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The Hungarian Economic Policy Model After 2010

SUMMARY: The aim of this paper is to understand and provide reasoning for the strategic changes in Hungarian economic policy after 2010. High levels of foreign indebtedness and internal imbalances have necessitated the strategic changes in economic policy in Hungary after 2010. Due to the strategic changes results have been reached as follows. Decreasing internal imbalances: employment rate increased by 9 percentage points, tax burden of SMEs decreased by 9.1 percentage points; wage ratio increased due to income redistribution from sectoral taxes to wage tax allowances; as a result net wages and minimum wage increased in real terms by 10% and 14% between 2010–2015. Decreasing external imbalances: NFL decreased by 40% of GDP between 2010–2015; foreign currency denominated state debt declined from 49% to 30% of GDP; state-owned shareholding increased by an estimated 5% of GDP between 2010 and 2014 mostly in utilities, critical infrastructure and oligopolistic and monopolistic sectors. Following the diagnosis of this paper, the measures after 2010 constitute a coherent economic policy strategy. The paper argues that current challenges of the Hungarian economy are deeply rooted in the past decisions and that the economic policy model after 2010 aims to address these challenges.

KEYWORDS: Transformation, Transition Economies, Unorthodoxy, Foreign Indebtedness, Internal Imbalance

JEL CODES: O57, P52, E60

The economic policy since 2010 induced mostly critical publications that rhymed with each other and generated a latent consensus among Hungarian economists. Namely that there is no coherent economic policy strategy in Hungary since 2010. Opinions appeared not only in daily, weekly and monthly periodicals addressed to the public (among others Békesi, 2014; Chikán, 2015; Mellár, 2015), but in scientific journals (Kornai, 2012) and renowned institutions' country reports (among others European Commission, 2014, 2015; IMF, 2014).

We must note though that recent opinions from the European Commission (2016), the IMF (2016) and some private global financial

service companies such as Morgan Stanley (2016)¹ at least partially acknowledge the successes of the Hungarian economic policy after 2010.

The aim of this study is to introduce the challenges of Hungarian economic policy after the 2008 financial world crisis and to evaluate any given solutions to the particular challenges in the context of the post–2010 period. The paper argues that current challenges of the Hungarian economy are deeply rooted in the past decisions and that the Hungarian economic policy model after 2010 aims to address these challenges.

Our hypothesis is that Hungary's unique foreign debt position in the region and the necessity for foreign debt financing combined with mismanaged economic transformation caused tremendous external and internal

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imbalances in the Hungarian economy that called for the change in economic policy strategy after 2010.

Section 2 contains a historical analysis of the most important strategic economic policy decisions between 1970 and 2010 that led to the external and internal imbalances of the economy. Section 3 is a summary of challenges that were created by previous strategic decisions, which manifested themselves during the 2007–08 financial world crisis. Section 4 is a summary of measures and results that the economic policy has achieved in the post–2010 period. In section 5, we discuss the future outlook of Hungarian economic policy.

HISTORICAL ANALYSIS OF THE HUNGARIAN ECONOMIC POLICY 1970–2010

■ TRIPLING GDP PER EMPLOYEE AND 28% INCREASE IN NET REAL WAGES BETWEEN 1970–2010

In 1970, (calculated in HUF, 2010) the average employee contributed 198,000 HUF per month to the production of GDP, with an average net real wage of 103,600 HUF.² By 2010, the GDP produced by the average employee had nearly tripled (586,400 HUF), but the average net real wage increased by only 28% to 132,600 HUF (Figure 1), moreover, the net wage ratio dropped to 23% from 52%. In 2010, 90% of total capital incomes were realised by the highest income decile, and annually 5–7% of the GDP left the country in the form of income transferred to foreigners.^{3,4,5} From the point of view of the average employee the growth of GDP has literally no effect. Why is this the case? On the one hand, at the transition 1.5 million jobs, 30 percent of workplaces ceased. The employment increased a little more than hundred thousand between 1995 and 2010. The average employee therefore have to cover the social expenses of more inactive citizen

from their gross wages, and consequently they receive less from the value of their work. The phenomenon is represented by *Figure 1*.

■ HUNGARIAN STATE DEBT INCREASED FROM 14% TO 80% OF GDP BETWEEN 1970–1989

Until economic transition, the state owned a majority of productive assets. Although this is an ineffective solution to managing an economy, the government covered the expenses of large distributive systems (such as education, health care and pensions funds) from the revenues of State Owned Enterprises (SOEs). However, the impending bankruptcy of the Hungarian state began unfolding in 1974 and the oil shocks of the 70s also had a serious impact on the Hungarian trade balance. Even so, internal economic policy chose not to restructure the economy and curb consumption, but rather turned to foreign currency loans to cover the resulting trade deficits (Bekker, 1995). These foreign currency loans only became public knowledge during the economic transition when it became evident that state debt had increased from 18 to 62% of GDP between 1974 and 1979 and subsequently to 80% by 1989 (*Figure 2*).⁶

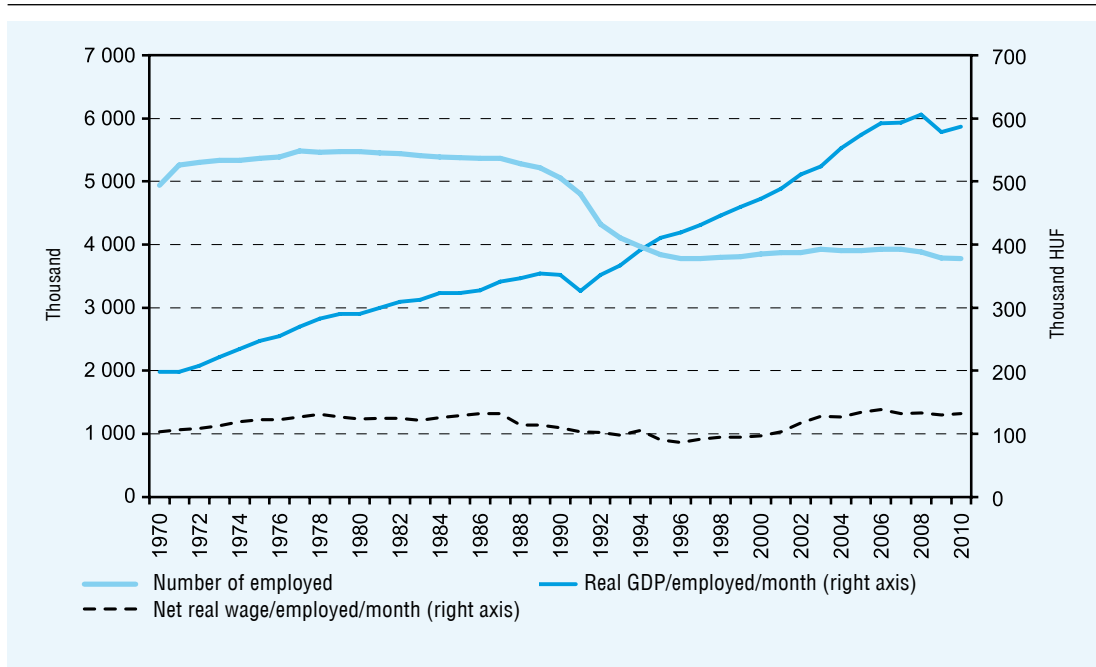
It is also important to emphasize that the Hungarian state found itself in a debt trap by 1979. It's not overconsumption, as professional opinions suggest, but the accumulated interest payments and exchange rate loss that caused the majority of indebtedness in the 70s and 80s. While net state debt increased by 14 billion USD, call for funds was only between 1–1.5 billion USD between 1974–1989. (For more detailed analysis see Oblath, 1992; Lóránt, 2009; Szabó, 2015.)

