

# BTI 2010 | Hungary Country Report

<b>Status Index</b>	1-10	<b>9.00</b>	# 8 of 128	
Democracy	1-10	9.25	# 10 of 128	➔
Market Economy	1-10	8.75	# 8 of 128	➔
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scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Transformation Index (BTI) 2010. 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 128 transformation and developing countries are evaluated.

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## Key Indicators

Population	mn.	10.1	HDI	0.88	GDP p.c.	\$	18799
Pop. growth	% p.a.	-0.2	HDI rank of 182	43	Gini Index		30.0
Life expectancy	years	73	UN Education Index	0.96	Poverty <sup>2</sup>	%	<2
Urban population	%	67.1	Gender equality <sup>1</sup>	0.59	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

## Executive Summary

Hungary is a consolidated democracy with inclusive, free and fair elections, a pluralist media environment, and a strong, independent judiciary. The general conditions of Hungarian democracy have remained stable but political tensions have grown. An extreme right has emerged on the margin of public politics with a nationalist and racist profile that has been encouraged, or at least never directly and unambiguously condemned, by the main opposition party, Fidesz.

The years between 2007 and early 2009 were rather turbulent; due to the sharp and hectic changes they can be divided into three main periods. The first period covers the reform efforts of the second Ferenc Gyurcsány government, lasting until 9 March 2008 when a referendum on health care reforms – against the introduction of a treatment fee to be paid by patients – stopped the reforms. In the second period, coalition tensions led to a minority government, after the SZDSZ left the coalition government due to the failed referendum and the halting of reforms. The third period was the crisis management stage, when the 2009 budget was approved by the Hungarian parliament. This represented both the stabilization of the minority government, and the successful management of at least the first stage of financial crisis. But this too was the beginning of a new period, since the financial crisis continued in Hungary as an economic crisis, and led to the restructuring of the national economy with increasing unemployment and uncertainty for small and medium-sized enterprises (SMEs).

Until the onset of the global financial crisis, the political elite proved incapable of agreeing on a reform strategy. Popular dissatisfaction was growing, with the political elite in general and with the austerity measures of the government in particular. However, the emerging period has also produced new government initiatives for a relaunching of the reform efforts. Indeed, the crisis seems to have provided the opportunity to implement creative, radical reforms. The global financial crisis has rewritten the future scenario of Hungary's structural accommodation to the European Union and the Europeanization process. The introduction of the euro as a safeguard against global uncertainties has become a priority on the agenda.

## History and Characteristics of Transformation

After the 1956 uprising, unlike its neighbors, Hungary “liberalized” its system of single-party socialist rule relatively early. In the late 1960s, a more consumer-based communist economic system began to emerge under the leadership of the János Kádár regime. Some spheres of social life remained relatively unpoliticized, and private, economic and social life was partially liberalized. Reformed communist elites initiated the democratic transition. Against the backdrop of political change in Moscow, a dreary economic situation at home and unsustainable external debt, these forces were prepared to allow at least a limited degree of liberalization and pluralization in the political arena. Kádár 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. 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 implement constitutional amendments necessary for this process. 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 five alternating governments of either center-right or socialist-liberal coalitions, all of which 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, the judicial system, the media, the 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 reformed 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. Governments successfully reduced tensions with neighboring countries, which had become home to sizeable ethnic Hungarian minorities after the First World War. Good neighborly relations developed that are punctuated by occasional conflict, but are based on institutions and norms enabling the civilized resolution of disputes.

The European Union acknowledged the success of the country’s democratic and economic transformation by granting membership to Hungary in 2004. Intensive preparations 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. Following the center-right Viktor Orbán government (1998 – 2002), Prime Minister Péter Medgyessy formed a center-left government in 2002, but was replaced by Ferenc Gyurcsány in 2004.

For the first time in Hungary's recent political history the incumbent government was reelected in 2006. However, political polarization by that time had reached such a level between left and right, government and opposition that the center-right opposition represented mostly by Fidesz was no longer prepared to cooperate with the government in its radical reforms. Therefore a large part of the proposed public administration reform initiatives failed due to the lack of the needed two-thirds support in the parliament. In the 2000s, there an excessive twin deficit had developed, which was drastically reduced from 2006 onward by the Gyurcsány government's convergence program. Nevertheless, the global financial crisis shook Hungary profoundly and indicated the necessity of further basic reforms if sustainable economic growth and better governance were to be achieved.

