

BTI 2008 | Hungary Country Report

Status Index	1-10	9.18	# 5 of 125	
Democracy	1-10	9.35	# 7 of 125	➔
Market Economy	1-10	9.00	# 7 of 125	➔
Management Index	1-10	6.70	# 17 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	10.1	HDI	0.87	GDP p.c.	\$	15,913
Pop. growth ¹	% p.a.	-0.2	HDI rank of 177	35	Gini Index		26.9
Life expectancy	years	73	UN Education Index	0.95	Poverty ³	%	<2
Urban population	%	66.3	Gender equality ²	0.56	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

In the period between 2005 and early 2007, Hungary experienced national and local elections, a mobilization of protest against the socialist-liberal government that escalated into unprecedented violence and the initiation of comprehensive, far-reaching policy reforms aimed to restore the fiscal balance and improve economic competitiveness. The parliamentary elections, held on 9 and 23 April 2006, confirmed the incumbent governing coalition of the Hungarian Socialist Party (MSZP) and its junior partner, the Alliance of Free Democrats (SZDSZ) for the first time since the democratic transition. In contrast, the dominant opposition party on the national level, the Alliance of Young Democrats – Hungarian Civic Alliance (FIDESZ-MPSZ, hereafter: FIDESZ) won the local elections on 1 October 2006. Refusing to accept the socialist-liberal victory in the 2006 parliamentary elections, FIDESZ tried to oust the government of Prime Minister Ferenc Gyurcsány by mobilizing a protest movement. The aggressive and populist campaign of FIDESZ leader Viktor Orbán encouraged right-wing extremists and hooligans to inflame violent protests against the government in Budapest. The prime minister's confession of having lied to his voters prior to the national elections provided Orbán with a ready justification. Anti-government demonstrations and violent clashes continued during the 50th anniversary of the Hungarian revolution of 1956. Despite this wave of protests, the governing parties maintained their support of the prime minister, his government and the government's reform program. Substantial increases in government spending had caused large fiscal and current account deficits and a steady growth of public and external debt. These imbalances in 2006 prompted the Gyurcsány government to initiate a mix of tax increases, expenditure cuts and structural reforms in public administration, the education and the health system. The public administration reforms include a 20% reduction of central government employment, a centralization of planning, infrastructure and service functions within government, and a shift from county to

regional-level government. The education reforms aim at improving the productivity and efficiency of schools, universities and research institutions. The health system reforms seek to increase the cost-efficiency of health care providers (hospitals, doctors, pharmacies) and to widen the inclusiveness of health insurance contributions. A successful implementation and sustainability of these reforms depend on the political leadership's ability to build a basic consensus over their aims and desirability. The current degree of political polarization in Hungary however limits the scope for such a consensus is.

History and Characteristics of Transformation

Unlike its neighbors, Hungary “liberalized” its system of single-party socialist rule relatively early, after a period of Stalinist totalitarianism that followed the 1956 uprising. As early as the late 1960s, a more consumer-based communist economic system began to emerge under the leadership of the Kádár regime. Not all spheres of social life were politicized and private, economic and social life was partially liberalized. However, the policy that legitimized communist rule – raising the standard of living – as well as the dual dependence on Western goods and politically regulated trade relations within the state socialist world generated an unsustainable external debt. Reformed communist elites initiated the democratic transition. Against the backdrop of political change in Moscow and the desolate economic situation at home, these forces were prepared to allow at least a limited degree of liberalization and pluralization in the political arena. János Kádár, who had been the leader of the Communist Party since 1956, was ousted in the spring of 1988 and replaced by communist reformers Károly Grósz and Miklós Németh. Accelerated political and economic reforms strengthened opposition to the regime and ultimately led to the abandonment of the single-party system. In 1989, round table discussions were established following the Polish example. These discussions were intended to fundamentally change the political system and the constitution. However, given the prevailing circumstances in Hungary—a demobilized and apolitical society—the talks remained exclusive and resulted in a compromise negotiated by the elites. The compromise consisted of an agreement to hold free elections in 1990 and to initiate the necessary constitutional amendments. Center-right political groups that had emerged from the opposition won the first democratic elections. In the years that followed, Hungary was able to establish a stable democratic political system characterized by four alternating governments of either center-right or socialist-liberal coalitions that were largely sustained over their full terms of office. Reforms were implemented in all areas of public policy and society necessary to achieve democracy: public administration, judicial system, media, non-governmental sector, education and social affairs. The democratically elected governments of the 1990s privatized state-owned companies, liberalized markets,

attracted foreign direct investment and restructured the economy, which is now dominated by private and internationally competitive companies. Hungary re-formed its industrial relations and institutionalized a close cooperation between economic interest associations and government. Political and economic reforms spurred economic growth, which increased significantly from 1996 onward. Hungary's governments successfully reduced the tensions with neighboring countries, which had become home to sizeable ethnic Hungarian minorities after the First World War. Good neighborly relations developed that are affected by occasional conflicts, but provide institutions and norms enabling the civilized resolution of disputes. The European Union acknowledged the success of the democratic and economic transformation and decided to grant full membership to Hungary in 2004. Intensive preparations had preceded this accession, in the course of which Hungary implemented the full body of EU legislation and became deeply integrated into the European Union's internal market.

Transformation Status

I. Democracy

1 | Stateness

There is no competition with the state's monopoly on the use of force throughout the entire territory.

Monopoly on the use of force

All citizens have the same civic rights, and the constitution is fundamentally acknowledged by Hungary's citizens. Hungary has an active policy for protecting national minorities within the country and seeks to support ethnic Hungarian minorities in neighboring countries.

State identity

The state is defined as a secular order. Religious dogmas have no noteworthy influence on politics or the law. The state provides financial support and tax breaks to large or traditional religions, such as the Roman Catholic Church. Some church leaders have expressed their support for FIDESZ in the 2006 electoral campaigns.

No interference of religious dogmas

The state has a differentiated administrative structure throughout the country, making it possible to extract and allocate state resources on a broad basis.

Basic administration

2 | Political Participation

There are no constraints on free and fair elections, which are organized on the national, regional and local level. Parliamentary elections are organized according to a mixed majoritarian-proportional system. The parliamentary elections held on 9 and 23 April 2006 confirmed the incumbent governing coalition of MSZP and SZDSZ for the first time since the democratic transition. Electoral turnout was 68% in the first round and 64% in the second round. On 1 October 2006, municipal and regional elections took place, generating opposition majorities in nearly all county assemblies and in 48% of the larger municipalities (counting more than 10000 inhabitants).

