pouring money into the economy, has to cope with the daunting task of meeting the budget deficit laid down by the EU (as already mentioned, 3 per cent for 2011 and 2.5 per cent for 2012). The budget requirements have forced the government to introduce successive stabilisation packages which, in effect, are reducing domestic consumption and hurting domestic enterprises, which are mostly oriented towards the domestic market. Thus, the government, while seemingly opposed to certain forms of FDI, especially in public utilities, retail and banking, does welcome manufacturing investments by strategic foreign investors and offers ample support to major players wishing to invest in Hungary. Tax holidays and state support for large foreign investors leaves a high tax burden on smaller domestic enterprises. For domestic enterprises it is especially difficult to cope with the high tax level: as a rule, their productivity is poor and they generate lower revenues.

Thus the contradictory objectives of reducing the effective tax level and, at the same time, maintaining tax allowances for those who are deemed strategically important, while cutting the budget deficit leave the government no room for manoeuvre. It has been forced to severely reduce welfare payments and cut back essential, but costly public services. The redesign also influences labour market policies: the time span for receiving unemployment benefit was reduced to three months and a work obligation in community projects has been introduced for those on welfare benefits at very low pay (around half the national minimum wage). It is also important to note that FIDESZ’s redesign of labour market policy is partly driven by their social vision of creating a workfare-based society instead of welfare dependency. In other words, it is not only the need to cut costs that is shaping policy in this sector.

The government also intends to reduce pension costs by eliminating early retirement schemes and by the revising pension entitlements of those who took early retirement or pensions due to disability. In public services, education and health care will suffer major cutbacks. The only area in which the government is increasing spending and welfare entitlements is the policy directed towards families with children under 18 to offset the impact of the demographic crisis.

Finally, with regard to labour market regulation, the government is also preparing a clear break with the developments of the past 20 years, which were intended to emulate the European Social Model. The draft of the new Labour Code moves away from the traditional concept of
labour legislation, which sees the main task of the Labour Code as counterbalancing the labour market weakness of individual employees. The bill is intended to approximate the regulation of employment to that of civil contracts. The new Code would allow very flexible work organisation practices. The intention is to drastically reduce the thresholds laid down in the existing Labour Code with regard to various practices and to leave as much leeway as possible for individual agreements between employee and employer. The draft would also reduce the various limitations laid down in the existing Labour Code on termination of employment, allowing employers ample room to fire employees at will. The planned elimination of various traditional stipulations governing the employment relationship is accompanied by a plan to eliminate almost completely statutory trade union rights, except the right to conclude a collective agreement at workplace level.

The remaking of the welfare state, severe cuts in universal public services and labour market governance represent a major break with the policies of the past 20 years and would create a completely new societal model in an EU member state. No wonder the prime minister is hailing all these changes as a break with the moribund European model and promising citizens a new, efficient workfare-based societal model instead of the allegedly unsustainable welfare state model. Supposedly, this will lift Hungary out of the current stalemate.

Another key issue is the secondary effects of such bold measures. Any measure may have unwanted consequences and they may cause bigger problems than the original measure was intended to solve. For example, to set off the negative consequences of an increase in the tax burden on low-wage employees, the government plans to lift the minimum wage by 19 per cent in 2012 and compel companies to apply a 5 per cent across-the-board wage increase. Such a measure, in the context of economic crisis and estimated 1–1.5 per cent growth, would certainly have a negative effect on employment, especially in low-wage industries and

---

4. It is important to note that the 19 per cent increase in the minimum wage aims only to offset the increase in the tax burden on the minimum wage. Until the introduction of a 16 per cent flat rate personal income tax, those on the minimum wage paid no tax and low-wage employees received a tax rebate. The 19 per cent increase in the minimum wage, however, does not offset inflation and thus means a loss in the real value of the minimum wage in 2012.
would most hurt domestic enterprises competing for the shrinking domestic market at low productivity levels. Another example is the bold measure to allow to repayment of foreign currency-based loans in one sum at low exchange rate. This measure would impose huge losses on the banking sector, while freeing around 100,000 families from the burden of an ever increasing mortgage. The banking sector losses are likely to strangle credit flows to the economy, which would have a very negative effect on the company sector that depends on the domestic banking system and does not have alternative routes to obtain loans through foreign headquarters located in other countries. The palpable hostility of the government to certain types of FDI and the frequent changes in the legal environment are also unlikely to be conducive to attracting FDI on a larger scale.