# Transformation Status

## I. Democracy

### 1 | Stateness

There is virtually no competition with the state monopoly on the use of force throughout the entire territory. Violent demonstrations began in mid-September 2006 and continued on 23 October 2006 against the government, and since then have been repeated on national holidays (15 March and 23 October) and on many other occasions. By 2009 the violence tendencies at these street demonstrations had been more or less controlled by the police.

Monopoly on the use of force

All citizens have the same civic rights. The overwhelming majority fundamentally acknowledges the state's constitution.

State identity

The state is largely defined as a secular order. Religious dogmas have no significant influence over politics or the law. Regular churchgoers comprise just 10% of the population. However, the role of Christian churches in Hungary is far from neutral. Religious bodies interfere in political life by supporting the conservative forces, and by providing communication facilities for conservative activities that would not be tolerated in consolidated democracies.

No interference of religious dogmas

The state has a differentiated administrative structure, and the legal order is maintained throughout the entire country. Administrative institutions and public officeholders perform the basic functions of their jurisdiction, making and implementing political decisions, and pursuing public policies.

Basic administration

### 2 | Political Participation

There are no constraints on free and fair elections. General elections have been held regularly at both the country and municipal levels. They have been accepted as the legitimate means of filling leadership positions.

Free and fair elections

Elected rulers have the effective power to govern. Executive power is restricted only by the constitutional checks and balances of the legislative and judicial powers.

Effective power to govern

The freedoms of association and assembly are unrestricted within the basic democratic order. Political participation is completely assured at the formal level.

Association /  
assembly rights

The freedoms of opinion and of the media are unrestricted and framed by the basic democratic order. The public media are supervised by a board composed of representatives of all political parties (National Radio and Television Council, ORTT), which limits government influence to a great extent. In general, the print and electronic media are privately owned and have a very pluralistic ownership, and are thus basically free of government control.

Freedom of  
expression

### 3 | Rule of Law

There is a well established system of mutual checks and balances in Hungary.

Separation of  
powers

The judiciary is free both from unconstitutional intervention by other institutions and corruption. There are mechanisms for judicial review of legislative and executive acts. A quasi-complete separation of the judges from external control was established by means of a working self-government system in 1997. However, this legislation has also produced counterproductive effects, since the establishment of the National Judicial Council (OIT) has allowed judges to defend themselves against any reform pressure. The judiciary is certainly independent from government, but is not necessarily independent from pressures exerted by opposition politicians. The efficiency of the courts has been very low, with trials and other processes producing sentences and verdicts lasting for very long periods of time; this practice has created some legal uncertainty. The Constitutional Court has evolved into a powerful arbitrating body but it has handed down a number of controversial decisions, including a much-debated verdict allowing a March 2008 referendum on some budgetary details, despite the constitution's stipulations that there can be no referendum on issues concerning the state budget.

Independent  
judiciary

As a rule, corrupt officeholders are prosecuted under established laws, but frequently slip through political, legal and procedural loopholes. Office abuse has become more widespread in recent years. This has manifested at various municipal levels in cases of the sale of municipal property, in preference given during public tenders, public procurement and public-private partnerships, or by the appointment of public officials or party allies to plum positions.

Prosecution of  
office abuse

There are no legal restrictions on civil rights. There has been public debate over the introduction of a ban on "hate speech," and restrictions on the right of assembly as applied to violent demonstrations by members of the extreme right, but the Constitutional Court has rejected these efforts at amendment of civil rights despite their introduction in many other Western countries.

Civil rights

#### 4 | Stability of Democratic Institutions

The system of democratic institutions works rather effectively and efficiently. As a rule, political decisions are prepared, made, implemented and reviewed in legitimate procedures by the appropriate authorities. But the institutions have a “genetic disease” of fragmentation and lack of coordination that lowers efficiency. The government has engaged in regulatory impact assessments (RIAs), but the monitoring of implementation processes and the final evaluations of RIA measures has usually been weak or missing.