Free and fair elections

The socialist-led governments prior to and after the 2006 elections —both headed by Ferenc Gyurcsány—enjoyed full authority during their terms without challenge from anti-democratic veto powers (e.g., economic actors, the security apparatus or the military).

Effective power to govern

The freedom of association and assembly is unrestricted within the basic democratic order. Following the violent clashes around the 50th anniversary of the Hungarian revolution in October 2006, the Budapest police authority prohibited demonstrations on the Kossuth place in front of the parliament building. FIDESZ protested against this restriction of the right of assembly and the President of the Republic, László Sólyom, criticized that the existing legal regulation of demonstrations did not authorize the ban.

Association / assembly rights

There are unrestricted freedoms of opinion and the press framed by the basic democratic order. Numerous electronic and print media outlets embedded in a pluralist ownership structure ensure pluralism of opinion. Factual information, analysis and commentary are not clearly separated in many news reports. Newspapers and journals reflect Hungary's polarized political climate, but the professional quality of journalism is adequate. In 2005, a new law was adopted on the freedom of electronic information, which obliges bodies providing public services to disclose data of public interest via the Internet. Libel and the disclosure of state or security service secrets are considered criminal offenses, and there have been numerous libel and state secrecy lawsuits. The Organization for Security and Cooperation in Europe representative on freedom of the media intervened with the Hungarian authorities to request that charges be dropped against journalists accused of the deliberate breach of a state secret.

Freedom of expression

3 | Rule of Law

There is a well-established system of mutual checks and balances in Hungary. Although the socialist-led governments have upheld this system, they, like the preceding FIDESZ-led coalition, have continued to increase and centralize the power within the executive branch. In 2006, the prime minister was entitled to appoint or select all leading government officials and to approve the internal procedural rules of all ministries. The functions of line ministries were reduced to administration and policy implementation. These recent changes have reinforced the trend from a cabinet model towards a prime ministerial model of government. Incumbent governments since 1998 have increasingly disciplined their deputies' voting behavior and controlled legislative output, weakening the role of parliamentary scrutiny. The Constitutional Court and, to a certain extent, the president of the republic review executive decisions and bills. The Constitutional Court is entitled to examine the constitutionality of bills prior to their enactment. In 2005/06 the Court's preventive review found six bills unconstitutional and

Separation of powers

President Sólyom sent three bills to the Court for a preventive review. Sólyom also criticized Prime Minister Gyurcsány's admitted concealing of the true fiscal situation prior to the elections and suggested the prime minister's resignation in October 2006. To expand the judicial accountability of public officeholders, the parliament in November 2006 reduced the group of posts that confer immunity to their incumbents.

There is an independent judiciary with a working self-government. Legislative and executive acts are subject to judicial review, and the judiciary is free from unconstitutional intervention by other institutions. The Constitutional Court has evolved into a powerful arbitrating body, shaping the understanding of democracy in Hungary. Its judges are elected with a two-thirds majority in parliament. In 2006, the court again demonstrated its independence by scrapping the government's bill of an entrepreneurial petty cash tax. The judicial branch has been self-governed by a National Judicial Council. The council is chaired by the president of the Supreme Court, and consists of nine judges elected by the judiciary, the minister of justice, the chief prosecutor, the chairman of the Hungarian Bar Association and two parliamentary deputies.

Independent
judiciary

As a rule, corrupt officeholders are prosecuted under established laws, but they can also slip through political, legal or procedural loopholes. Party and campaign financing are insufficiently and opaquely regulated, providing ample incentive for corruption. Discrepancies between accounting law and the legislation on parties over reporting systems as well as in the regulation of campaign finances provide loopholes for illegitimate activities. Illicit bookkeeping of party financing is not effectively penalized. Due to these loopholes, parties entering government have established a practice of rewarding their campaign donor firms with preferential treatment. In addition, the operations of party-based businesses lack transparency and adequate control. In 2005 parliamentary committees investigated the family business interests of Prime Minister Gyurcsány and former Prime Minister Orbán. The committees failed to come to any conclusions.

Prosecution of
office abuse

There are no restrictions on civil rights, and the EU anti-discrimination directive is implemented. Hungary's constitution guarantees national and ethnic minorities the right to form self-governing bodies, and all 13 recognized minorities have exercised this right. NGOs have reported individual cases of violations; for instance, the police have been criticized for discriminating against the Roma minority and mistreating drug addicts, prostitutes, immigrants and petty criminals. In August 2006, the parliament amended the anti-discrimination law inter alia to strengthen the independence of the anti-discrimination agency. In January 2007, the Constitutional Court restricted the police's access to the use of secret service methods (e.g. wire-tapping telephones) to conduct investigations.

Civil rights

4 | Stability of Democratic Institutions

Democratic institutions perform their functions in principle, but suffer from the populist confrontational policy of FIDESZ. Refusing to accept the socialist victory in the 2006 parliamentary elections, FIDESZ tried to oust the Gyurcsány government by mobilizing a protest movement. Orbán framed the local elections of October 2006 as a plebiscite on the government's austerity package, arguing that an electoral defeat would render the government illegitimate. After the local elections he called upon the government to resign within 72 hours, threatening to stage demonstrations to force the prime minister's resignation. Orbán also threatened to hold Gyurcsány and his cabinet legally accountable for the damage they had, in Orbán's view, done to Hungary. To protest against the ban on demonstrations before the parliament, FIDESZ deputies in February 2007 tore down the cordons blocking access to the place in front of the parliament building. While they declared their action as "civil disobedience," the president condemned it as a rebellion against the rule of law. Orbán's aggressive mobilization campaigns encouraged right-wing extremists and hooligans to stir up violent protests against the government in Budapest. The publication of the prime minister's confession of having lied to his voters provided Orbán with the necessary legitimacy. To sustain and strengthen societal mobilization, FIDESZ initiated a referendum on key elements of Gyurcsány's reform program. The referendum campaign sought to capitalize on the widespread societal opposition against welfare cutbacks and tried to limit the governing majority's discretionary power over reform measures by challenging their legitimacy and providing the public an opportunity to reject them. Parliamentary debate is ideologically polarized. FIDESZ and KDNP deputies have boycotted parliamentary speeches of the prime minister since October 2006. Following his electoral defeat in 2002, Orbán did not speak in parliament until 7 November 2005, although he was the leader of the most important opposition party. A new law on administrative procedures entered into force in November 2005. The law unified the existing administrative procedures and aimed at strengthening the rights of citizens in contact with public administration through more transparent and effective procedures.