■ HUGE FOREIGN INDEBTEDNESS LED TO PREFERENCE FOR EXTERNAL SOURCES OF CAPITAL DURING PRIVATISATION

The symptoms of previous wasteful economic resource allocation became immediately

Figure 1

**THE MOST IMPORTANT INCOME INDICATORS AND THE STATE OF EMPLOYMENT, 1970–2010
(CALCULATED IN HUF, 2010)**



Source: figures calculated based on HCSO statistics included data concerning the changes in real wages and minimum wages between 1992–2015; national accounts, 1960–2010; The development of Hungarian labour market, 1998–2010; Consumer price index, 1960–2010; Statistical pocketbook of Hungary, 1956–1995.

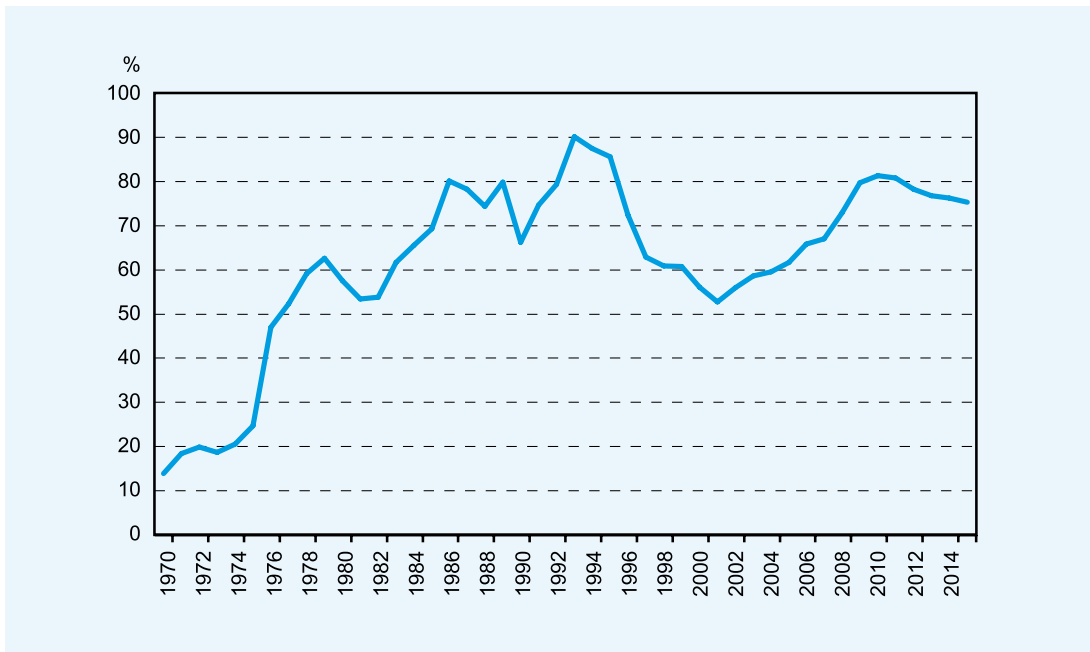
evident. The economic transition process was burdened by external financial pressure, resorted to a large share of the banking sector and utility companies, among other sectors, being privatised to foreign owners to ease capital constraints. Sectors which in mixed economies (Switzerland, France, Germany and Singapore among others) and in transition economies would normally remain in government or national ownership, were sold off to foreigners. As privatisation and foreign direct investment (FDI) could only cover the short-term financial problems of the Hungarian economy, the symptoms of external indebtedness were temporarily remedied (Mihályi, 2010; László, 2004), this conclusion is also confirmed by Oblath and Pula (2000); Czeti and Hoffmann (2006), and see also detailed information about the effect of FDI in transition economies given

in Muraközy (2007); Kaderják (1996); Hunya (1995).

At the time of the economic transformation, economists in decision-making positions saw the opportunity to repay the state's external debt through the privatisation process arguing that the sale of half of the state's productive assets would be sufficient to repay the debts. State-owned assets earmarked for privatisation had a value of 1.670 billion HUF at 1990 prices or 27.18 billion USD.⁷ This was roughly double the value of net government debt of 15 billion USD that existed in 1989. Following cautious estimates, the government sold state-owned assets at 28.7% of their book value between 1990 and 2008.⁸ Hungary did not ask for debt relief being afraid of loss in confidence of the financial markets. Without detailing the debates dealing with the effects

Figure 2

THE DEVELOPMENT OF GROSS GOVERNMENT DEBT AS A PERCENTAGE OF THE GDP



Source: 1970–1995: HCSO Statistical book of Hungary, 1956–1995. 1996–2015: Eurostat General government gross debt (% of GDP)

of a debt reduction, we just signal the fact Poland appealed to its creditors for debt relief and reached 50–50 percent debt reduction from its state and private creditors during the 90s. After a short transitional financial impacts of the Polish debt relief, Poland’s international assessment and credit rating was steadily similar, or almost identical to Hungary’s from the end of 90s until the financial crisis of 2008.

