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Notoriously repeated budget policy

Since the end of the communist regime it has been an obvious, what's more a normal phenomenon in Hungary that public finances are never balanced. The only surprise might be that the rate of the deficit is not outstandingly high compared to the other transition countries in Eastern Europe. In this brief paper I will attempt to outline:

❶ *why Hungary has been unable to reduce the rate of the deficit at least to the Central European average;*

❷ *what factors affect economic policy makers as a result of which the deficit – which is the consequence of their measures – becomes important for them only in case of external funding constraints;*

❸ *if the budget deficit that has so far been regarded normal can be reduced by means of laws, by establishing the so called rules based budget policy and its institutional systems.*

BUDGET DEFICIT: IS IT A NORMAL CONDITION FOR NEW DEMOCRACIES?

Since the end of the communist regime the balance of the central budget and – as a somewhat natural concomitant – the balance of general government has been negative. It has become customary to explain the fact that deficit became the natural condition right after the end of the communist regime, with transformation problems, such as the loss of revenue due to the liquidation of jobs and plants, (loss of tax-payers and tax revenues), and soaring tax evasions (more decentralised economy), as well as with the rapid growth in expenditures (costs of people squeezed out of the labour market). This explanation also made us cherish the benign assumption that after the period of transformation shock, the processes would converge towards the equilibrium, or at least the imbalance that was typical for the years of socialism, too, would no longer be accompanied by the current deficit of the general government. This assumption was based on the fact that the institutional system that dominated the period preceding the change of the social and economic regime lacked both the motive for sustainable and balanced growth, and the obstacle of the necessary force: the general public did not hamper the voluntarist economic policy. On one hand, the competing, multi-party system and parliamentary democracy prevent processes from being concealed, revealing the consequences of the unfavourable, balance deteriorating economic policy, on the other hand the alternative economic policies represented by the competing parties guide the budget towards the state of balance, and finally, the requirements of the legal state: the process of budget planning and execution that meets the require-

ment of transparency is a sufficient guarantee to avoid the deficit.

Five election cycles have passed since the change of the regime, wherefore being in possession of sufficient empirical experience we can state that the assumption about the beneficent impact of parliamentarism has not come true in Hungary. The parliamentary parties in power have made attempts to reduce the public finance deficit when in the absence of sufficient domestic savings they have encountered an external funding constraint that could not even be offset by non-debt generating capital influx: the high deficit of the balance of payments (which was not offset by capital influx), i.e. the unfavourable rating by foreign markets and funders.

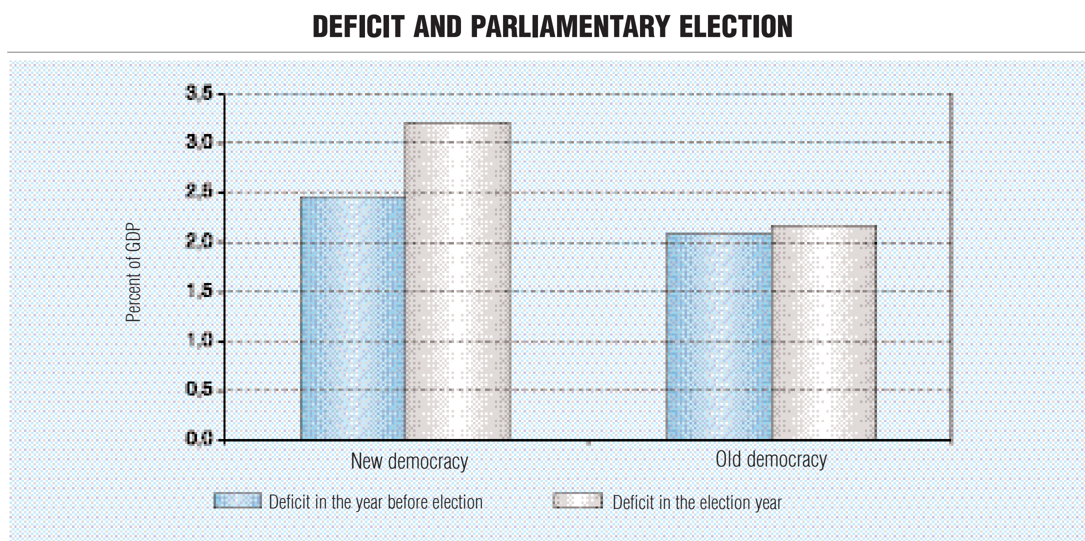
This Hungarian phenomenon that occurred after the end of the communist regime, was not at all different from the experiences of the other new democracies. What is more, it did not differ either from the experiences of the developed countries after the oil crisis, which could be regarded as the premonition of the globalising world economy. Since the appearance of the public choice school literature has taught us that in order to obtain and hold on to power, politicians make use of the fiscal illusion of "lay" electors[1]. Politicians capitalise on the fact that electors overestimate the current benefits of increasing governmental expenditures and tax reductions, while they underestimate the future costs of eliminating the budget deficit arising from the popular measures, the future growing tax burdens, and the rampant inflation. *Alesina* and *Perotti*[2] also described five known methods to systematically maintain the fiscal illusion. These methods range from the optimistic forecasts of macroeconomic processes through the assessment of the efficiency of adjustment measures, and off-budget expenditures reducing transparency, to the failure of making the necessary tax correction that keep pace with inflation, or to multi-year budgeting instead of annual budgeting.