All relevant political and social players accept democratic institutions as legitimate. However, FIDESZ leader Orbán repeatedly demonstrated his disrespect for democratic institutions and conventions by resorting to extra-parliamentary strategies and means of opposition.

Performance of
democratic
institutions

Commitment to
democratic
institutions

5 | Political and Social Integration

There is a stable and socially rooted party system characterized by moderate fragmentation, low voter volatility, broad consent among the population and stable linkages with civil society. The 2006 parliamentary elections confirmed the dominant confrontation of the two big parties MSZP and FIDESZ, which is based on a predominantly sociocultural cleavage between progressive and conservative values. MSZP received 43.2 % of the votes and FIDESZ obtained 42.0%, which the effective number of parties – 2.61 – reflects. However, the trend towards a two-party system was interrupted with the re-entrance of the center-right Hungarian Democratic Forum and the Christian Democratic People Party into parliament, upping the number of parties in parliament to five. The left side of the party spectrum is dominated by the Hungarian Socialist Party (MSZP), which has twice formed governments with the small liberal center-left Alliance of Free Democrats (SZDSZ). The Hungarian Civic Alliance (FIDESZ) leads the right, accompanied by the Hungarian Democratic Forum (MDF) and the KDNP. Former Prime Minister Viktor Orbán has been trying to build a unified party on the right, a move that led to the annihilation of the Smallholder party and jeopardized MDF's existence as an integrated political party. The orthodox Communist Hungarian Workers' Party has continued to lose influence on the national level. Groups and networks such as "68 Vármegye," "Jobbik," Hungarian Truth and Justice Party (MIÉP) have effectively organized and mobilized the right-wing extremist and nationalist segments of Hungarian society. They are responsible for the violent protests in September and October 2006. While these extremist groups act independently from FIDESZ, they have sought to infiltrate the larger social milieus sympathizing with FIDESZ.

Party system

The network of interest groups is relatively close-knit but dominated by a few strong interests, which creates a latent risk of pooling conflicts. Trade unions represent about one-third of all employees. Trade unions are politically weak, fragmented and primarily represented in the public and infrastructure sectors; by 2005 their membership had declined to 14 % of the labor force. In 2006, the parliament adopted a law defining the role and tasks of the National Council for Interest Reconciliation. However, the president refused to sign the law and asked the Constitutional Court for a preventive examination of its constitutionality, because he considered the Council's member organizations to be lacking democratic legitimacy. Hungarian farmers are well organized, and in February/March 2005 demonstrated for several weeks in order to obtain higher subsidies.

Interest groups

Consent to democracy as a form of government is high. According to a Eurobarometer opinion survey conducted in Spring 2006, the share of Hungarian

Consent to democratic norms

citizens who were satisfied with the functioning of democracy rose from 27 % (2005) to 46 % (2006). Citizens' trust in government increased from 33% (in 2005) to 48% (2006).

There is a robust but heterogeneous web of autonomous, self-organized groups, associations and organizations. Most of the 77,000 non-profit organizations registered in Hungary provide their communities with human services as well as sport and recreational opportunities. Observers estimate that approximately half the registered groups are in fact operational. According to a Eurobarometer survey carried out in November/December 2006, 81% of the Hungarian population do not participate or work as volunteers in civil society organizations. Hungary's new president has been a leading representative of the environmental movement and NGOs strongly promoted his election in 2005. The groups engaged in civil society have traditionally been socialist and liberal in orientation. However, since its electoral defeat in 2002 FIDESZ has sought to mobilize civil society by renaming the party "an alliance" and by establishing a network of "civic circles." Responding to these activities, MSZP also tried to expand its networks in society.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

Social exclusion is quantitatively and qualitatively minor and not structurally embedded. With a gross national income of \$16,940 per capita (Purchasing Power Parities, 2005), Hungary's level of economic development has reached 62.5% of the EU average. A Gini coefficient of 26.9 indicates limited income disparities. The informal sector is estimated to comprise 15-18% of Hungary's GDP. There is no systematic exclusion of women from the labor market, but the female employment rate is 12.1 percentage points less than the (comparatively low) male employment rate. Many of Hungary's Roma population are living below the poverty line. There are also considerable regional disparities between the capital / western regions and the eastern / northeastern regions.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	65,592	83,148	100,764	109,239
Growth of GDP	%	3.8	3.4	5.2	4.1
Inflation (CPI)	%	5.3	4.6	6.8	3.6
Unemployment	%	5.8	5.9	6.1	-
Foreign direct investment	% of GDP	4.6	2.6	4.6	5.9
Export growth	%	3.9	6.1	15.8	10.8
Import growth	%	6.6	9.3	13.5	6.5
Current account balance	\$ mn.	-4693.4	-7231.0	-8638.5	-8106.2
Public debt	\$ mn.	13,551.3	16,473.4	21,093.4	21,215.9
External debt	\$ mn.	34,957.6	47,507.0	63,526.5	66,118.6
External debt service	% of GNI	23.9	19.5	18.5	22.9
Cash surplus or deficit	% of GDP	-8.5	-6.2	-6.3	-7.4
Tax Revenue	% of GDP	21.6	22.1	20.9	20.5
Government consumption	% of GDP	10.9	11.2	10.7	10.3
Public expnd. on edu.	% of GDP	5.3	5.9	-	-
Public expnd. on health	% of GDP	5.3	5.9	5.7	-
R&D expenditure	% of GDP	1.0	1.0	0.9	-
Military expenditure	% of GDP	1.7	1.7	1.5	1.5

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

Market competition is clearly defined both macroeconomically and microeconomically; there are state-guaranteed rules for market competition with largely equal opportunities for all market participants. The government provides major subsidies in support of pharmaceutical prices, agriculture, housing, transportation and public utilities by maintaining low end-user prices. By mid-2007, the government has planned to partially liberalize the gas market and to fully liberalize the electricity market. Business regulations are insufficiently

Market-based
competition

transparent and consistent in comparison with regional and OECD peer countries. Particularly problematic areas are the costs of launching a business, obtaining licenses and registering property. Hungary's fiscal stabilization policies brought about significant non-wage labor costs that provide incentives for informal employment.