As a consequence of these actions, Hungary is now facing an enormous debt burden. Debt service cost was 4.4% in Hungary in 2013 compared to 2.6% in Poland, 2% in Slovakia and 1.4% in the Czech Republic. Between 1995–2015 the average annual debt service in Hungary was 4.05 percentage points higher in terms of GDP compared to the Czech Republic.⁹ Poland was the only country that faced a higher state debt at the time of economic transition, however the Polish governments came to an agreement

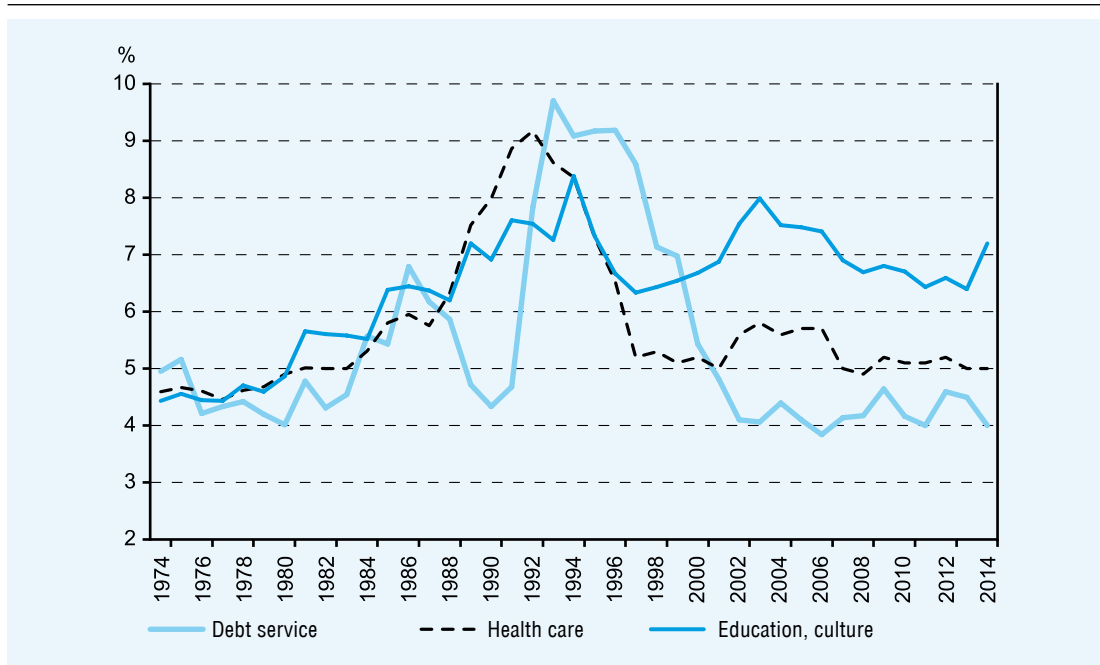
with their creditors during the 90s and wrote off 50% of their debt.¹⁰ In Hungary, between 1993 and 1999 debt service expenditures were higher than the expenditures on education, culture and health service (*Figure 3*).¹¹

AN AVERAGE HUNGARIAN EMPLOYEE EXPERIENCED A HUGE PUBLIC PRODUCTIVE ASSET LOSS BETWEEN 1970–2010

The public productive asset almost completely disappeared during the twenty years following the transition. This has two consequences. In 1970, (calculated in HUF, 2010) the productive public assets per average citizen reached 1.6 million HUF and the government debt amounted to 51,000 HUF, which means that the net public financial position of a citizen was 1,549,000 HUF.^{12,13} By 2010, the state-owned assets per capita decreased to 106,000 HUF while the government debt increased to

Figure 3

EXPENDITURES SPENT ON DEBT SERVICE PAYMENTS, EDUCATION AND CULTURE AS WELL AS HEALTH SERVICE AS A PERCENTAGE OF THE GDP



Source: 1974–1995: data series of HCSO on health service, education and culture
 1996–2014: data series of Eurostat on general government expenditure by function.

1,634,000 HUF. As such, the public financial position of an average citizen became negative, and instead of having more liabilities than assets, he was indebted to an amount of 1,528,000 HUF (cca. 5,000 EUR; *figure 4*).

CONSEQUENCE OF HURRIED LIBERALISATION AND DEREGULATION: COLLAPSING EMPLOYMENT AND INDUSTRIAL OUTPUT

Economic transformation is an extremely complex and far-reaching process, and we cannot deal with each field extensively.¹⁴ We concentrate on policies that in our opinion established the conditions for a later lag in economic performance in Hungary as compared to the Czech Republic and Poland.

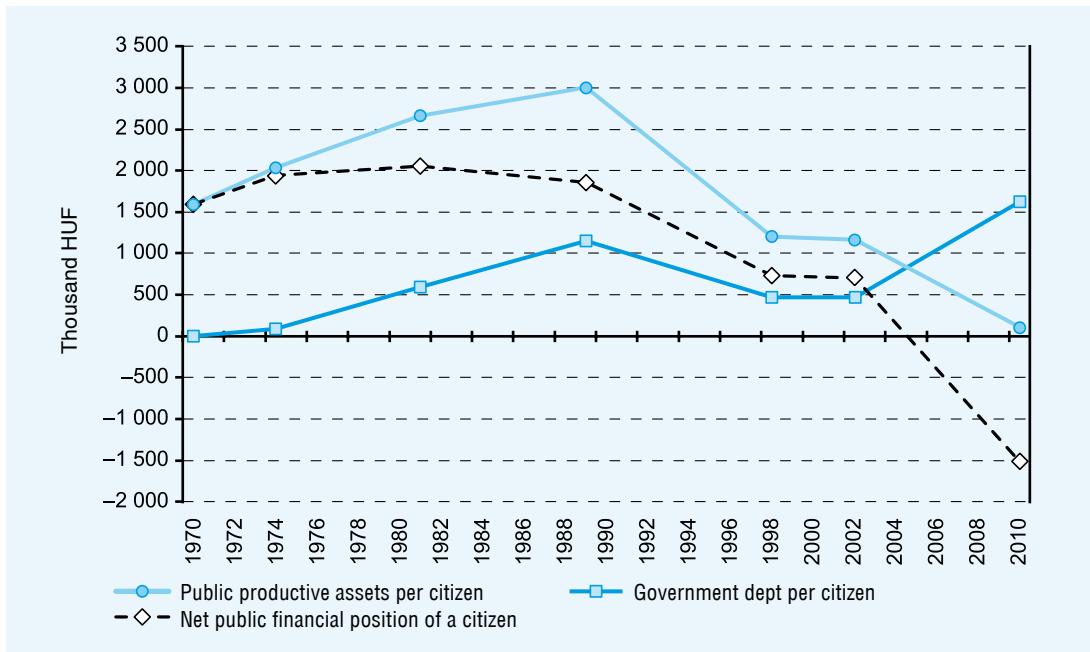
Hungary was the front-runner in the region when establishing the institutional framework of the market economy (Györffy, 2006,

Kolodko, 2000). The process of changing the economic system began in the 80s, with the enactment of new and modern company and bankruptcy laws. Regulations to ensure the protection of direct foreign investments and to establish a two-tier banking system were also created before the change of the regime. By 1992, 90% of foreign trade was liberalised by Hungarian economic policy governance (Nagy, 1995).¹⁵

The rapid liberalisation without any significant protective measures, with the exception of a few products, and the non-devaluation of the Forint (compared to Polish zloty and Czech koruna) significantly contributed to the collapse of the Hungarian industry leading to a disappearance of jobs and the reduction in export volumes versus imports (Nagy, 1995). During the economic transition in

Figure 4

THE DEVELOPMENT OF THE PUBLIC FINANCIAL POSITION OF AN AVERAGE CITIZEN, 1970–2010 (THOUSAND HUF, CALCULATED IN HUF, 2010)



Source: Own calculation based on data from Lóránt (2009): Net government debt/citizen: 1970–2007, CBH Quarterly and annual data on Balance of Payments, HCSO: Population and information on mobility. The continuous line facilitates the clarity only and has no further meaning.