Performance of  
democratic  
institutions

The performance of democratic institutions has also been lowered by the ambiguous behavior of Fidesz, which has attacked public authorities such as the police, the courts and the state attorney for alleged political intervention. There have been some accusations that the police have committed minor injustices during anti-government demonstrations, but these accusations have not been proven. However, the use of violence by participants in these demonstrations clearly disrespected democratic principles, and right-wing radicals have threatened minorities (e.g., by violently disturbing the peaceful gay-rights demonstration on 4 July 2008 or the Hanukkah celebration on 21 December 2008). Fidesz, the biggest opposition party, has not directly supported these demonstrations but has not condemned them clearly and unambiguously. In some cases, party members have indirectly defended or even shown approval for the demonstrations, calling them the expression of popular discontent against the “illegitimate” government.

All relevant political and social players accept democratic institutions as legitimate. However, extremist movements and parties have entered the scene in recent years that have questioned the legitimacy of systemic change and its institutional foundation. These extremist movements emerged during the 2007 – 2009 period, when Fidesz initiated a discussion calling for the reevaluation of systemic change, and suggesting that the followers of the old communists were still in power. In a December 2008 speech, Viktor Orbán referred to the incumbent prime minister as “baby dinosaur,” implying that Gyurcsány was the child of the “old dinosaurs.” All in all, the influence of extremist and openly anti-democratic forces remains marginal, but holds potential dangers for the future. The violent street demonstrations have had serious consequences for future political developments and societal attitudes, since they have undermined the role of the police and called the constitutional order into question; in this respect, they have led to the habitualization of antidemocratic practices. The role of the Hungarian Guard (Magyar Gárda) as a semi-military, extreme-right organization has to be mentioned in this respect because its activity threatens the democratic order; this organization would have been prohibited and disbanded in Western democracies. The official party of the extreme-right forces, Jobbik (“Better,” with an additional association in

Commitment to  
democratic  
institutions

Hungarian with “right”), has gained influence in society and has regularly received between 4% and 5% support in public opinion surveys, while support for SZDSZ, the liberal party, has declined to 2% – 3% among decided voters.

## 5 | Political and Social Integration

Hungary has a stable party system with low volatility. However, the main parties’ social linkages are still rather weak, and are therefore inefficient in aggregating societal interests. The party system is based on a sharp polarization between left and right, government and opposition, with an increasing tendency toward a two-party system. The left considers the right to be leaning toward anti-democratic practices, and the right still considers the left to be an illegitimate successor of the Communist party. Fidesz has attempted to embrace the extremist adherents, and – with the further concentration of the party system and the disappearance of smaller parties – it is an open issue whether a new parliamentary party will emerge on the extreme right in the 2010 elections.

Party system

Hungary’s network of interest groups is relatively close-knit, but a few of the strongest show a clear practical dominance. Most interest groups’ ability to represent society at large is low, and their legitimacy has thus often been questioned in the National Interest Reconciliation Council. Trade unions represent less than one-third of employees, and membership levels are further declining. In the present crisis situation, this sector’s weakness has produced increasing politicization, with aggressive demands by some employers’ representatives for tax reductions as well as sporadic strike actions by some marginal employee groups. In contrast to earlier years, the 2007 – 2009 period saw an increase in the number of strikes. For example, in mid-December 2008 there was a nine-day strike by a relatively small trade union of railway workers making excessive demands, with a rather clear political affiliation to the main opposition party. These strikes reflect the chaotic situation in the interest representation sector. The strikes mostly occur in the public service sector, and usually have no broader popular support.

Interest groups

Consent to democracy is high, at well above 70% of the population. The constitutional framework is fully accepted by the large majority of citizens.

Consent to democratic norms

There are many voluntary associations in Hungary; numbers are almost at the level seen in Western nations, although the level of real activity is much lower. Many civic associations are in fact formed expressly to allow tax avoidance by business firms, and/or have been politicized and supported by powerful political figures. The latest surveys indicate increasing social polarization in this arena, with a concentration of voluntary associations in the big cities and in the affluent strata of society. Social trust has drastically decreased in recent years between and among interest groups and social strata. The population’s low levels of mutual trust have

Associational activities



been caused by acute conflicts over resources and by growing mass dissatisfaction due to stagnating and deteriorating standards of living. The weak social trust is also caused by the fact that cheating and falsifying documents in general, and for everyday consumer goods in particular, has become rather widespread in business circles.