There is a coherent and effective anti-monopoly policy compatible with EU legislation. On 1 November 2005, the competition law was amended to clarify ambiguities regarding complaints procedures and sector investigations and to adapt the law to changes in the EU competition regime as well as to the new law on administrative procedures. In 2005/06, the Competition Agency conducted 162 competition supervision proceedings against unfair manipulation of consumer choice and 205 antitrust and merger proceedings.

Anti-monopoly
policy

As an EU member state, Hungary is part of the fully liberalized Internal Market and applies EU tariffs to imports.

Liberalization of
foreign trade

There is a solid banking system oriented toward international standards with functional banking supervision, minimum capital requirements and market discipline. In 2005, foreign companies owned 83% of bank assets, and the share of non-performing loans comprised only 3% of the total. Capital markets are open to domestic and foreign capital with sufficient resilience to cope with speculative investment. Stock market capitalization reached 32% of GDP in 2005. Pension funds, introduced in 1998, held assets in 2005 amounting to 5.2% of GDP.

Banking system

8 | Currency and Price Stability

The government and the Hungarian National Bank (MNB) try to coordinate inflation and foreign exchange policies with other goals of economic policy. The MNB governor in office until 2007, Zsigmond Járαι, was criticized for some monetary decisions that seemed to have been influenced by his unconcealed sympathy for the opposition parties. However, the government respected the bank's independence, and the bank has no role in financing public budget deficits. Hungary applies an exchange rate band, which has been determined by the government and the MNB together. In 2005/06, the forint weakened and its volatility increased.

Anti-inflation /
forex policy

Macroeconomic stability is acknowledged as an important aim among experts and policy makers, but it lacks institutional safeguards and is prone to populist policy changes. According to the International Monetary Fund, fiscal and external imbalances in 2006 eroded Hungary's growth potential and exacerbated its economic vulnerabilities. Hungary had the largest fiscal and current account deficits among sizable emerging markets, and its public and external debt ratios

Macrostability

have grown steadily in recent years. Substantial increases of government spending caused these fiscal problems. Between 2001 and 2005, public sector wage increases ranged from 15 to 55%, and a 13-month pension benefit was introduced. The annual amount of housing subsidies was quadrupled between 2000 and 2005. The state budget support covering deficits of the health and pension insurance funds grew from 1% of GDP (1998) to more than 4% of GDP in 2006. Expenditure growth was compounded by a projected decline in tax revenues, in light of shortfalls from social security contributions and a tax reform launched in 2005. In response to the worrisome fiscal situation, the government announced an ambitious adjustment package in June 2006. Heating, gas and electricity subsidies were reduced. Taxes on capital incomes were introduced, the VAT, personal income tax and health insurance contribution were increased, and steps were taken to broaden the tax basis as well as to reduce the scope of the informal economy. The measures led to significant energy price hikes, which in turn led to peaking inflation. In September 2006, the government adopted a convergence program comprising its policy to fulfill the EU's "Maastricht" fiscal rules on the overall balance of the general government and gross public debt. Previous convergence programs were considered unrealistic because the state budget deviated from the program targets and costly transactions (most notably military fighter leases and public private partnerships, including those involving the State Motorway Management Company) were not fully taken into account in the budget.

9 | Private Property

Property rights and the regulation of the acquisition of property are well defined in terms of acquisition, benefits, use and sale; they are limited solely by basic liberal rights. The acquisition of agricultural land and forests is prohibited for foreigners and restricted to Hungarian citizens possessing less than 300 hectares.

Property rights

Private companies are viewed institutionally as the primary engines of economic production and are given appropriate legal safeguards. The private sector comprises 80% of Hungary's GDP. Strategic industries were privatized during the 1990s, and the government plans to privatize the remaining state-controlled transport infrastructure assets and parts of the education, health care and prison system. The Budapest airport was privatized in December 2005. The Hungarian State Railways were restructured, and the network infrastructure is to be fully separated from passenger and cargo services that are envisaged for liberalization and privatization.

Private
enterprise

10 | Welfare Regime

Hungary has a Bismarck-type welfare regime based on the principle of mandatory social insurance that provides nation-wide protection against the standard risks of unemployment, poverty, illness, old age and disability. Apart from social insurance and unemployment benefits, family benefits are significant transfers administered as an entitlement and granted to everyone based solely on number of children. Most other cash benefits are means-tested and managed by local government. In addition to the public sector, churches, non-profit organizations and companies also provide social services and charity. According to an EU report on social inclusion, poverty and income disparity are below the EU average. In 2004, 13% of the population was threatened by poverty with a disposable income below 60% of the median per capita income. The ratio of the total income received by the 20% of Hungarians with the highest income to that received by the 20% with the lowest income amounted to 4.0 in 2004. Low average wages, public sector wage restrictions and minimum wage regulations limit the gap between social benefits and labor market incomes. The median individual pension income of retirees (aged 65 to 74) was 0.61 of the median individual earnings of employed persons aged 50 to 59, indicating the pension system's relatively high income-replacement effect. The health system is inclusive, but not sufficiently effective, which the average life expectancy figures – clearly below the EU – reflect. Hungary's low employment rate of 56.9% (2005) in combination with its contribution-based welfare system concentrates the burden of financing social policy on a relatively small share of the population. Accordingly, the "tax wedge" between the total labor costs to the employer and the corresponding net take-home pay for single workers without children was the third highest among OECD member states (51% at average earnings levels, 2006). Labor market policy has been effective insofar as the share of long-term unemployed in 2005 was lower than the EU average or than in other east-central European countries.

Social safety nets

There are sufficient institutions to compensate for gross social differences. Women and/or members of ethnic or religious groups have equal access to higher education and public office. Public opinion surveys indicate a high level of popular awareness regarding discrimination. For example, 86% of Hungary's population considered it disadvantageous to be a Roma, compared to, for example, 60% in Romania (Eurobarometer survey conducted in June/July 2006). The socialist-led governments have established a governmental agency for equal rights to implement the EU anti-discrimination legislation. The Roma issue is handled with care politically and within the framework of the EU minority policy. However, discrimination against the Roma in Hungarian society and in some local branches of the public administration has not fully disappeared. There is an

Equal opportunity

enormous contradiction between the legal norms of anti-discrimination and equal opportunity and the reality of exclusion and discrimination against the poor, the Roma, refugees, the homeless, the handicapped and women. This is especially true for access to health care and education. The established practice of bribing health care personnel (“gratuity money”) discriminates against poorer segments of the population. The “same wage for the same work” principle has been difficult to implement. According to an EU report, the average earnings of women in 2005 were 11% less than the earnings of men. The government’s efforts have brought some institutional and procedural gains for women with respect to domestic violence and discrimination, as well as for the handicapped with a program to improve infrastructure. Raising the Roma’s standard of living is an almost unattainable task however, due to their rate of unemployment and their traditional family and kinship structures. Current government programs do not provide sufficient resources to address these issues.