Hungary, nearly 30% of the workplaces disappeared, while only 20% disappeared in Poland and 10% in Czechoslovakia. It is important to note that, although liberalisation occurred faster in Poland and Czechoslovakia than in Hungary, it went along with the abolishment of quotas, higher protective tariffs and subsequent devaluations (Csaba, 1998; Gács, 1993).¹⁶

The social effects of economic transformation were aggravated by hurried liberalisation, deregulation and a too rigorous bankruptcy law. By the disintegration of Comecon, Hungary’s markets not only ceased but further market share was lost due to wrong economic policy decisions. The economic policy makers did not realize that while Hungarian market players had to face world market prices due to deregulation, East Asian competitors with

subsidized raw material and energy prices, and heavily subsidized European agricultural players entered our liberalized markets.

Also, the most important export sector, the food industry collapsed partly due to mismanaged compensation. The 2,300 USD per capita output of the agricultural industry in the mid 80s decreased to below 800 USD per capita by the mid 90s and fluctuated between 540–782 USD per capita between 2000 and 2012 (calculated in USD PPP, 2005). The subsidy intensity of Hungarian agriculture never reached the intensity levels of the EU and OECD countries through the 80s – which fluctuated between 40 and 48% – and dropped to 5% in the beginning of the 90s (for further information see Adam, 1995; Benet, 1997; Oblath, 2009; Penczner, 2010; Szabó 2010).

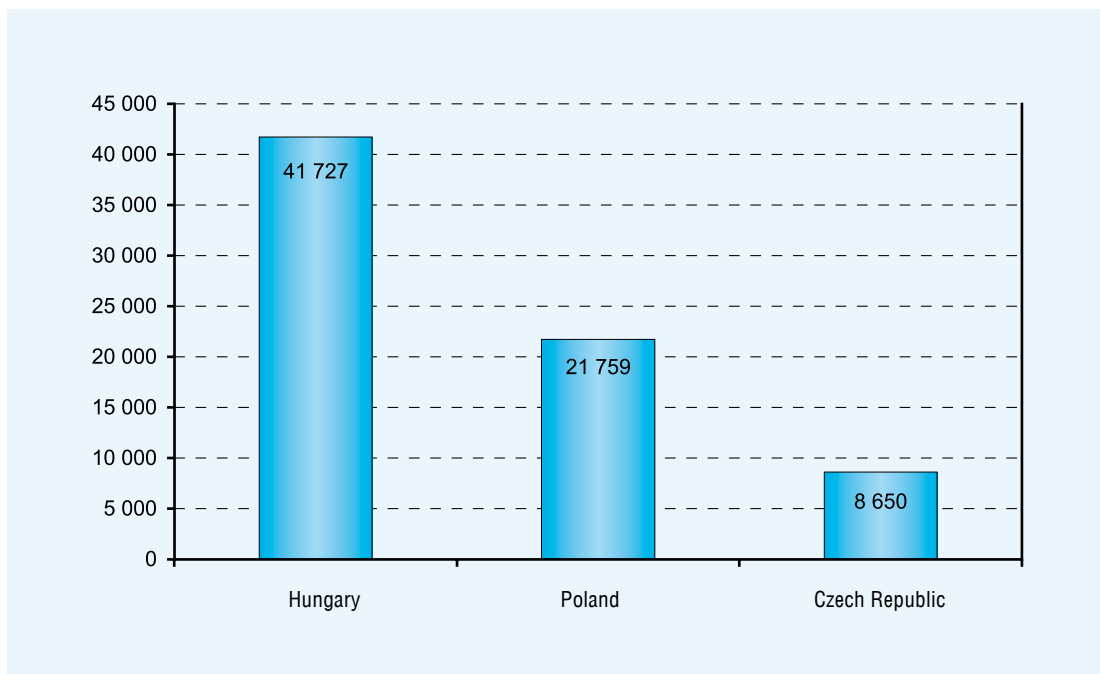
Furthermore, many companies went bankrupt between 1992 and 1996 because of extensive trade liberalisation accompanied by an extremely strict bankruptcy law (Adam, 1995; Lóránt, 2009). The lack of resources and the circular debt of state-owned companies during the transition period resulted in an abnormally high number of bankruptcies due to the severity of the bankruptcy laws, this conclusion is confirmed by Bonin and Schaffer (1995); Ábel (1995), who provide more in-depth analysis in different perspective about the hidden motivation, the process and the short-term results of the above-mentioned Hungarian bankruptcy law. Between 1992 and 1996 five times more companies went bankrupt in Hungary than in the Czech Republic and twice as many as in the four times more populist Poland (Antal, 2004; see Figure 5).¹⁷

LIBERAL ECONOMIC POLICIES COMBINED WITH AN UNWISE STRUCTURE OF SOCIAL EXPENDITURES LEAD TO LOW ACTIVITY

Hungarian social policy expenditure is not high compared to the EU, however, it is high compared to its most developed regional counterparts.¹⁸ According to the Eurostat COFOG database, Hungarian social expenditure in the 2 decades after the transition was 3 percentage points lower than the EU15 average. Apart from the period between 2004 and 2009, this was similar to that in the UK, a country that pursues a liberal economic policy. It is true, however, that it was still 3–6% higher than in the Czech Republic during the same period. Compared to the EU-average the social expenditures are therefore not too high, but it is compared to Hungary’s most developed regional competitor, which might be explained by the differences in employment as a conse-

Figure 5

NUMBER OF RECENTLY CLOSED COMPANIES (1992–1996)



Source: Antal (2004)

quence of differences in transition economic policies.¹⁹ The combination of liberal economic policies (hurried liberalisation, deregulation and privatisation) and generous social policies including lavish early retirement schemes (see also Csaba, 2000) led to the early retirement of approximately 800,000 employees by the time of the economic transition and inspired inactivity in the long run, these facts are also supported by more in-depth analysis in working papers by Blanchard (1994); Mihályi (2008, 4th chapter); Köllő (2001). If employment was proportionally as high and debt service as low in Hungary in 2010 as it was in the Czech Republic, Hungarian net real wages would, theoretically, be 23% higher.²⁰

■ 2002–2010: NEW WAVE OF INDEBTEDNESS²¹

To finance consumption between 2002 and 2010, the country accumulated debt over and above that of the 70s. Gross government debt rose by 25.4%; this debt quadrupled in foreign currencies (its ratio in government debt increased from 25 to 48%). Private sector debt increased by 30% of GDP because of retail foreign currency borrowing and the weakening Forint (see also Oblath, 2014; EEAG, 2012).