4. Conclusion

FIDESZ, which between 2002 and 2010 protested vigorously against any cut in welfare spending, has embarked on a major redesign of the welfare state to turn it into a workfare state and to cut essential universal public services.

Time will tell whether the government is able to carry out its planned remake of society within the framework of a democratic political order. The overwhelming parliamentary majority has allowed the government to avoid possible institutional roadblocks that, under the old constitutional order, could have made it possible to reverse some of its decisions. Consequently, the four-year period before the next election in 2014 will probably be sufficient for the government to carry out a major overhaul. Nonetheless, the shift towards a workfare model will hurt large numbers of voters, as it gives a clear preference for strengthening the position of the upper-middle strata of the society, while cutting back universal welfare state entitlements, public services and basic rights of employees intended to ensure stable employment relations. Furthermore, the re-organisation of the Hungarian model is occurring during a major debt crisis, which calls into question the sustainability of the model that allowed the debt build up. Moreover, the crisis is also fed by long-term labour market problems and demographic changes and the consequent welfare burden on the society.
The crisis is also one of public disillusionment with the development path Hungary chose in 1989. Thus, besides the ability of a charismatic leader such as Orbán to build up sufficient loyalty and support, there may also exist an element of tacit consent on the part of the majority in a disillusioned society which favours a reorganisation plan and many people hope that the re-organisation may indeed put the Hungarian economy back onto a sustainable path. The opposition parties still lack a credible alternative vision and also lack charismatic leaders to challenge Viktor Orbán. Hungarian society, furthermore, is very individualised, highly segmented and lacks a strong grassroots institutional network which would be able to mount effective resistance to bold measures. On the other hand, no one can be sure how Hungarian society would react, lacking institutions and without checks and balances, to the rapid remaking of the welfare state in a period of profound economic crisis, with nowhere to turn.

Time will tell whether the supposed trickle-down effects of new regulations will be more beneficial, or the unwanted negative consequences of bold measures would have stronger negative effects on the economy. And besides the success or failure of these bold measures, only time will tell whether loyalty and tacit consent or protest against reorganisation will prove stronger determinants of the public mood. At the latest, in 2014, Hungarians will have a chance to vote on whether they trust the vision of the government or not.

Hungary is in a very difficult position. Poor luck, a difficult legacy from the socialist past, poor government policies, greed, misguided policies on the part of key banks, lack of experience and errors of calculation have led to a Catch 22 situation. There is a danger that the interrelated crises will feed back on one another and plunge Hungary into a whirlpool.

In principle, Hungary could overcome the crisis by becoming a low-cost manufacturing base in the vicinity of the one of the largest consumer markets in the world.5 The crisis induced incentive for companies to cut

---

5. In our 2007 analysis we concluded that this path would be not sustainable due to increasing competition from other low-wage countries. (Neumann and Tóth 2009). The tacitly supposed alternative way, a switch from a ‘low-road’ to a ‘high-road’ path would entail massive public investment in human capital, especially education. However, given the ongoing policy of severe cuts in public services, this scenario is at present practically ruled out.
Hungary’s full-blown malaise

A triumph of failed ideas – European models of capitalism in the crisis

costs may represent a new chance for Hungary to attract investment based on low wages and flexible working practices. Striking out once again on the export-oriented manufacturing development path may provide the resources needed to reduce the debt to a sustainable level. However, given the extremely interconnected nature of national economies within the European economic and political system, it is unlikely that Hungary could solve its crisis alone. If Hungary is plunged into an uncontrollable crisis, while Europe itself is still stumbling from crisis to crisis may raise the stakes dramatically and dangerously. More policy coordination and accompanying funds to help countries in trouble is urgently required at European level. In the absence of such European coordination, regime competition will be exacerbated and desperate last-resort measures with who knows what consequences may pose a systematic risk to the whole European structure.

Bibliography