11 | Economic Performance

Following robust performance from 1997 to 2001, growth of per-capita GDP has slowed and is expected to lag behind neighboring countries in the years ahead. The declining growth rates are associated with moderate inflation as well as a twin deficit of the state budget and the balance of payment account. Growing exports and a slower growth of imports since 2004 have reduced the trade balance deficit. Multinational companies, attracted by low corporate taxes and the cheap skilled labor, have invested in the country and contributed considerably to economic growth. The net in-flows of foreign direct investment reached a record level in 2005, but subsequently decreased (in relation to regional peers as well). According to European Bank for Reconstruction and Development, Hungary’s external debt rose to 76% of its GDP in 2005. Unemployment is moderate, but the level of overall employment is unsatisfactory.

Output strength

12 | Sustainability

As an EU member state, Hungary has to take EU environmental standards into account. Compared to the EU average, energy intensity in Hungary remains relatively high, but the country has improved its energy intensity and is performing better than most other EU 10-Member States. In 2004, only 2.3% of total electricity was produced from renewable energy resources. Hungary’s greenhouse gas emissions are 32% below its 1990 level, which far exceeds its Kyoto commitments, although this decrease mainly owes to the closure of heavy industries in the course of economic restructuring. Solid waste is predominantly disposed in landfills, many of which do not comply with EU standards. The export of solid waste from Germany to Hungary as well as the continuous

Environmental
policy

pollution of the river Rába in Western Hungary by an Austrian leather factory have raised criticisms against these neighboring EU members. Production and the use of environmental friendly technologies in Hungary are rather low. In 2006, the government adopted an action plan to develop the environmental protection industry and energy-saving technologies.

Both state and private institutions for education, training and research and development are in some cases quite advanced. Quantitatively and qualitatively, investment is average in education and training (5.8% of GDP in 2005) and research and development (around 1.5% to 2.0% of GDP), although it has weakened in the last years. The public education system is not only in a fiscal and economic crisis, but also in a personnel crisis, as talented teachers are leaving the schools en masse. On a more positive note, participation rates in upper secondary and tertiary education have increased considerably. There has been a delegation of schooling decisions to the local level. In 2001, several reforms to enhance the quality of education were introduced, including a new national framework curriculum, quality development systems for schools, a comprehensive evaluation scheme and a teacher career model. Schools are co-financed by the central budget (covering appr. 70% of the costs) and the municipalities (30%). The second Gyurcsány government planned to replace the distribution of budgetary allocations according to the number of pupils by a distribution according to several performance indicators (teaching time requirements for individual school years, envisaged average class size, mandatory teaching hours). These measures were expected to provide further incentives for local governments to fuse classes. Enrollment rates at Hungarian universities now resemble those in Western Europe. However, this increase has come at the price of an overloaded infrastructure and growing costs, manifest in the need for student loans and increased teaching staff salaries. Public spending on tertiary education is relatively high, both in per student and absolute terms, but the number of graduates has not increased accordingly compared with other countries. Low enrollment in the more practical curricula has led to shortages in the supply of engineers. A significant number of university students now pay cost recovery fees. In October 2005 and September 2006, the Constitutional Court ruled that the university reform introduced in 2005 was unconstitutional because the plans to establish governing boards over university senates and to grant them veto rights over management decisions restricted academic self-government and independence. In November 2006, the parliament amended the law on the Hungarian Academy of Sciences in order to restructure the Academy and improve its scientific productivity. The division of functions between the National Scientific Research Fund (OTKA) and the National Research and Planning Office (NKTH) is unclear.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

The structural constraints on governance are low, as Hungary has been able to rely on a relatively homogenous society, a high level of general education, a skilled labor force, a relatively developed infrastructure and a territory that has not been contested internally or externally. Due to the demobilizing and privatizing legacy of Kádárist political culture, democratic and economic reforms in the 1990s were not affected by violent conflicts or social unrest. The country has a long rule of law tradition dating back to the Hungarian state during the Habsburg Empire and most recently enhanced by the traction of EU membership, which has constituted an external anchor to domestic reforms and a common platform for major political actors.

Structural
constraints

There are considerable traditions of civil society in Hungary that were developed in the various milieus of opposition during the era of state socialism as well as the reform-oriented technocratic elites that had been endorsed by the country's liberalized authoritarianisms. This particular model of reform socialist governance emerged as a response to the revolution of 1956, which carved out a space for societal autonomy. While limited to small segments of the intelligentsia, the milieus of opposition are rooted in pre-war and 19th-century intellectual cleavages between urban liberals and national conservatives. These different elite groups have not, however, insulated themselves from the wider, predominantly rural society. On the contrary, they articulated the socioeconomic and sociocultural cleavages that emerged during the process of Hungarian nation-building under the Habsburg Empire and in the multiethnic environment of the Carpat basin.

Civil society
traditions

There are no irreconcilable ethnic, religious or social cleavages, as Hungary inherited a society with relatively limited social or other disparities from state socialism. The imposed reduction of its territory following the collapse of the Habsburg Empire had already generated a high level of ethnic homogeneity before the establishment of the state socialist regime. The problems related to the Roma are sociocultural rather than political, and have not lead to political protest or mobilization. However, by sustaining its antagonist mobilizing and polarizing policy, FIDESZ has sought to split society, deepen sociocultural divisions and contribute to the escalation of political conflicts.

Conflict intensity

II. Management Performance

In the period from 2005 to 2007, Hungary was governed by two cabinets led by Prime Minister Gyurcsány. Both governments were minimal winning coalitions of the MSZP and SZDSZ, relying on stable majorities in parliament that increased from 51% to 54% of deputies after the 2006 elections.

