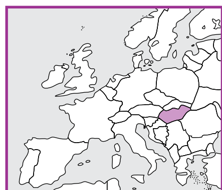
Neoliberal's best student is the weakest link in the crisis



Despite the fact that it was the first country in Eastern Europe to adopt International Monetary Fund prescriptions in 1982 and that it was more highly developed than its neighbours when it embraced a market economy, Hungary is now the weakest economy in the region. The reasons for this are manifold and have led the country to waver between potential social upheaval – if a change of direction is not made – and the total collapse of a very vulnerable economy. The phantom of right-wing extremism lurks in the background, fed by popular discontent.

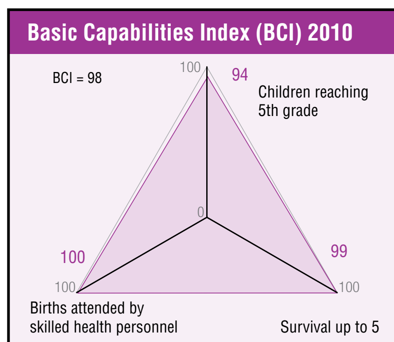
ATTAC HUNGARY
Matyas Benyik

Hungary has a unicameral parliamentary system dominated by two parties – the Hungarian Socialist Party and the right-wing Hungarian Civic Union. Democratic institutions seem robust and likely to remain so, despite reckless party politics, intolerant rhetoric, high-profile corruption, and radicalization of the political Right aimed at the minority Roma population. The political elite is engaged in slandering itself and ready to launch more reforms according to the International Monetary Fund (IMF) dictates, but the people strongly resist, as shown by protests following the recent health care reform.[1]

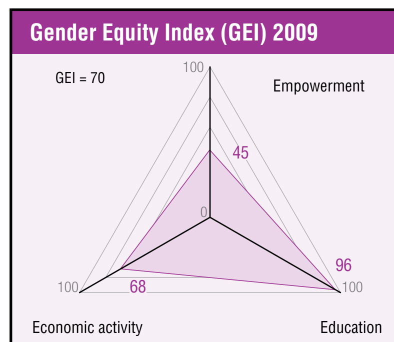
There was little novelty in the intervention of the IMF in 2008. However, what is different from other crises is the response of the international financial institutions (IFIs), which supported stabilization against the unprecedented hysteria of transnational private finance. As Hungarian economist and European Bank for Reconstruction and Development former board member László Andor[2] points out, "an explicit objective of the intervention undertaken by the IFIs is to prevent the escalation of the social crisis, to protect the business structures of the Hungarian economy, including the significant role that some Hungarian corporations have acquired in the wider region."[3]

In mid-October 2008 a EUR 20 billion credit package was announced, based largely on orthodox stabilization prescriptions. Apart from helping Hungary, the package was a message for the region as a whole. Although Hungary has been probably the only country that went for such pro-cyclical tightening in this period, the IMF originally demanded further deficit reduction (in October 2008). In April 2009, when the new Government assumed power, the IMF and the EU agreed to lift the deficit target for 2009 from 2.9% to 3.9% of GDP – and to 3.8% for 2010.[4]

Basic Capabilities Index (BCI) 2010



Gender Equity Index (GEI) 2009



The best student

While most of the former socialist countries joined the IMF and the World Bank after 1989, Hungary did so in 1982, enabling it to push forward some market reforms that its neighbours had not yet adopted. This allowed Hungary to become Eastern Europe's model student of neoliberalism. However, this did not help the country to get out of its massive foreign debt. The country joined the "new system" with the highest per capita foreign debt but, unlike Poland, the Government decided to refrain from any potential debt reduction schemes.

