Europe-Asia Studies ›
Volume 58, 2006 - Issue 2

Original Articles

Governance in a low-trust environment: The difficulties of fiscal adjustment in Hungary

Dóra Győrffy

Pages 239-259 | Published online: 16 Aug 2006

Cite this article https://doi.org/10.1080/09668130500481410

Abstract

The favourable assessments of international organisations regarding the character of democracy in the Central European countries seem to suggest that, in spite of early fears, democracy can be established even in a low-trust environment. Through analysing the difficulties of fiscal adjustments in Hungary this article examines how lack of trust affects the quality of these democracies in terms of effective governance. Hungary used to be a front-runner in the transition process but given its ballooning budget deficit, it is now considered a laggard in terms of meeting the requirements for introducing the euro. This article claims that while strong continuities from the socialist period gave the country a head start at the beginning of the transition process, the same continuities have slowed down development more recently because of their effects on the general level of trust. The prevalence of distrust both towards and within the elite provides a fertile environment for economic populism and under such circumstances fiscal adjustment becomes more difficult. The main conclusion is that

while the low level of trust did not prove decisive in terms of establishing the institutions of democracy, the existence of trust is critical for effective governance.

Notes

[1]For an extensive description of the economic reforms during the communist period see Berend (1990).

[2]This section substantially relies on Istvánffy (1992, pp. 997–1000).

[3]The decision to finance the debt instead of defaulting on it gave rise to significant policy debates, which continue up until today. In 1990 there was some hope that a new Marshall Plan would be forthcoming for the transformation countries, but this proved illusory. Later hopes for cancelling debts were also disappointed, not least because, unlike in the case of Poland, the main share of Hungarian debts were commercial credits rather than governmental loans, which could have been cancelled (see Oblath, 1993, pp. 206–209).

[4]See Appendix for the results of parliamentary elections since the transition.

[5]This list implies that public finance reform does not equate with balancing the budget, and structural reforms might have precisely the opposite effect in the short term (see Csaba, 1995b).

[6]Kornai (1994) provides five reasons for such transformational recession: (1) a shift from a sellers' to a buyers' market; (2) the transformation of the real structure of the economy; (3) disturbances in coordination mechanisms; (4) the macroeconomic consequences of hardening the budget constraint; and (5) the backwardness of the financial system.

[7]The major feature of the new law was that it provided an automatic trigger of bankruptcy by obliging any debtor in default for more than 90 days to initiate bankruptcy procedures. This was compulsory even when the outstanding debt was small or when the debtors' receivables exceeded debts (see OECD, 1993, pp. 82–83). Because of the toughness of the law it was called the ‘hara-kiri’ law (Várhegyi, 2002, p. 34).

[8]The strains on the budget were due not only to the costs of restructuring but also to the impossibility of continuing the earlier governmental policy of raising revenue from the heavy taxation of financial intermediation (Surányi & Vincze, 1998, p. 154). On the details of the consolidation programme see Szapáry (2002, pp. 107–112) and Várhegyi (2002, pp. 34–36).

[9]Prior to 1991 the NBH borrowed abroad in its own name and lent the money to the budget, charging only the foreign interest rate. However, since inflation was much higher in Hungary the NBH suffered large losses resulting from the devaluation of the forint, which were settled by non-maturing non-interest bearing loans to the government (see Barabás et al., 1998, pp. 67–68).

[10]These measures indicate that although there was no formal policy of macroeconomic shock therapy in Hungary a process of microeconomic shock therapy did take place, which means that Hungary can hardly be seen as a model of gradualism (see Csaba, 1995a, pp. 192–194).

[11]Interview with Iván Szabó, finance minister between 1993 and 1994 (see also Rádai, 2001, p. 96; Matolcsy, 1998, pp. 32–33).

[12]The rate of interest decreased from over 30% in 1995 to less than 20% by 1997 while the maturity structure was prolonged (László, 2001, p. 856).

[13]This section relies heavily on Kiss (1998) and László (2001).

[14]An element of this reform was the debt swap between the government and the NBH, which made explicit the state debt that had been hidden in the accounts of the NBH. This arrangement did not affect the total deficit of the government's consolidated general budget since the interest balance deteriorated but the profits of the NBH increased (see OECD, 1997, pp. 32–33).