Without the detailed presentation of the new developments of the Hungarian budget policy here, it is evident that during the hardly one and a half decade long history of parliamentary democracy Hungary has managed to apply all methods mentioned in Alesina's and Perotti's excellent work published in 1996. One of the explicit objectives is not to master the manipulation techniques of developed democracies, but to study the increased application thereof in Hungary throughout several government cycles. This work is greatly facilitated by the comparative studies recently performed by *Brander* and *Drazen*[3] (2005–2006), for their study issued in April 2006 contains especially interesting statements for Hungary. Already the title contains certain implications for us: How Do Budget Deficits and Economic Growth Affect Reelection Prospects?[4] The most important conclusion drawn from the election cycles of over 74 countries between 1960 and 2003 (347 campaigns) is that there is a striking difference between the economic policy characteristic for the new democracies (between the economic policy, especially the budget policy reactions characteristic for the first four election cycles following the transition to democratic parliamentarism) and the economic policy of established democracies (reactions throughout the entire period under survey, i.e. from 1960 through 2003, or over a longer period than the first four election cycles). As long as "…voters … in… established democracies do not like deficits, particularly in election-years" (page 20), what's more, "…deficits are punished in old democracies" (page 17), "...in the new democracies … we find no … effect of the fiscal balance on the probability of reelection." (page 18)

It is also interesting that although voters value better macroeconomic performance both in the new and old democracies, however, in the developed democracies the economic successes of the country are not regarded as the

Figure 1

DEFICIT AND PARLIAMENTARY ELECTION



outcome of better government performance, wherefore in those countries GDP growth has no effect on the probability of reelection. *(See Figure 1)* In less developed countries – not necessarily new democracies – however, balanced, good economic performance and high GDP growth rates have a significant effect on the probability of the government's reelection.

Unfortunately, their papers do not contain conclusions that are specifically valid for the transition countries of Central and Eastern Europe. Although the figures of Eastern European countries were also processed, due to the shortness of time series, which do not meet the criteria selected in the paper (at least four election cycles) the transitional European countries are not included as a separate group in the tables supporting the conclusions about the new democracies. For the lack of conclusions specifically valid for the transition countries of Central Europe I refer to the authors' findings only as the closest analogy, since I believe that their conclusions hold true for Hungary, too. There are two other conclusions that are especially edifying: according to them the probability of reelection is improved by the robustness of economic growth, while deficit – although this is primarily a neutral factor in the new democracies – lowers the probability of reelection if its inflation generating features are apparent.

In Hungary only one government has been reelected. In the year of reelection the public finance deficit was the highest since the political turnaround (over 10% of the GDP), and was relatively high even during the previous term of the Government (on average 6% of the GDP). However, it is a fact that the term of the previous Orbán-Torgyán administration was characterised by gradually decreasing economic growth. In the period between 1998 and 2002 one could also witness the highest growth rate achieved since the change of the political regime. (2001 Q1: 6.5% of the GDP). Since then, however voters could witness gradually and continuously deteriorating economic performance, for one decade after the transformation (1990–1992), the Orbán administration left diminishing economic growth (2.7%) to the election year (2002). The Government that took office in 2002 set out from this low level, and albeit with occasional halts it gradually reached a growth of around 4%, which seemed relatively steady. Inflation on the other hand, largely due to the tax cuts of 2006 that consequently led to the high deficit, dropped to the

lowest level in the election year (2006) since the change of the regime. If we rely on the conclusions of the above cited excellent paper about the election cycles we may see that Hungarian voters decided – being caught up in the fiscal illusions, and in full accordance with the international experiences, and also irrespective of the politological correlations not discussed here – to reelect the coalition in power since 2002.