## II. Market Economy

### 6 | Level of Socioeconomic Development

Poverty and social exclusion are quantitatively and qualitatively pronounced, and to some extent structurally ingrained. At a conservative estimate, 20% of the Hungarian population can be considered poor (i.e., below 60% of the national average of standard of living). Real wages in 2008 increased only an average of 0.6%, but in fact declined for many strata; at the same time, the Hungarian population's volume of outstanding credit grew by 27.3%, 68.6% of which was in foreign currency. With the worsening exchange rate of the Hungarian forint, this credit became far more costly, threatening to tip many lower-middle-class families into crisis. Structurally embedded social exclusion appears in social and territorial manifestations. Some poor social strata – mostly but not only the Roma – have fallen into a negative spiral of low education levels in needy families, with the poorly educated family members thus having little chance of getting a job to lift them out of the spiral. Meanwhile, there are islands of poverty on the map, representing areas with poor infrastructure and low levels of economic activity, remote from other parts of the country. About 50 out of the 174 small districts, mostly in northern Hungary and southern Transdanubia, can be considered as declining. The socioeconomic situation in some Hungarian regions has deteriorated both in relative and absolute terms.

Socioeconomic  
barriers

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	102076.2	110195.4	113005.7	<b>138757.2</b>
Growth of GDP	%	4.7	3.9	4.0	<b>1.2</b>
Inflation (CPI)	%	6.8	3.6	3.9	<b>7.9</b>
Unemployment	%	6.1	7.2	7.5	<b>7.4</b>
Foreign direct investment	% of GDP	4.4	6.9	17.4	<b>26.8</b>
Export growth	%	15.0	11.3	18.6	<b>16.4</b>
Import growth	%	13.7	7.0	14.8	<b>13.4</b>
Current account balance	\$ mn.	-8770.8	-8261.3	-8610.0	<b>-8922.3</b>
Public debt	\$ mn.	-	-	-	-
External debt	\$ mn.	-	..	-	-
Total debt service	% of GNI	-	-	-	-
Cash surplus or deficit	% of GDP	-6.2	-7.4	-8.7	<b>-4.9</b>
Tax Revenue	% of GDP	20.7	20.3	20.1	<b>21.4</b>
Government consumption	% of GDP	10.0	9.9	10.2	<b>9.7</b>
Public expnd. on edu.	% of GDP	5.4	5.5	5.4	-
Public expnd. on health	% of GDP	5.8	6.0	5.9	-
R&D expenditure	% of GDP	0.9	0.9	1.0	<b>1.0</b>
Military expenditure	% of GDP	1.5	1.4	1.2	<b>1.3</b>

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

## 7 | Organization of the Market and Competition

Market competition has a strong institutional framework, but the rules are not always consistent or uniform for all market participants, particularly with respect to the big multinationals. Transnational corporations are very important vehicles in the country's export drive, but the Hungarian government can do little to influence their decisions. However, in one case when major multinational firms engaged in highway construction formed a price cartel, they were punished by the Hungarian

Market-based  
competition

Competition Authority (GVH). The informal sector plays an important role, with its share of GDP estimated at 20%.

Although the formation of monopolies and oligopolies has been regulated consistently at the formal legal level, big international firms have often been given tax breaks, since they have special bargaining power vis-à-vis the state when threatening to withdraw from Hungary. The Audi case is indicative; the car manufacturer asked for, and received, special treatment when the Hungarian government imposed extra taxes on enterprises in an attempt to balance the budget.

Anti-monopoly  
policy

Foreign trade is liberalized within the European Union, and by and large with the broader world by virtue of WTO membership. There is no fundamental state intervention in foreign trade.

Liberalization of  
foreign trade

There is a solid banking system oriented toward international standards, with functional banking supervision. Capital markets are open to domestic and foreign capital. Around 80% of Hungarian bank assets are owned by foreign capital. Liquidity reductions imposed by foreign parent banks on their Hungarian subsidiaries have threatened to impede access to credit in Hungary, and have also provided opportunities for populist politicians to challenge market-economic principles.