14 | Steering Capability

The political leadership is generally committed to constitutional democracy and a socially responsible market economy. However, polarized political competition has induced the governing and opposition parties to ignore and erode democratic standards that had appeared to be consolidated achievements of Hungary's democracy. During the 2006 electoral campaign, the Gyurcsány government withheld information from citizens in order to ensure electoral victory. Although the government knew about the dramatic crisis of public finances, it kept the data secret during the electoral campaign and thereby damaged its credibility. Speaking to a closed meeting of socialist deputies after the elections, Prime Minister Gyurcsány acknowledged that his party had deliberately lied during the electoral campaign. His speech, abounding with vulgar words, was leaked to the public in September 2006 and provoked spontaneous demonstrations of several thousand people that turned into a country-wide series of protest demonstrations supported by FIDESZ. On 18 September, the demonstration in Budapest escalated into violence, enabling right-wing extremists and hooligans to occupy the national TV station for several hours. The president said that the publication of Gyurcsány's open confession had caused a "moral crisis" in Hungary. While the government sacrificed long-term priorities in favor of short-term promises during the electoral campaign, it insisted on its post-electoral reform program despite this unprecedented wave and scale of protests, the government. The deputies of the governing coalition supported Gyurcsány in a vote of confidence after the violent protests and the ensuing local election defeat. In February 2007, Gyurcsány's party reinforced this support by electing him as chairman.

Prioritization

The Gyurcsány government is committed to democracy and a market economy, but has had only limited success in implementing its announced reforms. In 2005, 95% of bills submitted by the government were adopted in parliament, while only one opposition-sponsored bill was adopted. However, several bills requiring a two-thirds majority were not submitted to parliament as the government and the opposition failed to establish a consensus on their adoption. The government successfully reduced the number of ministries and central

Implementation

government employees. It failed to implement a transparent system of party financing until January 2007, despite this reform being considered a priority. The Constitutional Court stopped laws on higher education and on the taxation of petty cash savings. Judicial reform, aimed at streamlining the judicial system and improving equal access to judicial assistance, has slowed down. The envisaged regionalization has been limited to the creation of regional bodies of territorial and sectoral state administration. County-level self-governments were not replaced by regional self-governments because the opposition parties refused to support the required qualified majority law. The envisaged major reform of the health care system was only partially implemented until Spring 2007. Hungary's health system has been characterized by relatively high expenditures (8.3% of GDP in 2004), structural inefficiencies and weak outcomes (e.g., the average life expectancy). According to government estimates, approximately 13% of those liable for health insurance contributions shirk their payment obligations. The majority of current spending on health care services is financed by a health insurance fund that receives health care contributions from employers and employees. There is, however, no transparency regarding the contributions paid by an employee during his working life and the extent of employers' contributions for individual employees. Hungarian citizens are accustomed to paying informal user charges ("gratuity money") for health care services, averaging eight to ten thousand forint per capita per year. While the capital Budapest has an oversupply of practices and hospitals, rural and peripheral areas lack a sufficiently dense network of institutions. Since there is no differentiated system of long-term care, persons requiring long-term care are frequently cared for in hospitals. Hospitals also face financial incentives to provide inpatient stationary care instead of cheaper ambulant treatment. Spending on pharmaceuticals comprises an excessive share of total health expenditure. The government was able to reduce the number of hospital beds from 50,000 to 34,000, but failed to close down more than three hospitals due to local protests and the resistance of local governments, which owned and operated most hospitals. The government introduced co-payments for visits to hospitals and physicians as an attempt to replace the gratuity money. However, the co-payments were considered too low and overly bureaucratic. A system of individual health insurance accounts was established, a program supporting preventive activities was launched, and the subsidies for prescription medicines were reduced. Plans to establish long-term care insurance, a separate sickness benefit insurance and to extend the mandatory health insurance contribution to household members were not implemented until January 2007.

The political leadership responds to mistakes and failed policies with changes, but its policies are inconsistent and do not seem to be informed by the accumulation of knowledge. Learning processes occur, but rarely affect the knowledge base or cognitive framework on which policies are based. The

Policy learning

contradictory signals sent by the tax reform measures in 2005 and 2006 provide a telling example. In 2005, the government reduced the VAT, personal and corporate income taxes, the taxation of dividends sourced in the European Union and the social security contribution. In contrast, the adjustment package of June 2006 increased the VAT, the personal income tax and the health insurance contribution. In effect, these measures tended to reverse the impact that had been expected from the previous reform. Moreover, the adjustment program did not balance the trade-off between the generation of revenues and the informalization of employment. While aimed at reducing the scope of informal economic activities, the program's increases in tax and health care contribution provided new incentives for tax evasion.

15 | Resource Efficiency

The government uses most available resources efficiently and has embarked upon a downsizing of government administration on a scale unprecedented in the history of Hungary's democracy. The second Gyurcsány government reduced the number of ministries from 14 to 11 and the number of central administrative bodies by 57%. In 2006, 7,301 posts in public administration were abolished, and an additional 15,042 posts were to be dissolved in 2007/08. Central government employment was to be reduced by 20% by the end of 2007. Regional administrative bodies replaced the county-level state administration. New regional-level bodies were created as well in the labor market, pension insurance, taxation and treasury, agriculture and military administration. These reforms were, firstly, associated with a wider scope of political appointments. The second Gyurcsány government replaced the administrative and political state secretaries with a single, politically appointed state secretary and transformed the deputy state secretaries, who previously had civil servant status, into sectoral state secretaries now qualified as political appointments. The personal advisory cabinets of ministers, staffed with political appointees, were expanded and given strategy-formulating tasks. The heads of these cabinets in some ministries even took over the direct management of ministerial departments. Secondly, the reforms followed substantial public sector wage increases leading to an average salary of public administration employees that is, according to an IMF report from January 2007, estimated to be 25% higher than in the private sector. The public sector wage bill grew from 11% of GDP in 2001 to nearly 13% of GDP in 2005. Tax administration, budgeting, auditing and procurement procedures meet high international standards. The government's accounting system records both cash transactions and also many accrual transactions. All state budget units are part of the Treasury Single Account. However, the IMF in its most recent fiscal transparency assessment noted that the variance between budget and actual out-turns has been considerable as a

Efficient use of
assets

result of the unreliability of budget estimates of both expenditure and revenue. Thus, for example, the average percentage difference over the three years 2002, 2003 and 2004 between budgeted and actual primary expenditure was 12%. The average difference between budgeted and actual tax revenue was also 12%. According to the IMF, this appears to be due to the fact that “a number of expenditure appropriations in the annual budget are in the nature of an estimate rather than a limit. Accordingly, some agencies are permitted to spend more than the appropriated amount if required, without a need for parliament to increase the appropriation. These appropriations apply to a wide range of expenditure programs, including to those that are not mandatory in nature. The flexibility to exceed the appropriated amounts has been accompanied by a tendency to underestimate expenditure and to thereby misrepresent the fiscal adjustment that is planned.” The budget documents contain only limited information on contingent liabilities and do not include information on quasi-fiscal activities undertaken, for example, by the Hungarian railways and the Budapest Transport Company. The Hungarian government has also sought to reduce the measured deficit and debt by moving the expenditure and debt arising from the construction of new motor-ways off-budget.