Consumption growth was fuelled by credits, only partly backed by economic performance, and after 2008, the GDP dropped significantly. For the whole period of 2002–2010, economic growth only reached 12% while private sector and state debt increased by 55%.

CONSEQUENCES OF ECONOMIC TRANSFORMATION AND DILATORY ECONOMIC POLICY IN HUNGARY: PROBLEM OF INTERNAL AND EXTERNAL BALANCES IN 2010

The consequences of the above-mentioned economic transition and dilatory economic policy are summarised in Figures 1–7.

Firstly, there is a noticeable internal imbalance in the economy (Figure 1.) The average employee contributes to a social welfare system based on inactivity (Cseres, 2007; Orbán, 2006). In this system, staying at home and receiving subsidies is more economical than working. This system is partly the result of the mismanaged economic transition, which in itself is a structural problem, but it is largely due to attitude which promotes inactivity and which is culturally embedded in the Hungarian society. The structural and cultural factors reinforced each other in the 20 years after the economic transition (Kovács, 2008; Kornai, 2005; Muraközy, 2008). This problem can be verbalised either as one million employees are missing, or as one million jobs are missing from the labour market.

Further problems related to the internal balance include the dual economy and the tax structure. The allowances given to foreign direct investments and revenue losses from the sale of state-owned monopolies and oligopolies should be compensated in some way. This compensation is only possible by placing an extraordinary tax burden on the SME sector, wages and consumption. Earnings resulting from privatisation were spent on repaying the government debt instead of improving the economy as it was originally planned. That was one of the main reasons for the development of the dual structure of the Hungarian economy by 1996. In other words, there is a mostly foreign-owned enterprise sector that enjoys considerable tax allowances. In this sector, the profitability is double, and it has triple available assets of its Hungarian-owned counterpart (Lóránt, 2009; Papp, 2012; Pitti, 2010). For many years, the tax burden on foreign companies was 10–18% (Papp, 2012), while our calculations and data of World Bank show that the Hungarian SMEs faced a tax burden of 57.5%. Therefore, many of these small- and medium-sized companies chose to evade taxes, which was detrimental

to their growth (Gergely, 1998; Belyó, 1998). This phenomena is explained by Jensen (2006) who argues that the trickle down effects of FDI in transition countries is quite fragile partly due to widespread tax holidays, subsidies and acquisition discounts which has to be compensated from the domestic sector of the dual economy.

The lack of external balance posed another problem. The net external debt of the country (government, private and company) peaked in 2009, at 130 billion USD, at nearly 115% of the GDP (*figures 6 and 7*). This is the amount of foreign direct investments, portfolio capital and stock of loans in Hungary, upon which the Hungarian economic players have to pay the costs of financial resources. The balance of income shows a 5–7% deficit since the beginning of the 2000s. If the outflow of incomes are from such enterprises that establish the hedge of these outward incomes by exports, they do not generate external imbalances. But as it was introduced earlier, as a result of transition external imbalance was created by privatising to foreign owners those oligopolistic and monopolistic countries that are producing or providing services to domestic markets.

Compared to the Czech Republic, Hungary's external debt is very high and the cost of borrowing places a significant burden on the actors of its national economy. The degree of external debt can be expressed by the amount of Net Foreign Liabilities (NFL) as a percentage of GDP (*Figure 8*).²²

The figures show that, due to a wrong economic policy decision in 1974 the borrowings and their consequences, Hungary underwent the economic transition with large external debts, while the Czech Republic was not burdened by any. Nearly 90% of the Czech external debt is derived from foreign direct investments; the balance of portfolio capital, the so-called 'hot money' is not negative, thus it does not appear in the figure, while government and private external debts reach only 10% of the GDP.

A more detailed discussion about Hungarian external and internal macroeconomic balances can be found in papers by Halpern (2014), Csajbók (2010); Szél et al. (2010); EEAG (2012); Czeti (2006), and the references therein.

STRATEGIC ECONOMIC POLICY ANSWERS AND ACHIEVEMENTS IN THE POST-2010 PERIOD

To summarise the scope of economic policy in Hungary after 2010, it is necessary to retool the economy from a 'debt-fare' model based on external resources to a 'work-fare' model based on employment and savings.^{24,25} This would require a shift from supercapitalism to market capitalism, a healthy balance between domestic and foreign ownership and balancing the field of competition for small- and medium-sized enterprises (SMEs).²⁶

Creating this new 'work-fare' economy involves two strategic tasks:

- 1 Increase activity and employment, increase savings and achieve demographic turn to reach long-term sustainability;
- 2 Decrease external financial vulnerability and increase the sovereignty of economic policy:
 - Consolidate budget and set the state debt on a downward trend. Moderate private sector and public external indebtedness;
 - Create a balance between domestic and foreign ownership, thereby strengthening SMEs and the export sector.

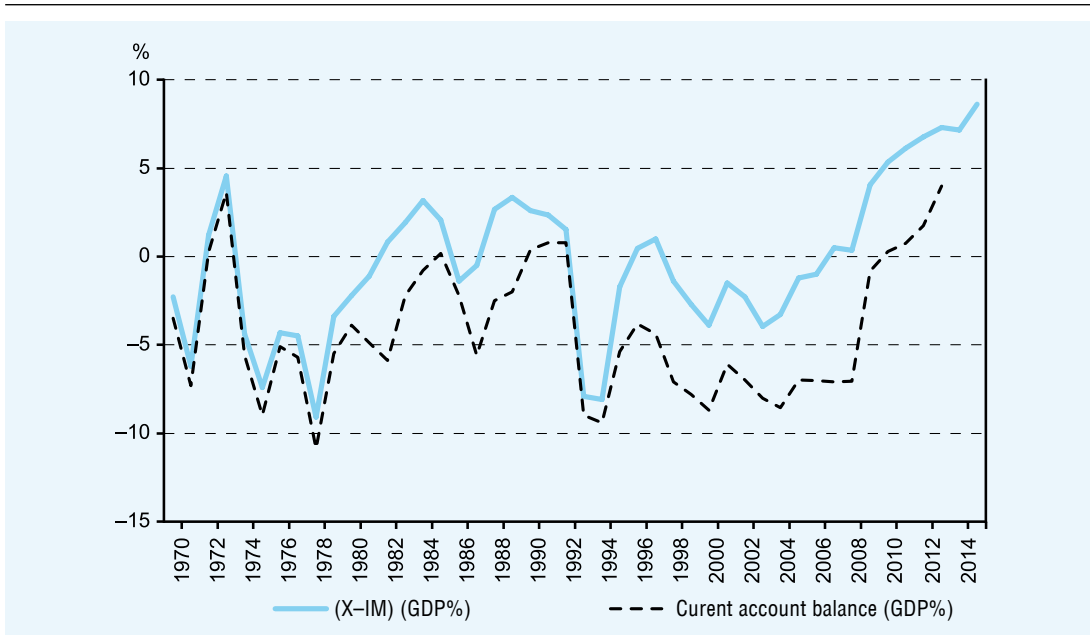
Strategic decisions to increase activity, employment, savings and fertility rate in Hungary after 2010