Although Hungary was the most developed of the new EU member states, it remained the most financially vulnerable. In the early transition period, the debt-to-GDP ratio did not decrease but increased in the early transition period, and the "Maastricht debt ratio" was only reduced (to about 51%) thanks to a period of extraordinary foreign direct investment in the late 1990s.[5]

Andor affirms that "there are further reasons why Hungary has turned out to be the region's weakest link in the current international financial crisis." Since GDP caught up with the 1989 level only in 1999, he points out, successive governments turned to risky financial solutions to improve the feel-good factor. One government unleashed reckless subsidy schemes for home builders and buyers; another increased by 50% the public sector wages. Meanwhile, an ambitious road construction program equipped Hungary with the best highway network in the region, but at the price of skyrocketing state debt.[6]

Apart from fiscal policy, monetary policy also played its role, and contributed to the economy's fatal fragility. The inflation targeting paradigm – which was never intended for small, open economies, dependent on flows of foreign trade, investment and finance – was adopted by Hungary's Central Bank, the Magyar Nemzeti Bank (MNB) in 2001. The MNB did not abandon this orthodoxy even when central banks around the world had repeatedly reduced interest rates in an attempt to avoid recession in the spring of 2008. Only in July 2009, the MNB started to lower interest rates. In January 2010, the inflation rate increased – from 4.2% in 2009 to 6.4%.[7]

Similarly, nothing happened to reduce the amount of foreign exchange-based domestic lending, despite the fact that excessive currency substitution was identified by international observers as a source of financial instability, contributing to the unsustainable strength of the forint. According to Andor, Hungary has been the country in the region hardest hit by debt since the second half of the 1970s. This is why it has fallen prey to the two great financial crises of the past 30 years. And also the reason why it became a target of panicky speculation and capital withdrawal again in early October 2008, even though the budget rigour imposed since June

1 This report was prepared in February 2010. In the parliamentary elections held in April the ruling Socialists were defeated, the far-right Jobbik party gained strength and the Hungarian Civic Union (Fidesz) reached a landslide victory. The new government has promised a lot of changes, but once in power it has been following the neoliberal agenda and dictates of the IMF and EU.

2 In February 2010 Laszlo Andor became the new EU Commissioner responsible for Employment, Social Affairs and Inclusion.

3 László Andor, "Hungary in the Financial Crisis: A (Basket) Case Study," *Debatte: Journal of Contemporary Central and Eastern Europe* 17, no. 3 (2009). Available from: <www.informaworld.com/smpp/content~content=a917910016?bios=true&db=all#b917910016>.

4 *Ibid.*

5 The Maastricht debt is that determined for the excessive deficit procedure. Its ratio to GDP is one of the criteria by which to evaluate public finance in EU Member States. See: L. Andor, "Hungary's boomerang effect," *The Guardian*, 29 October 2008. Available from: <www.guardian.co.uk/commentisfree/2008/oct/29/creditcrunch-eu>.

6 *Ibid.*

7 *Ibid.*

2006 had considerably improved the fiscal balance (from about 10% to close to 3% of GDP).[8] Andor states that "the austerity measures of the 2006-2008 period, which imposed massive sacrifices socially and in terms of forfeited growth, were insufficient to mitigate the mistakes of the previous five years, nor did they improve the overall picture, since the level of debt (as compared to GDP) did not decline even during the time the austerity measures were imposed."[9]

Challenges

The financial crisis constitutes a complex challenge for Hungarian economic policy and politics in general. The Government now faces some important challenges, to resolve which it must:

- In the short run, mitigate the fall of the economy and ensure the expansion of liquidity.
- In the medium term, create a framework for more dynamic economic growth.
- In the long term, achieve some kind of consensus about how the Hungarian financial system could be made less extroverted in order to reduce the vulnerability of the economy and the probability of similar crises in the future.

As Andor concludes, "Eurozone convergence will probably lie at the heart of this program, although the Irish and the Greek example illustrate that having the Euro alone does not save a country from financial turmoil if fundamental imbalances are not eliminated."[10]

According to the Hungarian Central Statistical Office, in 2009 the number of unemployed people was 28% higher than in 2008. The unemployment rate went up from 7.9% to 10.1% over a year. The net loss of 98,000 jobs involves various costs for the Government – such as less revenue, social welfare expenditures, early pensions and unemployment benefits. But there is also an additional cost to society in terms of health care, vandalism and petty crime.

In this context, some of the Government's austerity measures – which will affect most of the key social programs – will almost certainly make the employment situation worse. To give only one example: budget cuts to support programs to incorporate mentally and psychologically disabled persons into the labour market will make training such persons enormously difficult and will, therefore, limit their chances of finding work.