The government has been comparatively successful in coordinating conflicting objectives and interests. The political priorities of MSZP and SZDSZ are, in contrast with previous coalition governments, highly congruent. Truly, SZDSZ and MSZP differed over the extent of competition among health insurance funds. Whereas SZDSZ wanted to enable citizens to choose their health insurance fund freely by permitting private insurance companies, MSZP wanted to open only one sector (care or accident insurance) to private insurance companies. This conflict led to the resignation of the health minister and SZDSZ politician Lajos Molnár in April 2007. Nevertheless, the far-reaching reform measures of the government’s “New Balance” program from June 2006 indicate the determination and common orientation of the two coalition partners. Program formulation has been characterized by limited coordination. The EU Convergence Program, the National Development Plan, and the annual budget were developed independently of each other, although the National Development Plan and the Convergence Program provide important envelope figures orienting the annual budget. There is no long-term EU policy strategy. To achieve a higher degree of coordination, the second Gyurcsány government centralized the intra-governmental preparation of decisions. First, it centralized strategic planning capacities by establishing a State Reform Committee to coordinate the formulation of policy strategies. The Committee is headed by the prime minister, operatively led by a government plenipotentiary and assisted by the Prime Minister’s Office (MEH). The line ministries were obliged to coordinate their policy proposals with the State Reform Committee prior to a submission to the cabinet. Second, development and investment planning related to EU aid was

Policy coordination

transferred from the line ministries to a Government Commission for Development (FIT) located in the MEH. The Commission consists of five former ministers with the status of state secretaries. Third, background activities of line ministries such as accounting, IT, controlling, human resource management and asset management were concentrated in four central service agencies located within the MEH. In effect, the government largely reduced the ministries to tasks of administration and policy implementation. In addition, the ministers' power over the internal structure of ministries was limited by defining a unified hierarchic structure for all ministries. These reforms sought to strengthen cabinet-level and prime ministerial decision-making at the expense of ministerial autonomy.

Most integrity mechanisms are functioning, albeit with limited effectiveness. The State Audit Office is established by the Constitution as an organ of the parliament, independent of the executive branch. The Office has effectively audited the use of public funds. A Government Control Office was created to oversee and support internal audit in line ministries and agencies and to carry out audits on matters of government-wide significance. In 2006, the government decided to transform the Office into an agency of the Finance Ministry charged with the auditing of the implementation of EU funds. Hungarian procurement rules comply with EU standards. The government has launched a "Glass Pockets" anti-corruption initiative that requires ministries to publish all contracts involving larger expenditures of public funds or management of public property. A law on lobbying was adopted in February 2006. Among other things, it has established basic rules of lobbying and a national register of professional lobbyists. As of January 2007, the government had not adopted a law on party and campaign financing, and it failed to introduce a well-defined code of conduct for civil servants that went beyond the general provisions of the civil service law. The media ensure effective public scrutiny through frequent and investigative reports on cases of corruption.

Anti-corruption
policy

16 | Consensus-Building

All major political actors subscribe to the principles of a market economy and parliamentary democracy, but disagree on its structures and scope. The governing and opposition parties failed to agree on amendments to qualified-majority laws needed to dissolve self-governments at the county level and replace them with regional self-governments, as was envisaged by the Gyurcsány government. FIDESZ made its support contingent upon the creation of a "budgetary council" determining the distribution of EU funds. MSZP did not accept this condition, considering it a restriction of its legitimate mandate derived from its parliamentary majority.

Consensus on goals

<p>There are no influential anti-democratic veto actors in Hungary. Right-wing extremist parties again failed to enter parliament in 2006, which was partly due to FIDESZ's effective strategy of integrating right-wing extremist voters.</p>	<p>Anti-democratic veto actors</p>
<p>The political leadership and in particular the dominant opposition party FIDESZ led by Viktor Orbán have deliberately escalated conflicts, seeking to split society along sociocultural and socioeconomic cleavages. Whereas FIDESZ has associated the government with the old state socialist regime, MSZP has framed FIDESZ as closely being linked with fascist extremists. Oppositional networks, parts of the media and a nationalist subculture claim to represent "the" Hungarian identity, stating that they are "the nation" and the government and its supporters are "the traitors." The government has not been able to bridge this gap by emphasizing social justice, modernity, civic republicanism and European integration. A considerable segment of Hungarian society holds nationalistic views sometimes leading to xenophobic attitudes. Racism is mainly directed against Hungary's Roma population. Anti-semitism is also a problem, but to a lesser extent.</p>	<p>Cleavage / conflict management</p>
<p>The political leadership takes into account and accommodates the interests of civil society actors. The government is legally obliged to involve and consult with civil society stakeholders in the drafting of legislation. Both Gyurcsány governments have tried to establish a partnership with civil society by means of generous financial aid and, to a certain extent, the inclusion of NGOs into policy implementation, especially in the areas of environmental and social policy, gender issues and migration. A new law on volunteerism was adopted in June 2005, enabling NGOs to harness tax-free allowances, compensations and training opportunities for volunteer workers.</p>	<p>Civil society participation</p>
<p>The political leadership recognizes the need to deal with historical acts of injustice, but the process of reconciliation has fallen victim to political polarization. The 50th anniversary of the 1956 events in October 2006 was overshadowed by violent protests against the prime minister and characterized by a political confrontation between the government and FIDESZ, which refused to participate in a joint commemoration ceremony. While the left interprets 1956 as a socialist, anti-Stalinist revolution, the right views it as a national uprising against Soviet oppression and its domestic Communist collaborators. The rioting right-wing extremists of September 2006 claimed to be successors of the 1956 freedom fighters. An open debate on the role of the Communist secret services has been hampered by the arbitrary and intransparent practice of disclosing secret service files that document the surveillance of citizens in the period from 1945 to 1990. Since January 2005, the National Security Office, comprising Hungary's secret service organizations, has transferred selected files to the Historical Archives of the Hungarian State, where they can be accessed by interested researchers. Which files are handed to the Archives is decided by the</p>	<p>Reconciliation</p>

secret services themselves, generating suspicions about political motives guiding the disclosure of files. In October 2005, the Constitutional Court ruled that a bill granting access to the files for all citizens was unconstitutional because the modalities of access would violate the privacy of individuals who had been under surveillance.