Banking system

## 8 | Currency and Price Stability

The largely independent central bank controls the inflation and foreign exchange policies. There has long been controversy over the Hungarian National Bank's monetary policy, since many analysts think that high interest rates and the strong national currency were harmful to the Hungarian economy. This debate has recently diminished, since crisis management measures have necessitated high interest rates to keep Hungarian state bonds viable in the market.

Anti-inflation /  
forex policy

The government's fiscal and debt policies had many problems before June 2006, when the European Union accepted a new convergence program with drastic austerity measures. As a result of this plan, Hungary's budget deficit has more than halved (from 9.2% of GDP to less than 4.5%) since October 2006. The crisis following EU accession was provoked by the dual pressure of meeting tough EU requirements for the introduction of the euro on one hand, and the social demands for a decent standard of living, improved public services and a more inclusive social policy on the other. A new budget act was passed on 17 November 2008 aimed at avoiding excessive government spending. On 20 December 2008 the government sent its latest convergence program to Brussels, envisaging reduction of the deficit to below 3% in 2009. The inflation target for 2009 is 4.5%. The latest corrections seem to be sufficient and Hungary in 2009 will enter the ERM-II (European

Macrostability

Exchange Rate Mechanism-II) group. In early 2009, the new György Gordon Bajnai government expressed its intention to keep deficit levels below 3% in 2009.

## 9 | Private Property

Property rights and the regulation of the acquisition of property are well defined in principle, but there are problems with their implementation under the law. The obscure property relations inherited from the former regime have in many cases created chaotic situations. For instance, property changes were sometimes not registered, or were left in archaic forms such as common land ownership. In many cases it is still not clear which kind of public property one is dealing with, since a particular piece of land in Budapest can be owned by the state, the capital or the given district of the capital. In January 2008, the government's plan to build an administrative city housing all ministries behind the Western Railway Station failed, partly because of the obscure property relations at the given site.

Property rights

Private companies are viewed institutionally as the primary engines of economic production, and are given appropriate legal safeguards.

Private enterprise

## 10 | Welfare Regime

In principle, there is a solid network to compensate for social risks nationwide, addressing health care and prevention of poverty. In fact, this network does not cover all citizens, since some hundreds of thousands of citizens have avoided paying fees to the health care and pension system, and are thus entitled only to minimal services. In the case of deep poverty, this national system embraces those concerned, but has been unable to prevent the perpetuation of poverty.

Social safety nets

Hungarian social policy has to a great extent been counterproductive, since it has been incapable of coping with the marginalization of large sections in Hungarian society despite its high costs relative to the country's GDP. However, one has to take into consideration that the rapid privatization in the early nineties produced a relatively large group of long-term unemployed individuals.

Due to budget limitations, the central and local authorities have been unable to avoid the development of extreme social polarization and the emergence of an underclass made up of those harmed by the process of systemic change. There is also a danger that this underclass status will be passed from generation to generation, in a social group that lives largely on social policy transfers. In order to avoid this situation, new social legislation was passed by the parliament on 16 December 2008 that links social benefits to participation in public works projects for those who are fit to work.

There are institutions designed to compensate for gross social differences. In principle and at the formal-legal level, members of all social groups have equal access to higher education and public office. However, these institutions and the supporting public measures are not yet sufficient to compensate for the lack of education in the poorer part of society. Women are equally represented in higher education, unlike the Roma and other poor strata. Women have equal access to public office, but their participation is lower in the higher posts.

Equal opportunity

## 11 | Economic Performance

Hungary's economy was in a period of slowdown in 2007 and 2008, which turned into a full-fledged recession in 2009. There have been positive processes in the economy, as with the drastic reduction in the deficit and the balancing of the budget, or the growth in exports led mostly by multinational firms (most SMEs focus on the domestic market). However, negative processes can be seen in the very low level of output generated by SMEs, and an employment rate that is still barely above 57%. One positive effect of EU accession was that the share of Hungarian exports bound for the new EU member states (including Bulgaria and Romania from 2007 on) increased from 7.5% to 20% between 2003 and 2008, with imports from these countries rising from 8% to 14% of the country's total. In consequence, Hungary's traditional trade deficit with the new member countries turned into a substantial surplus. In addition, with the exception of Malta, Hungary has a trade surplus with each of the new member countries (probably a clear sign of international competitiveness, despite all predictions to the contrary).