[15]On the details of the Treasury arrangement see Thuma et al. (1998, pp. 383–384). The system also allowed for ex-post financing, which resulted in substantial savings as previously the outflow of yearly allocations to public sector institutions allowed for considerable interest revenues from commercial banks while the government was charged a high rate of interest for its loans, often from the same banks.

[16]In 1995 the longest maturity for treasury bonds was one year, which increased to five years in 1997 and ten years in 2001 (László, 2001, pp. 856–857).

[17]The first pillar is the traditional pay-as-you-go system, which provides a minimum level of pension. The second pillar is a mandatory private pension fund while the third pillar is a voluntary pension fund.

[18]This description of the speculative attacks is based on UN ECE (2004, pp. 51–52).

[19]In early 2005 public sector wages started to rise again: during the first three months of the year public sector wages were 27% higher than during the same period in 2004.

[20]In Hungary the payment of a ‘13th month’ wage is part of the compensation package for public sector workers. Turning it into ‘0 month’ wage was an attempt by the government for a one-time saving. Later the Constitutional Court found this move unconstitutional and required the government to pay the withheld benefits.

[21]According to the estimations of Kiss et al. (2005) a cut of about 4.5% in primary expenditures is necessary to improve the fiscal balance in line with the objectives of the convergence programme.

[22]Union density is only 20%, which stands in sharp contrast with the EU-15 (except for Britain), where over 60% of the labour force is a member of a trade union. Collective agreements cover only 34% of the work force, compared with over 60% in the old member states (except for Britain) (see Carley, 2002). Furthermore trade and business unions are consistently the least trusted institutions in Hungary. On the declining level of trust in unions during the 1990s see Hann & Karácsony (2001, p. 789).

[23]For a discussion of the foreseeable consequences of routine macroeconomic decisions, see László Antal (2004a).

[24]Consumption reached its pre-1989 level only by 2001.

[25]According to a survey on political cynicism the proportion of those who agree with the statement that ‘one can never trust politicians completely’ grew from 64% in 1989 to 83% by 1992. Similarly, over 80% of the respondents agreed with the statement that ‘ordinary people are always excluded from politics’ (see Körösényi, 1999, p. 15).

[26]See Hann & Karácsony (2001, p. 789).

[27]In more technical terms this means that no property rights are attached to institutional reform (see Hagen, 2002).

[28]The ‘honeymoon’ period lasted until March 2003 when the Socialist government had a lead over the FIDESZ opposition of over 20% in the opinion polls. However, within four months this lead had disappeared and the opposition overtook the government in public opinion (Hann & Karácsony, 2004, p. 704).

[29]On the social pact in Northern Ireland see Boltho (2000).

[30]For a discussion in terms of ‘Kulturkampf ’ see Lengyel (2004, pp. 141–151). On the origins and description of the socio-cultural divide see also Bozóki (2003, pp. 521–530).

[31]Looking back, the leader of the SZDSZ, János Kis, acknowledges that this was a mistake [see interview with János Kis in Beszélő (Révész & Mink, 2004, pp. 5–15 at p. 15)].

[32]For exact data on the turnover of personnel see Fricz (2004, pp. 125–129).

[33]This was originally theorised by Buchanan & Wagner (1977).

[34]Even György Matolcsy (1997, p. 784) claims that by early 1995 a confidence crisis had emerged, which needed some intervention. His main argument against the package was that if the government had devalued the currency and introduced a new exchange rate regime earlier, fiscal adjustment would not have been needed.

[35]Some Hungarian economists advocated debt relief before society was broken by the restrictive measures. See ‘Ne várjuk meg a társadalom összeroppanását’, Magyar Nemzet, 6 April 1995. For a survey on the contemporary reaction by economists see Antal (1998).

[36]Rabár (1996, p. 257) talks about a hypnosis situation, when people were made to suffer so much that they immediately believed that their little sacrifices would save the economy.

[37]This kind of disregard for the opinion of the public or his own party was also unique to Bokros—his predecessor, László Békesi, admitted in an interview that he would have been unable to do the same (Rádai, 2001, p. 144). In contrast, Bokros persisted even when he was the least popular public figure in the country.