Public services and corruption

The situation is no different for three of the main public transport companies, namely, the Budapest Transport Company, the State Railroad and Hungarian Airlines. To their condition of near bankruptcy and the impossibility of operating without receiving external funding is added, in the case of the last two, appalling mismanagement and extremely corrupt administrations. Cutting financial aid could be disastrous.

At a local level, the municipalities are undergoing a similar situation. Some of them have already declared insolvency, others have been forced to go into debt in order to provide basic services and yet others have begun to fail to discharge these services due to lack of funds.

In addition, despite continuous parliamentary efforts to provide the country with a legal framework which would make it possible to fight corruption at the highest levels according to international standards, things have changed little in this regard.[11] There has been no significant progress in the investigation of old scandals and new cases come up regularly. In Hungary, the scourge of corruption is far more widespread than in any of the other EU countries.

The economy

The main problem currently affecting the economy is its overdependence on imports. Not only have no measures been taken to change this situation, but it has been enabled and reinforced by the unusual and unjustified strength of the forint, the laxness of taxation and the existence of import incentives, all of which conspires against the competitiveness of national production.

A further complex and unfathomable matter which the country has been unable to overcome and which makes the task of rising above the economic crisis little less than impossible, involves soaring interest rates. In this, the IMF plays a pivotal role. Every time the Government attempts to lower the interest rates, the forint rapidly begins to weaken to alarming levels, which forces the MNB to raise interest rates once again. Thus, the Hungarian economy has operated as a large reserve fund for foreign investors seeking guaranteed high returns, something which no longer happens in their own countries.

One way in which the Government can prevent monetary speculation and the excessive increase of interest rates is to establish some form of control over the inflow and outflow of foreign capital. However, the IMF, which the country was forced to resort to in order to overcome bankruptcy, has traditionally prohibited such measures as restrictions on economic freedom.[12] The threat of a sudden currency devaluation – which would have a disastrous effect on savings and on property values, and which would increase poverty dramatically – has backed the country into a dead-end road.

Stable consumer prices, which are essential for any economy to function efficiently, are non-existent in Hungary. Most worrying is the increase in the price of electricity and natural gas, which, added to the drop in income, has led many families to stop paying for these services – despite the credit facilities offered by the utility companies in an attempt to maintain supply.

The risks of discontent

Two of the most visible consequences of this state of affairs are the huge unpopularity of the present socialist government and the rapid growth of anti-multinational feeling among the population.[13] With pressure on the increase in every sector of society, a social outbreak would appear to be imminent. This, however, does not imply that the population will set in motion a sudden mobilization which would require the Government to abandon IMF directives or that economic stimulus reforms will be introduced (examples abound of countries which have imposed IMF directives despite protests and even popular uprisings).

Among Hungarians, economic insecurity has led to both apathy on the one hand, and extremism on the other, as manifested, for example, by the growth of Jobbik, an ultra right-wing party. The most extreme cases of emerging right-wing groups and a strong trend towards historical revisionism which looks back with nostalgia on the days of the fascist movements and their symbols are to be found in Hungary at present.

Intolerance of minority groups and the radical tendencies of the right have intensified since 2006. There have been assaults against the Roma, including the death of six persons and several armed attacks. The Hungarian Guard – an openly xenophobic, anti-Semitic and anti-Roma movement, with close links to the Jobbik – continues to recruit members and strengthen its self-defence system against what they call "gypsy criminality," despite having been dissolved and prohibited by the Metropolitan Court of Budapest in 2008. ■

8 Andor, "Hungary in the Financial Crisis: A (Basket) Case Study," *op. cit.*

9 *Ibid.*

10 *Ibid.*

11 One of the most notorious cases involved a director of the MNB and the present Prime Minister, Gordon Bajnai, who transferred a large portion of their fortunes to offshore accounts.

12 Recently the IMF has acknowledged the advantage of some capital controls, although this may not benefit Hungary.

13 The notion that not everything should be in private hands was made very clear in the southern town of Pecs, where the municipality took control of the waterworks, closing the way to the French company Suez.