No matter how "welcome" it is that Hungarian voters were caught by fiscal illusions in the same manner as those in new democracies (Brander – Drazen, 2006), this is not a sufficient explanation for the long-term budget deficit. From this point of view it is not enough to reiterate that the Hungarian political class extremely quickly mastered the manipulation techniques – discussed in the study by Alesina and Perotti – suitable to systematically generate fiscal illusions. Other factors also contributed to the formulation of the economic policy trend that causes the budget deficit.

HELD CAPTIVE BY "GOULASH COMMUNISM" AND THE "PREMATURE WELFARE STATE"

After the end of the communist regime, the Hungarian budget policy was unable to give up consumption maintained at an artificially high level by budget means dictated by "Goulash Communism" and the "premature welfare state" *(János Kornai)*[5] providing substantial subsidies. These two were accompanied by the prudent reform policy "tested" by *János Kádár* (chief secretary of the Communist Party), as well as the preservation and gradual modification of the characteristic framework conditions, which is also known as "gradualism". Without entering into a politological discussion, I would like to refer to the competition of the Hungarian election programmes, and the outcome of this competition. Since 1990, the tendency has persisted that the general public prefers the programme of that political party that announces gradual transformation while maintaining the consumers' consumption level and the welfare services, irrespective of the fact that it leads to severe public finance deficits or greater dependency on the state.

Analyses of the conditions of existing socialism show that as a result of the Hungarian revolution of 1956 consumption and state welfare services were at an incomparably higher level than in other socialist countries at a similar stage of development, and the maintenance of which occasionally ran into external funding constraints. The lack of transparency of public finances was astounding even in comparison with the secrecy of data pertaining to the assessment of the external balance. This explains that Hungary could become the classic country of twin deficit only in the 1990s, after the change of the regime, although all prerequisites had existed since the late 1960s. The substantial and still lingering effect of this period is that voters are unimaginably sensitive to the decline of their consumption level and to losing the conditions "protected" by the welfare systems.

This "basic voter's instinct" is strengthened by the established "stepping order", i.e. the gradualism of economic changes in Hungary. This prolonged action that pushes the break with the former typical behaviours to the future in an uncertain manner instead of implementing radical and drastic changes leads to the fact that the force of resistance to the necessary changes is similar as in the case of radical changes, but the force and intensity of the expected and perceptible outcomes are negligible. This can explain why they are relatively easy to revert, and why they lack efficiency. This can be illustrated with the fact that the major objective of the last Hungarian public finance reform, the pension reform, i.e. the

restoration of the balance of the pension fund has been characterised by an enormous deficit within less than a decade after the reform. One of the explicit objectives of the pension reform in 1997 was to create the harmony between the contributions (payments) and benefits, and potential benefits. The reform seemed to be very successful for a few years (until about 2000). However, the cushioning of the changes back then (e.g. the prolonged and gradual raise of the retirement age, the lack of prohibition of changing contributions and benefits without comprehensive, transparent and controlled calculations) and the lack of a rule that would prohibit political bias deteriorating the balance of the pension fund, could not restrain the munificent government. As a consequence, within less than a decade (according to the calculations of the National Bank of Hungary), the implicit debt of the pension system has by now become more than twice as big as the explicit state debt, i.e. the pension fund is in fact in a much worse condition now than it was before the reform.[6] In contrast with this, the radicality of reforms implemented in the neighbouring Slovakia is indicated by the fact that the standard, flat-rate tax system lacking all sorts of discounts, and the health insurance system based on the competition of health insurance funds were not changed by the socialists who came to power (despite their promises), since the effectiveness of these measures was tangible and convincing especially due to the radical nature of introduction and the sweeping effect of the coerced changes.