Output strength

The present global crisis has arrested the upward turn of the Hungarian economy, which was expected after the severe convergence program in place since 2006. On 22/23 October 2008 there was a speculative attack against the Hungarian currency, which threatened the collapse of the Hungarian economy as a whole. Although this danger was avoided, the domestic conditions for a return to sustainable growth will still be greatly determined by the further development of the global crisis.

## 12 | Sustainability

Environmentally compatible growth is taken into account at the institutional level in important aspects of economic policy-making, but tends to be subordinated to growth efforts. A new act on environmental protection fees was passed on 10 November 2008, with a stricter implementation of the "polluter pays" principle. According to a Eurobarometer opinion survey conducted in 2008, 95% of Hungarians think that the European Union should be responsible for protection of the environment. Hungary was pushed to accept the EU climate package compromise at the 11/12 December 2008 European Council meeting. This

Environmental policy

agreement was not advantageous for Hungary, or for other new member states, since their levels of carbon reduction were determined on the basis of very low CO<sub>2</sub> emission figures resulting from the deindustrialization process in the nineties. But this was not taken into consideration by the old member states, and the new states' coalition was too weak in presenting their case.

The state ensures a nationwide system of training, including university education attended by roughly half of each age cohort, with a relatively high level of state funding. However, the education system in fact contributes to social inequality and structural unemployment, since the level of basic and middle-level education has become very uneven in different schools. The innovation triangle is weak, since research gets less than 1% of the state budget, and the link between innovation and production takes too long to develop, or often is altogether lacking. The OECD Review of Innovation Policy – Hungary (2008) comments that “additional government efforts are needed to mobilize the scientific community.” The EU Competition Council decided on 18 June 2008 to establish a new agency in Budapest, the European Innovation and Technology Institute (EIT), which has helped open new perspectives. Some multinational companies have also begun to locate their R&D activities in Hungary, but most SMEs are weakly connected these R&D operations, and have not appreciably benefited from these developments.

Education policy /  
R&D

# Transformation Management

## I. Level of Difficulty

“Natural” structural constraints are low; 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 Kádárist political culture’s legacy of demobilization and privatization, the democratic and economic reforms in the 1990s were not affected by violent conflicts or social unrest. The country has a tradition of the rule of law dating back to the Hungarian state during the Habsburg Empire, and most recently enhanced by EU membership, which has provided an external anchor for domestic reforms and a common platform for major political actors.

Structural  
constraints

Hungarian civil society to a great extent shares a common tradition with its Western counterparts, and its legal regulation has basically been the same for the last 20 years. Nevertheless, the living traditions and actual practice of Hungarian civil society have been markedly different, due partly to the interrupted development of Westernization, and partly to the drastically distorting effects of economic and political systemic change, with their perverse modes of privatization and power concentration. The living Western traditions of Hungarian civil society are today rather restricted, since recent history’s progress and setbacks have not allowed for the organic continuity of these traditions. Éva Kuti, a Hungarian sociologist, prepared an overview of the Hungarian civil society in May 2008 for the Economic and Social Council, a social and scientific advisory body to the government. She pointed out that there had been a very robust development until 2006, but this fell off in 2007 – 2008 with a setback both in terms of numbers and resources. Altogether only 4% of about 60,000 Hungarian civil organizations have any kind of international contacts, and very few of them are very active in the European Union.