- 1 Introduce flat income tax and widen the scope of family allowances:

Flat income tax is the most debated measure of economic policy after 2010. More money,

Figure 6

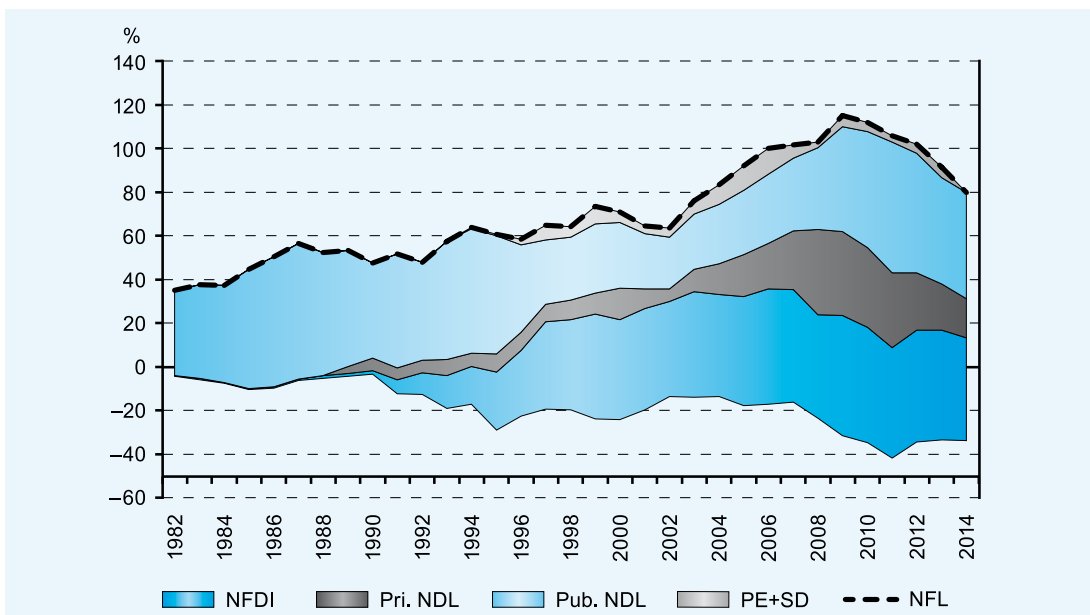
THE CURRENT ACCOUNT AND THE BALANCE OF FOREIGN TRADE AS A PERCENTAGE OF THE GDP



Source: Hungarian Statistical Yearbooks of HCSO, 1956–1995; CBH Quarterly and annual data on Balance of Payments from 1995 on

Figure 7

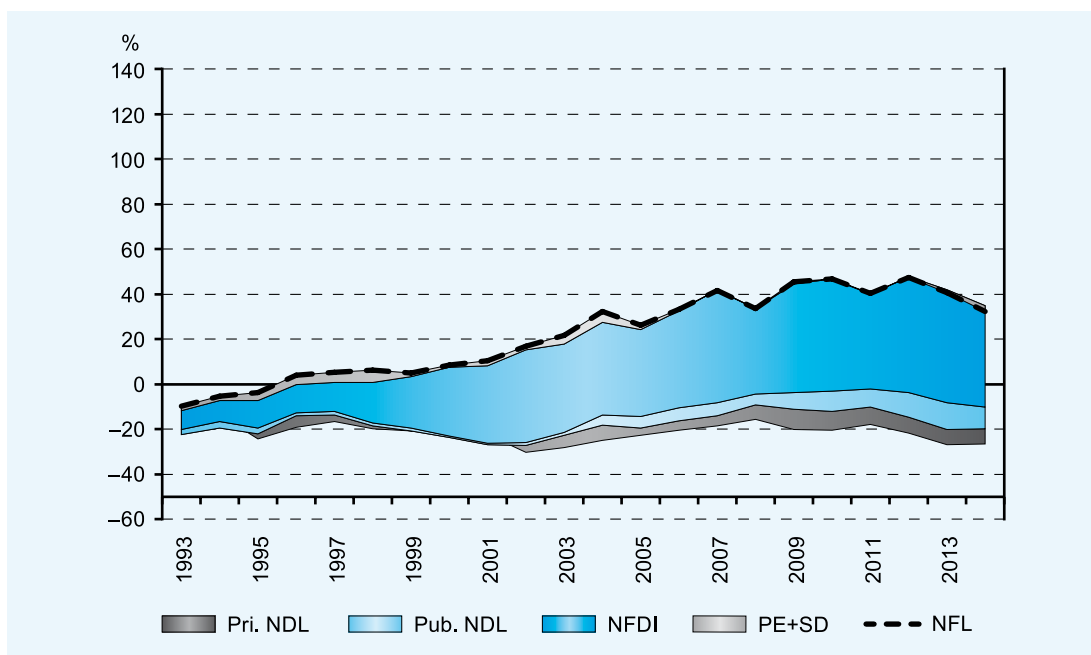
THE DEVELOPMENT OF HUNGARY'S EXTERNAL DEBTAS A PERCENTAGE OF THE GDP*



*NFDI – Net Foreign Direct Investment; Pri. NDL – Private Net Debt Liability (private sector + companies); Pub. NDL – Public Net Debt Liability (government + central bank); PE + SD – Portfolio Equity + Short Debt

Source: Calculations based on Balance of Payments Statistics of CBH and IMF

THE DEVELOPMENT OF THE EXTERNAL DEBT OF THE CZECH REPUBLIC AS A PERCENTAGE OF THE GDP²³



Source: Calculations based on the data of the Česká Národní Banka (Czech National Bank) Quarterly statistics on balance of payments.

the equivalent of 2–2.5% of the GDP remains with the households, especially with the top 20% of wage earners and families. The launch of a flat tax was misinterpreted as income redistribution from low-income employees to middle and high-income employees, however, it was a form of redistribution towards a fairer sharing of the burden by charging less tax on wage earners and levying higher taxes on capital gains of oligopolistic and monopolistic market players. Special taxes were levied on oligopolies and monopolies (banks, utilities, mobile service providers, retail chains) and the VAT was increased by 2% to improve the balance of the budget. It is also worth mentioning the fact that in the lack of competition taxes on transactions and consumption can be easily passed onto consumers. Changes in wage income taxation contributed to a decrease in marginal tax

wedge of the average wage from 71% to 49% between 2009–2013 (OECD statistics)²⁷. Partly due to the income redistribution from sectoral taxes to decreasing personal income taxes, net wage and minimum real wage increased by 10 and 14% respectively between 2010–2015²⁸.