Table 1 clearly shows that there is some correlation between quick economic growth and the redistribution function of public finances. The greater the income redistributed by public finances, the lower the growth rate of the economy. Although the attached table presents the processes of a few years only, the presented five years make it possible not only to compare the different countries, but also to observe the consequences of the economic policies implemented within one country in different periods. We also know that between the millennium and 2005, the redistribution function of public finances grew not only in Hungary, but also in Poland and the Czech Republic, for instance. Public finance expenditures grew proportionately to the GDP, which increased the public finance deficit instead of accelerating economic growth. We were aware of the impacts of this well-known correlation, but have been unable to present them in such a plastic manner. (See the examples of Bulgaria, or Latvia on the other end of the spectrum.) The table also shows that Hungarian public finance expenditures were outstandingly high

Table 1

ECONOMIC GROWTH AND STATE REDISTRIBUTION

	GDP growth				Budget deficit as a percentage of the GDP				Budgetary expenditures as a percentage of the GDP				Primary deficit as a percentage of the GDP			
	2000	2004	2005	2006	2000	2004	2005	2006	2000	2004	2005	2006	2000	2004	2005	2006
Bulgaria	5.4	5.6	5.5	6	–0.5	1.9	3.1	3.3	n.a.	38	38.7	37.3	3.6	3.7	4.8	4.7
Estonia	10.8	8.1	10.5	10.9	–0.2	2.3	2.3	2.5	36.5	34.2	33.2	32.3	–0.3	2.5	2.5	2.7
Hungary	5.2	4.9	4.2	4	–3	–5.3	–6.5	–10.1	46.5	48.8	49.9	51.7	2.6	–1.1	–2.6	–6.1
Latvia	6.9	8.6	10.2	11	–2.8	–0.9	0.1	–1	37.3	35.8	36	39.5	–1.8	–0.2	0.7	–0.4
Lithuania	4.1	7.3	7.6	7.8	–3.2	–1.5	–0.5	–1	39.1	33.3	33.6	34	–0.8	–0.5	0.3	–0.2
Romania	2.1	8.4	4.1	7.2	–4.6	–1.3	–0.4	–1.4	40.6	38.3	38.2	38.8	–0.7	0	0.5	–0.4
Serbia-M.	5	7.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source : Eurostat

compared to the GDP, which sufficiently clearly indicates the typical high rate of state dependency in Hungary, the gist of the Hungarian phenomenon called "Goulash communism".

However, abstention from the radical changes aimed at the elimination of the public finance deficit does not explain the policy that led to the deficits. On the other hand, "Goulash communism", and the institutional system of the "premature welfare state" functioning within its frameworks, as well as the burdensome nature of this premature welfare state on the expenditure side of public finances, have an explanation that can be derived therefrom: tax evasion and the unimaginable depth of "free riding". It is a well-known fact that out of Hungary's 10 million citizens less than 4 million (4.9 million) citizens pay taxes, and from among them only 3.6 million people pay health insurance and pension contribution. It is worth adding that the number of employed people (those who work at least 2 hours per week according to statistical standards + registered job seekers) is less than 4 million. It is also a known fact that the number of employees registered as minimum wage earners is extremely high (1.6 million). Based on tax evasion and the high number of free riders, in terms of the budget policy to be followed I refer to the only conclusion that can be drawn from the statistics: only that political programme receives the majority of the votes that does not affect the ratios influencing the established attitude of the voters.

Attention to these ratios was drawn by János Kornai[7] in a study of his published in 1995. Kornai started to apply the model developed by *Assar Lindbeck*, the famous Swedish economist to the Hungarian society. In the 1970s, Assar Lindbeck started to study how the famous Swedish welfare state changed the basic structure of the Swedish society, to what extent wide layers of the Swedish society became dependent on state redistribution. Applying Lindbeck's model to Hungary, using the Hungarian statistical figures, Kornai found that in Hungary some social groups are even more dependent on state redistribution. By supplementing the figures of the table presented in

Table 2

NUMBER OF PARTICIPANTS IN THE MARKET AND NON-MARKET SECTORS IN HUNGARY AND SWEDEN

Activity	Number of participants (thousand)			
	Sweden		Hungary	
	1970	1989	1993	2004
1. Public administration and public services	806	1427	875	827
2. Pensioners	1135	1899	2647	3063
3. Unemployed	59	62	694	253
4. Participants of labour market programmes	69	144	54	129
5. People on sick leave	264	317	150	107
6. People on maternity leave	28	126	262	296
7. Total 1 through 6	**2361**	**3975**	**4682**	**4695**
8. Employees in the market sector	3106	3020	2842	3173
9. 7/8 (percent)	**0.76**	**1.32**	**1.65**	**1.479**

Source: Sweden, Assar Lindbeck (1990, page 23). Hungary, Rows 1 and 2: HCSO (1994b, pages 14 and 54); Rows 3 and 4: Research Institute of Labour (1994, page 45); Row 5: HCSO (1994b, page 54. 1994c, page 22); Rows 6 and 8: HCSO (1994b, page 54)

Cited by János Kornai: Paying the Bill for Goulash-Communism: Hungarian Development and Macro Stabilization in a Political-Economy Perspective, in Kornai: Struggle and Hope, in Hungarian by Közgazdasági és Jogi Könyvkiadó, 1996, Budapest

Kornai's study published in 1995–1996 with figures for 2004 I found that instead of fading away, dependency on state redistribution became a massive phenomenon in ten years.