17 | International Cooperation

The political leadership makes well-focused use of international aid and demonstrates a substantial ability to learn or to utilize international assistance for its domestic policy agenda. As an EU member state, Hungary has incorporated a multitude of policy impulses from various EU policy areas and cooperation contexts. Between 2004 and 2006, Hungary was able to make contracts for 99% of the Structural Funds resources committed by the European Union 54% of these commitments were paid to beneficiaries, which is considered to be a very high absorption rate in comparison with other EU member states. Of the EU Cohesion Fund resources provided for Hungary in the same period, 59% were contracted and 26% were paid out. According to the European Commission, Hungary up to 2006 had transposed 99.1% of all Internal Market directives in accordance with the EU deadlines.

Effective use of support

Since 1989, foreign policy has been solidly West-oriented and supported by both left and right. Milestones of this development were the accession to the OECD in 1996, to NATO in 1999 and to the European Union in 2004. Hungary's government is considered credible and reliable by the international community. Hungary supported the U.S. intervention in Iraq but withdrew from military participation in 2004, confining its support to technical assistance. The government initially declared its intention to support the Russian pipeline project "Blue Stream." Simultaneously, it promised to support the construction of the Nabucco gas pipeline, an EU project intended to tap Caspian Sea gas resources and thereby reduce the European Union's dependency on Russian gas.

Credibility

The political leadership actively and successfully builds and expands cooperative international relationships. It promotes regional and European integration. Hungarian neighborhood policy has been committed to the concerns of the millions of ethnic Hungarians that were excluded in the founding of the Hungarian state in 1918. At times, the advocacy for Hungarian communities abroad has raised the ire of neighboring states. In 2001, FIDESZ and its coalition adopted the so-called "Status Law" on the provision of cultural, educational and welfare services to all registered ethnic Hungarians abroad. In December 2004, FIDESZ and the World Federation of ethnic Hungarians initiated a referendum in order to grant Hungarian citizenship to all ethnic Hungarians. Although a majority of the voters supported the proposal, the referendum failed to attain the

Regional cooperation

constitutionally required quorum. Both Gyurcsány governments preserved the status law but opposed the granting of dual citizenship to ethnic Hungarians and abolished the Permanent Magyar Conference. This high-level forum of the Hungarian government and the ethnic Hungarian parties in neighboring countries had sought to develop a concerted policy on minority issues in Hungary's neighborhood. Based on a distinctly political notion of the Hungarian nation, both Gyurcsány governments attached higher importance to deepening their cooperation with neighboring states, cross-border cooperation involving ethnic Hungarian settlement areas and financial assistance to sustain ethnic Hungarian communities. Good neighborly cooperation with Slovakia has become more difficult since the anti-Hungarian and right-wing extremist Slovak National Party joined the Slovak government in 2006.

Strategic Outlook

During the period under review, Hungary has undergone further political polarization and domestic political conflict has escalated. These developments may erode the legitimacy and quality of democracy, if political agitation succeeds in splitting society, and if the deliberation and negotiation of policies are subordinated to partisan confrontation. Political polarization in Hungary has international, socioeconomic and institutional roots. First, the European Union has, over the years, been the most important agenda-setter in Hungary as well as in other accession countries. The transposition and implementation of EU laws dominated domestic legislation and parliamentary work; the EU criteria of functioning and competitive market economy defined the constraints and leeway for national economic and fiscal policies. Having opted for accession, governments, parliaments and citizens were no longer able to choose whether this technocratic agenda should be implemented. Only the timing of its implementation was negotiable. Many voters noticed that they were able to determine the composition of the political leadership, but had little influence on the substance of policies. Real (or apparent) alternatives were only offered by extremist and populist political actors. Second, market reforms and economic integration into the EU market effected far-reaching changes in economic and social structures that generated a constituency of people who suffered from the reforms and lacked or lost any chances of upward social mobility. This group includes low-qualified and elder workers, pensioners, small farmers and residents of rural, peripheral or declining industrial areas. These groups are susceptible to populist agitation and increasingly vote for extremist parties. Attempts by leaders of mainstream parties like FIDESZ to integrate extremist segments have blurred the boundaries between populist and extremist groups. As for the mainstream parties themselves, center-right and center-left no longer have the goal of EU accession to unite them. Third, majoritarian elements in Hungary's electoral system regularly generated clear governing majorities by endowing the strongest party with a bonus of parliamentary mandates. Hungarian electoral law supported the emergence of a quasi-two-party system that is today dominated by MSZP and FIDESZ. The bipolar nature of political competition has facilitated the inclination of governing parties to consider the executive an instrument of majority rule. Aspects thereof include the centralization of power within the executive, the politicization of leading administrative officials, the increasingly presidential character of the prime minister's role and the expanding role of the media in politics. By using the media as a communication tool, the government increasingly subordinates substantive policy-making to media interests and effects. Domestic and external

supporters of Hungarian democracy have little influence on the economic and international drivers of polarization. An integrative set of social policies should include disadvantaged and deprived groups as well as improve their chances of access to better education, health and employment. Expanding the distribution of benefits from EU membership to include more groups throughout Hungarian society seems to be the best strategy to contain the attraction of populist promises. Streamlining state spending is key to achieving these objectives, and in this respect, the Gyurcsány government is moving in the right direction. More could be done to influence the institutional drivers of political polarization. The aim should be to strengthen the institutional incentives for consensual policy-making. For example, the proportional elements of electoral law could be given more weight in the context of the envisaged downsizing of the Hungarian parliament. The information and control resources and rights of parliament should be enhanced in order to render parliament the focal institution of policy formulation. While the president, the Constitutional Court, the Hungarian National Bank and the Supreme Audit Office already provide important institutional checks and balances to executive dominance in Hungary, regional self-governments could be developed into additional counterweights to the central government. Such reforms would constrain executive power, increase the need and incentives for coalition-building strategies, and thus enhance policy sustainability.