② Create a flexible labour market policy:

Hungary's new labour law made the Hungarian labour market among Europe's most flexible labour markets (OECD, 2013).

③ A Reform of the education system to disseminate more valuable knowledge to the economy²⁹:

- Increase the ratio of vocational training at secondary level.
- Centralise the public education system first and foremost to decrease inequality.
- Increase teachers' salaries and introduce a teacher career model.

- Increase tertiary education quotas in the fields of science and technical education and decrease them in social sciences.
- Finance the costs of higher education only for those who graduate and work in the country for a certain period.
- However, we must add that these changes are far from over and while intending to solve the most important deep-rooted challenges of the Hungarian educational policy, they have resulted in the creation of a set of new challenges, whose effects are yet to be felt.

④ Reform the social benefit system in order to facilitate employment:

Public work programs were launched to lead inactive people back into the labour market. The reform established a healthy relation between social benefits, public work wage and minimum wages, thus incentivising inactive people to enter the labour market. Public work programs should not be seen as competing with private employment, but should be considered as the first step towards private employment for those who lacked employment opportunities in the previous 15–20 years.

The aim of restructuring the social benefit system was to create a financial incentive mechanism to help inactive people back to the employment market: the social benefits to inactive people tend to be lower than public work wage which is lower than minimum wage. In the light of above mentioned context, public work programs generated from a greater challenge (inactivity) a smaller challenge problem (not efficient work) in an area where there was no progress in the last two decades.

⑤ Revise early retirement allowances.

⑥ Decrease utility costs:

As a result of the 2008 crisis significant wage increases were not possible and economic policy looked for areas to reduce costs in order to increase the disposable income of households. Utility costs were rising at an ex-

ceptionally fast pace between 1996 and 2010, especially until 2007, and a viable solution seemed to be to decrease approved utility prices by 20–25%. This equated to a 6.3% real wage increase for people earning below median wages who spent one-third of their income on utility costs.^{30,31}

As a result, from 2010 to 2015, the employment rate increased by 9.0% to 63.9% and activity rate by 6.7% to 68.6%. This surpassed the employment rates of Poland and Slovakia, but was still 9–12 percentage points below the developed Eurozone countries' employment and activity statistics.³² The results were still tenuous and 42% due to the public work program (that is considered as a mean and not an end), the initial step towards market employment.

■ DECREASE EXTERNAL FINANCIAL VULNERABILITY AND INCREASE ECONOMIC POLICY SOVEREIGNTY

Consolidating the budget and setting the state debt and external debt on a decreasing path

➤ After 2010, the first and primary task was to increase the sovereignty of economic policy decision-making. Nationalizing mandatory private pension funds played an important role in reducing the budget deficit to below 3% in the first year. 2015 was the fourth consecutive year when Hungary's economy matched the Maastricht criteria.

◆ Reduce implicit state debt by creating the balance of big distributive systems such as the pension system and the financing of local governments.

◆ Decrease foreign currency denominated household debt ratio.

As a result, state debt decreased from 81.3 to 75.3% of GDP between 2010–2015 and the foreign currency denominated state debt declined from 49% to 30% of GDP be-

tween 2010–2015, the net foreign liabilities ratio also decreased from 111.73 to 71.51% of GDP between 2010–2015, representing a 40.22 percentage point decrease in 5 years. Further factors included the trade surplus and the measures taken to decrease foreign currency denominated household debts.

Excessive deficit procedure was subsequently suspended in May 2013, after nine years, and the fear of losing EU development funds decreased.

Moving toward a balance between domestic and foreign ownership, strengthening small- and medium-sized enterprises and the export sector

The extensive sale of public utility services in the 90s (gas and electricity providers, waterworks) to foreign investors is uniquely Hungarian. This practice was very rare even in the developed countries of continental Europe. Similarly, the privatisation of banks, national telecommunication and oil companies was carried out with the inclusion of foreign investors. One reason for this phenomenon was that domestic capital was not available for the purchase of valuable companies sold through competition (László, 2004), while the other was the extremely high need for foreign financing of the Hungarian government's foreign currency denominated debt service.

◀◆ Based on calculations by Lóránt (2009), foreign ownership in the banking sector rose above 80% due to privatisation in the 90s and the strategic goal to increase domestic ownership to 50% was achieved by 2014. The economic reason, besides power-political reasoning, was to create an even field for financing for local companies, mostly SMEs.

◆ The government increased domestic ownership in oligopolistic and monopolistic utility companies. The aim of

these re-nationalisation measures were to decrease profitability and move toward the balance between domestic and foreign ownership as it is recognised among the majority of developed countries and the successfully developing southeast Asian economies such as Singapore, South Korea, Japan and Taiwan. Although it is a conventional wisdom in the field of economics that private ownership is more efficient than public, there is evidence in the economic literature that government-owned enterprises can also be as efficient as privately run enterprises (Feng et al., 2004), and can even outperform their privately owned competitors (Ang–Ding, 2006). Therefore we'd rather focus on the balance of owning oligopolistic and monopolistic companies by foreign and domestic investors including the state.

- ◆ A company in the weapons industry sector (Rába) and some other manufacturing companies were nationalised for national security and solvency reasons.
- ◆ Measures were taken to level the playing field for SMEs and large, oligopolistic and monopolistic companies. !
 - ▶ The Central Bank of Hungary launched the Funding for Growth Scheme offering credit to SMEs at a 2.5% rate in July, 2013. Its effect on investments is around 1.7% of GDP (500 billion HUF) with a GDP growth of 0.8–1.6% by the end of 2014. (CBH calculated a 1% growth effect to Funding for Growth Scheme in 2014.)
 - ▶ Corporate tax on SMEs decreased from 19 to 10%.
 - ▶ The Hungarian National Trading House was established to help SMEs to gain export markets on traditional and newly emerging export markets. It is the question of present and future whether the structure can be filled with content.

- ▶ Taxes were increased or special taxes were levied on specific, mostly oligopolistic and monopolistic sectors (for detailed analysis see Voszka, 2013).
- ▶ To increase stability, by mid-2014 the government signed strategic partnership agreements with around 50 companies or groups of companies. The main reason was to increase predictability for the strategically important export-oriented investors and employers in the economy.

It is important to emphasise that the government does not want to bypass market and private property (Voszka, 2013) but rather restore mixed economic circumstances. As a result of renationalisation, the state ownership doubled between 2010–2014 with an estimated increase of 5% of the GDP. As a result of strengthening small- and medium-sized enterprises, the tax burden of SMEs decreased from 57.5% to 48.4% between 2010–2015³³.