This conclusion seems justified by the table prepared on the basis of the Kornai (Lindbeck) method. Especially this is why some people claim that the munificent economic policy in effect since the millennium has become the streamline policy of both large socialist parties following the populist economic policy, which in this sense strengthens redistribution, since the hidden understructure of the Hungarian society and economy got distorted to an unbelievable extent during the consolidation in the Kádár era and the subsequent decades. They argue that the ratio of people who receive their incomes not from the market, but primarily from state redistribution, is higher than in any other European country. The ratio of people living on market or non-market income reached extreme proportions by international comparison as early as in the 1970s. This ratio has got further distorted due to declining employment that appeared as a side effect of economic and social restructuring. After the collapse of the large state companies and market organisations (1990–1993) the proportions got further distorted, since at the end of the 1980s as much as 85% of the employees received their incomes from market organisations. This ratio has by today decreased by nearly 10%, to 78%. *Table 2* presenting the situation in Sweden and in Hungary gives a clear view about the differences.

In the early 1980s the ratio of people receiving labour or entrepreneurial income (market sector) to people with income from redistribution by the state was nearly 50 to 50%. According to research conducted by János Kornai[8], this ratio changed to 1 to 1.65% by 1993, to the benefit of people solely living on income from state redistribution. Slow consolidation improved this ratio to 1.47 by 2004.

Due to this extremely high ratio of people with non-market income the existence of "free lunch" has become natural, what's more, it is unimaginable that one should pay for "lunch" at all. The proportions also show that we must establish a very specific institutional background and restructuring schedule to set a clear direction for budgetary adjustment, so that the feature typical for democratic countries, i.e. austerity and solidarity with those really in need should manifest itself in the use of taxpayers' money.

The high ratio of people with non-market income has also led to the fact that not only market income, but also the natural expectations that we have got accustomed to in relation to services available on the market are lacking in relation to services and benefits funded from the budget, i.e. from public finances. "Don't look a gift horse in the mouth," claims the Hungarian saying. The fact that voters are interested in maintaining the current practice of state redistribution, and the low rate of tax and contribution payers explains not only the permanently high public finance deficit. The astounding depth and power of the free rider attitude also contributes to the preservation of the permanently high public finance deficit, as a result of which the utilisation of expenditures is inefficient, and the avoidance of cost-benefit type correlations and the value for money requirements become the dominant voter behaviour and an economic policy approach.

The extremely high ratio of people interested in sustaining state redistribution is one of the political economic explanations for why the Hungarian economic policy returned to the *stop-go* economic policy of the Kádár era after the millennium, why has the fiscal attitude leading to high budget deficits and high public debts become recurrent: a relapsing fiscal alcoholic[9], using the snappy expression coined by *George Kopits*.

COALITIONS FOR VOTE TRADING

The constitutional system of the Hungarian transition was shaped by the so called "legal state revolution" fought within the framework of the so called round table talks. The specific feature of this is the uniquely mixed election system, which most often forces the establishment of coalition governments due to the relative balance between the political forces. All five governments that have come to office since 1990, i.e. the change of the regime, have been coalition governments. It was possible only in one single case, in 1994 for the party that obtained the majority of the votes to form a government in the National Assembly by itself. Parties forming the coalition governments usually rely on the votes of different groups of voters, and promise the implementation of programmes prepared for the fulfilment of different voter demands.

Parties of a coalition government try to harmonise the election programme promises made for the different groups of voters on one hand, and confine them to the frameworks of funding resources available for implementation. This harmonisation is a rather complicated political task, and implies especially severe consequences for the economic policy to be followed if the coalition is made up of parties that usually prefer hanging around – in the figurative sense of the word – at the contribution and payment desks of the budget, respectively. The budget is threatened by the coalition of parties embodying so different voters' interests at each stage of governance, but such coalition is especially dangerous for the budget of the first and last year of governance. In the "opening year" the parties "send a message" to their voters with their initial measures and first budget proposals as per which of them can keep the promises made to the voters: which of them "can be better seen" behind the coalition shield. The budget is jeopardised to an equal if not greater extent in the last year of coalition governance, i.e. during preparation for the elections when the issue is again addressing each party's own voter base.

It is no wonder that in Hungary in all coalition governments except for the one in power between 1994 and 1998 the coalition parties fought tooth and nail to retain their voter base and buy uncertain voters with budget-burdening promises without bothering about the budget deficit, i.e. the consequence of the fulfilment of their promises. In Hungary there is no tradition of non-party affiliated, expert institutions helping voters by presenting the expected impacts of the election programmes on the budget. In the light of the promises made during the last three election campaigns (e.g. in 1998: 400% pay rise for physicians; in 2002: 800 km long new motorway, 13th month's pension; in 2006: reduction of the social security contribution by 10%, 14th month's pension, etc.) it would be very important to have such a tradition.

Based on the promises made for the purchase of voters, and then on the internal tensions of coalition governance it is becoming clear that it is very necessary to present the impacts of the promises on the budget in an independent, non-partisan and credible manner, using internationally accepted measurement and forecasting methods. When in 1998, upon the request of the prime minister then in office, the National Bank of Hungary prepared an analysis about the costs and possible impacts of the programme of the opposition party Fidesz on the budget, it made a mistake not by doing so, but by restricting such analysis to the programme of Fidesz, and by not extending it to all the other political parties. On the other hand, it made a mistake by not disclosing its opinion about the programmes of all political parties. The excellent research and analysis staff and the credibility of NBH could have laid the foundations for the practice that could have served the protection of the general public and

the budget. No wonder that in other countries of Europe such practice exists and such task is performed by authentic institutions in a non-partisan manner. As it is known, one of the important and acknowledged tasks of the Dutch planning and development institute established by *Tinbergen* is to form an opinion about the programmes of parties running in the coming elections. A decent party can run in the elections only if it subjects its programme to opinion-forming by this prestigious and credible institution. Based on the opinion of this institute voters may learn about the risks that threaten their wallets in case this or that party comes to power due to the necessary tax hikes or the expected inflationary consequences.

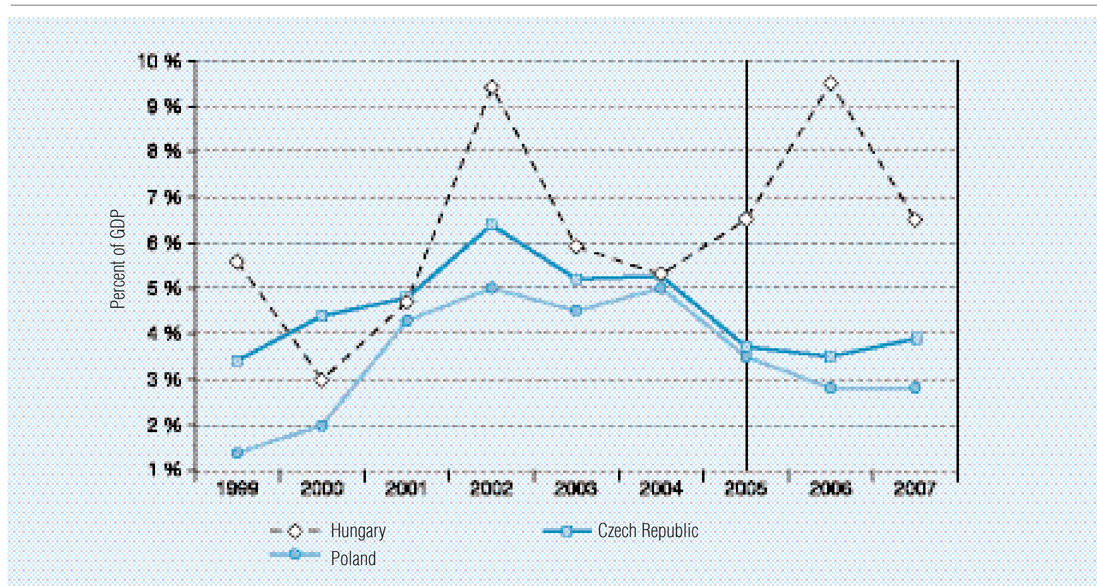
If there were such a non-partisan and authentic expert opinion institution in Hungary, the competition of promises – which undermined the budgetary position – could have been evaded in 2002. Perhaps this could have forestalled the full-scale implementation of those promises that concurrently undertook to radically increase welfare expenditures and public sector wages, significantly reduce taxes, realise robust community investments compared to the previous period, as well as to endure the consequences of Hungary's accession to the EU (payments made and loss of customs revenues). Each of these measures decreased budget revenues by 2% of the GDP (tax cuts – around 2%, loss of customs revenues due to accession to the EU, loss of excise duties and VAT after accession – around 1+1%). On the expenditure side 4 to 4.5% more money was spent on welfare services and wages, including: pay rise for public employees and civil servants – around 2 to 2.5%, 13th month pension – another 1%, increased social transfers – 0.6% , radical growth in interest subsidies on housing loans – around 0.5%. This situation is aggravated by the excess costs of accelerated motorway constructions – around 0.6 to 1%, and finally items that were formerly accounted as off-budget items (e.g. the one-off costs of the rescue schemes for the Hungarian Development Bank, motorway construction, the Hungarian Railways and the Budapest Transport Company), each 3 to 3.5% of the GDP. The interest hike that offset these items "deteriorating" the primary budget balance increased the deficit by at least 0.8 to 1.5% of the GDP, too. Even if we do not "admit" the one-off items of liabilities generated in the period between 1998 and 2002, the deficit grew by around 9% of the GDP due to the fulfilment of the promises, which was not compensated by the portion of the average economic growth of 3.5 to 4% channelled to public finances. This was especially due to the fact that the inherited deficit was also climbing towards 4% of the GDP.[10]