WHAT'S NEXT?

The changes targeting the internal and external imbalance of the economy were implemented during the aftermath of the 2007–08 financial world crisis, which had a dual effect on Hungary. First, because of the high external indebtedness of the economy, second, because of the high budget deficit and increasing state debt, which led to an Excessive Deficit Procedure against Hungary by the EU Commission in 2004.

The results must be measured accordingly. Critical opinions stating that the Hungarian

economic policy after 2010 is unpredictable are only partially true. If one follows the diagnosis of this paper, the measures after 2010 constitute a coherent economic policy strategy.

It is a cliché that the realisation of strategic plans can easily go awry and that strategic changes create new problems. The new rules and goals are set, but the transformation of the public and the higher education system, and the innovation system is far from over. The future of the Hungarian economy are dependent on whether efficiency enhancers start to work or their volatility burdens the economy further. Not going into the decomposition of GDP growth, it is important to remark that 2014 and 2015 were the first years since the early 1990s when significant growth was measured without adding to indebtedness, therefore implying that the budget was balanced and the current account recorded a surplus – not forgetting that EU development sources, which are implicitly foreign sources, but technically do not increase the foreign liability ratio, played an important role in this GDP growth. However the sustainability of this growth is highly dependent on Hungary's external markets and the success of Hungary's external economic policy strategy which aims to increase export share on faster developing export markets, and the quality of the most important efficiency enhancers of Hungarian economic development: vocational and adult education, tertiary education, the innovation system, coordination mechanisms of the economy and the bureaucratic, administrative burdens on market players.

NOTES

¹ For more detailed information about the mentioned analysis, see: Ministry for National Economy (2016).

² Own calculations of the Hungarian Central Statistical Office (Központi Statisztikai Hivatal,

HCSO); changes in real wages and salaries 1992–2015; consumer price index, 1960–2010 statistics.

- ³ See balance of payments statistics of the Central Bank of Hungary (Magyar Nemzeti Bank, CBH; Hungarian abbreviation: MNB)
- ⁴ In this study, we do not deal with non-productive private assets. However, we note that it also increased unequally. In the period examined, the income differences between the lowest and the highest income decile increased from the level of 4–4.5 times to the level of 7–7.5 times, and along with these changes in income the asset differences multiplied.
- ⁵ More detailed data analysis and empirical investigations are available in the working paper Cserhádi i(2009); Tóth (2005); Kornai (2005).
- ⁶ For more detailed analysis see Bod, P. A. (2000); Erdős, T. (1987).
- ⁷ In this study the value of privatised state-owned companies and incomes from privatisation have been determined in accordance with the assets managed by the state-owned asset management companies based on the work of Horváth and his co-authors (2008). (Horváth, Dóczy és Lehmann Law Office (2008). We get just the same results by using the asset estimates of Mihályi (2010).
- ⁸ Our calculation is a simple present value calculation of 1990 book value compared to the price paid for the SOEs during the privatization process. The calculation is available upon request. Mihályi gives 10 interrelated explanations for the asset devaluation (see more in Mihályi, 2010), from which we mention only one: the most generally valid explanation for the devaluation is that during the selling process that lasted for several years the asset management companies were not able to compensate the continuous devaluation of the Forint by the increase in Forint prices (in the same place, pp. 202–205).
- ⁹ Source: Eurostat General government expenditure by function (COFOG).
- ¹⁰ This conclusion is confirmed by Halpern (2014); Oblath and Palócz (2012), who give more detailed analysis and comparison between Hungary and the other CEE countries about this issue.
- ¹¹ For more detailed analysis see Pogátsa Z. (2013).
- ¹² In this study the value of privatised state-owned companies and earnings from privatisation have been determined in accordance with the assets managed by the state-owned asset management companies based on the work of Horváth et al. (2008). We get just the same results by using the asset estimates of Mihályi (2010).
- ¹³ Net government debt per capita: 1970–2007: Lóránt (2009), 2008–2010: CBH Quarterly and annual data on balance of payments, HCSO: Population and information on mobility.
- ¹⁴ More detailed data analysis and complex empirical investigations are available in working paper by Kornai (2005); Oblath and Pula (2000); Csaba (2007); EEAG (2012), and the references therein.
- ¹⁵ About liberalisation in practice see more details in Michaely–Papageorgiou–Choksi (1991); Oblath (1987); Köves–Lányi–Oblath (1993).
- ¹⁶ We are aware of the fact that the different monetary policy strategy caused higher inflation and worse turbulences in domestic consumption and real wages in the Czech Republic and Poland, but in the long run export and domestic production oriented trade and monetary policy paid off for Hungary's peers.
- ¹⁷ For detailed description of the four most important radical laws affecting the financial sector see Csaba (1998)

- ¹⁸ See Kármán (1998); Benedek (2006); World Bank (2006) for more information about the composition of Hungarian public expenditure in international comparison.
- ¹⁹ For more detailed analysis about the international comparison of the structures of the Hungarian public expenditures, see: Kármán (1998); Benedek (2006); World Bank (2006).
- ²⁰ Own calculations based on data from Eurostat Annual net earnings. Calculations are available upon request.
- ²¹ HCSO National Accounts, 1960–2010 and CBH Quarterly and annual data on Balance of Payments statistics
- ²² For more detailed analysis, see Komáromi (2008).
- ²³ There is reliable information available about Hungary since our accession to the IMF in 1982, while about the Czech Republic only since 1993. It is related to the interpretation of the figure that foreign exchange reserves are explicitly illustrated, they reduce external debts. Therefore it is possible that in 1993 the total amount of the net external debt of the government, companies and the private sector reached a little more than 10% of the GDP in the Czech Republic, but because of reserves of nearly 20%, the Czech Republic was in a demand position.
- ²⁴ Lack of savings contributed to the extremely high demand for external financing during the economic transition. For further analysis, see Csillag, I. (2009); Palócz, É. (2008).
- ²⁵ The analysis about the differences between the debt-fare and work-fare model were published first in the Financial Times by György Barcza: <http://blogs.ft.com/beyond-brics/2013/02/18/guest-post-in-defense-of-hungarys-economic-policy/>
- ²⁶ For more expensive description about the term of supercapitalism, see: Reich, R. B. (2008).
- ²⁷ OECD Taxing Wages.
- ²⁸ HCSO statistics on changes in real wages and salaries, 1992–2015.
- ²⁹ On challenges of the Hungarian education system in 2010 see György (2014) and OECD Education at a Glance statistics.
- ³⁰ Eurostat National Accounts statistics (2010-).
- ³¹ Own calculations based on HCSO data on household spendings distribution.
- ³² Eurostat Labour Market statistics. Population ages 15–64.
- ³³ World Bank Doing Business Statistics

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