Especially due to the special dividedness of the Hungarian election system and voters (see the dependency rate mentioned in the previous chapter: i.e. market income recipients that are consequently interested in tax cuts versus people obtaining income from state redistribution that are interested in raising taxes) it would be necessary to force parties running in the elections to present the budgetary impacts of their programmes before the elections. Then this budget analysis could be inspected by independent, authentic and non party-affiliated institutions that should in turn make their opinion public.

I do not think that in the other transition countries of Eastern Europe (for example in Poland or the Czech Republic) independent institutions analysed the impact of party promises aimed at "stupefying" voters, or the implementation costs thereof on public finances. However, by comparing the public finance processes, especially the deficits, we can conclude that the above mentioned countries were more successful in getting rid of the tools used for stupefying the voters. As we can see from the processes that took place in these three countries, Hungary established a regular election

Figure 2

PUBLIC FINANCE DEFICIT IN A FEW COUNTRIES OF THE REGION



Source: National Bank of Hungary

As a % of the GDP. In the case of the Czech Republic and Poland the balance does not contain the impacts of privatisation.

cycle characterised by increasing public finance deficit, and – what is more severe – by the stabilisation of this deficit at a high level (at least at 6% of the GDP), and in the periods of elections even greater fluctuations can be observed. Between 2001 and 2003, Hungary's two competitors also experienced the impact of election promises and the expansion of subsidies on the deficit. Yet, Poland and the Czech Republic could reduce the deficit to an acceptable level by introducing a legal obligation voted both by the opposition and the government (Poland) and by introducing a sober, restrictive economic policy (Czech Republic). *(See Figure 2)*

From the comparison of the three countries we can see that while in the Czech Republic and Poland the public finance deficit could be reduced to the "normal level" after the initial year of the election cycle with a more disciplined line of economic policy actions, Hungary failed to do so in the period between 2000 and 2006. What is more, instead of the former deficit of 3 to 5% relative to the GDP, the "normal level" of public finance deficit prior to the election campaign became 6 to 8% of the GDP, which can only be cut back by withholding the entire aggregate demand even under the conditions of the international markets abundant in cash.

THE ART OF BREAKING THE MUNIFICENCE OF THE STATE

The emergence of high general government deficit is attributed to structural causes in Hungary. Among these causes I first of all reiterate the exceptionally high rate of state redistribution, which at the end of 2006 exceeded 50% of the GDP (52.1%).[11] This ratio is much higher than the average ratio of 40% measured in the transitional countries of Central Europe, and is also by far larger than the 44% achieved in 1999 after 5 years following the introduction of the so called Bokros package (which meant an improvement of nearly 14%).[12] The high rate of

redistribution is the consequence of the steadiness of the so called "dependency ratio", which indicates the high ratio of citizens living on state income as described by Kornai and Lindbeck. Without the radical modification of these structural causes any change introduced in budget preparation, planning and execution – i.e. in the institutional frameworks of the budget policy – is a necessary but not sufficient condition for the elimination of the high budget deficit.

The institutional frameworks of the budget policy could yield long-standing results only in those countries (Sweden, Finland and Chile) where the institutional changes (laying down the objectives in the form of legal standards = rules-based budgets, tightening of the rules for planning, execution, modification and reporting procedures, reinforcement of the transparency requirements, reinforcement of the economic foundation of planning by means of independent, competing expert assessments, etc.) were combined with permanently implemented, balance maintaining economic policy objectives. The well-foundedness and consistency of macroeconomic assumptions, the logical order and unbreakability of the procedural rules, the specification of and adherence to new rules in relation to the continuous transparency of the entire budget process[13] – which yielded measurable results in several countries of Latin America – are exemplary for Hungary, too.

The requirements of institutional changes must be laid down in the new act on transparent public finance responsibility and the frameworks of public finance management between 2006 and 2015, which may contain requirements for:

- the rate of the positive primary budget balance to be enforced in the next 10 years (at least 2% of the GDP), without the well-foundedness of which the budget cannot be submitted to the National Assembly;
- the obligation according to which surpluses (savings) realised in the case of higher than planned budget revenues, or lower than planned budget expenditures can exclusively be used for reducing the deficit and improving the balance;
- state redistribution and public debts should be reduced below 40% and 50% of the GDP, respectively. This shift in proportions shall be achieved within the timeframe (deadlines) specified by the law, at least at an even pace of reduction, except for the periods of boom;
- the upper, GDP proportionate limit of primary budget expenditures, which shall be reduced by at least 1% each year;
- restoring the self-funding ability of certain public finance subsystems (central budget, social security funds, separated state funds, local governments);
- the chapter balance reserve formation in the amount of at least 1% of the GDP until the requirement pertaining to state redistribution (40% of the GDP) and public debts (50% of the GDP) is met;
- the quantification of the budgetary effects of the programmes of the parties running in the elections, and the control of such effects by non-party affiliated expert institutions (e.g. State Audit Office, National Bank of Hungary)
- in the case of macroeconomic assumptions serving as the basis for the budgets of next years (at least three years), the need for comparing the assumptions of at least three research institutes;
- opinion forming on the processes assumed in the submitted draft budget from the economic prospective by the Budgetary Expert Council working under the State Audit Office;
- the tightening of the modification of approved budgets, including the requirement for the submission of a supplementary budget in case the modification exceeds 2% of the gross sum of the budget[14];

- meeting the requirement pertaining to the full publicity and continuous availability of information on budget planning and execution processes in line with the standard international statistical rules;
- economically expanding the room for manoeuvring for the individual budget chapters within the budget (responsibility), but in case of deviation from the plan, the obligation of increased balance reserve formation shall be met (100%, i.e. a balance reserve equalling at least 2% of the GDP shall be formed in case of significant /5 to 10%/ deviations from the plan).

Apart from the modification of the above institutional frameworks, restoration of the public finance balance also requires adjustment measures (increasing revenues and reducing expenditures within the frameworks of the convergence programme), and reforms that compel a change in attitude. The impact of structural causes wear off, a radical change in "deficit production" occurs when direct interest in this, i.e. dependence on state redistribution subsides.

If the hands of the political class were tied by the rules specified in the acts, and therefore the reduction of the deficit, state redistribution and the high public debts would be a long-standing political obligation of the successive governments and their oppositions, the probability of the implementation of structural adjustment would increase by several orders of magnitude.[15] Obviously, these restructuring requirements removed from the political competition by force of law can be further reinforced with other legal technical tools (e.g. by inclusion among acts to be passed with a two-third majority). Actually, this may even be necessary based on the Polish examples. I would be content if the current government coalition decided on such a modification, because I find it too "risky" that the opposition would set the loosening of budgetary discipline as an attractive objective in the election battle. And if the representation of masses interested in deepening the state redistribution is not possible while maintaining the budget deficit and preserving the redistribution rate in the legal and legitimate form, this may somewhat ease the pressure on the political class, which may gradually lead to the fact that the incessant reforms modify the dependency ratio, and hence the main indicators of the macroeconomic structure.

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