Civil society  
traditions

Hungarian society has been deeply polarized along the cultural lines of “undigested history” –in particular over issues such as the post-World War I Trianon treaty (which stripped Hungary of significant territory) and the Kádár era, which manifest in today’s public debates as the controversy between modernization-Europeanization and nation-centric conservatism. Societal conflict intensity is high because of the confrontational nature of politics. The cultural cleavages may be deeper and more important than the economic cleavages. Extremist political actors

Conflict intensity

have recently been successful in mobilizing ethnic and/or religious conflicts as well. The “Trianon syndrome” has been revived by the neo-fascist and/or extreme-right forces, and it has become an ideological framing device with significant power. A public opinion survey from early October 2008 (before the effects of the global crisis reached Hungary) made it clear that Hungarians worry about the growing conflicts: 45% were concerned about increasing crime, and 33% about the deepening social conflicts. The main aspects of life valued by Hungarians are security for the family, happiness and material welfare (according to *Népszabadság*, the country’s leading daily, on 24 December 2008).

## II. Management Performance

### 14 | Steering Capability

The political leadership pursues long-term aims and considers the goals of sustainable economic growth and better governance to be strategic priorities more important than short-term expediency. Nonetheless, the socialist-liberal coalition government governing until 1 May 2008 was split on some basic goals, including the reform of health care and social policy. The new socialist minority government that took over in autumn 2008 turned immediately to the new strategic priority of fiscal stabilization and to the creation of preconditions for long-term economic development. The 2009 budget law was radically changed, three times in the course of a month. Ultimately, the budget plan contained some painful decisions for the population, including cuts in public employee salaries and in pensions. The priority given to crisis management was regularly part of the prime minister’s statements in late December 2008, and a large part of the population accepted the necessity of crisis management and considered the government’s activities to be successful. By January 2009, public opinion was to a great extent prepared for the presentation of a new reform program, as several public opinion surveys reported that around 70% of the population understood the need for austerity measures.

Prioritization

During the period under review, the government was determined in its agenda setting, but had only limited success in implementing its announced reforms. In June 2006 the government introduced tough measures aimed at reducing the budget deficit, without long consultations with the social actors that would be affected. This was combined with some other transformations to meet the requirements of the EU convergence program, and altogether marked the start of a new wave of top-down reform. However, the government was later unable to mobilize public support

Implementation



behind the reforms, and its popularity quickly sank. The main opposition party in turn was successful in mobilizing large parts of Hungarian society against the reforms in a referendum. In 2006 and 2007, the government created some special reform-centered institutions designed to take the lead in the new policies, but which were discontinued by 2008. The new flagship Ministry for National Development and the Economy (which also includes the National Development Agency) has proved to be rather efficient in absorbing EU transfers. Its minister, Gordon Bajnai, announced on 26 December 2008 that the EU funds allocated for Hungary in the 2004 – 2006 period had been nearly fully absorbed by the country, which was nearly unprecedented in EU history. At the government's request, the international consultancy firm KPMG prepared a proposal in late 2008 focusing on increasing efficiency in central government ministries and agencies. This proposal contained a list of the government's competencies, indicated the optimal way of carrying out mandatory public sector tasks, and made 450 suggestions for improving efficiency and lowering costs. The prime minister instructed his ministers to consider these suggestions and to concretize the KPMG proposal's recommendations in their own ministries.

The political leadership has demonstrated its ability for complex learning. It acts flexibly and can replace failed policies with new initiatives. For instance, the prime minister acknowledged in interviews about his 2008 experiences that his major mistake was running ahead in the reform process without properly securing social support. Policy learning can be observed on the part of the government, but much less on the part of the opposition, since Fidesz has proved resistant to reforms, and declared repeatedly that a change of government by means of an early election would solve all problems.

Policy learning

## 15 | Resource Efficiency

The government does not use administrative and budgeting resources efficiently enough. This problem is basically due to a lack of proper cooperation between and among ministries, as well as to the fragmented structure of public administration and intergovernmental relations. For example, Hungary's 3200 settlements are too small to provide public services efficiently. The settlements are grouped into 174 small districts, which lack the ability to perform local self-government functions. The 19 counties forming the intermediate level of public administration are also too small to perform functions of regional policy. The next larger territorial units are seven regions corresponding to the second level of the EU's system of territorial statistics (NUTS 2). However, these regions have only a weak constitutional-political status, since they are not self-governed and lack an elected, legitimate leadership. Laws aimed at strengthening the 174 small districts and seven NUTS 2 regions were blocked by the opposition. As a consequence, the Hungarian system of

Efficient use of assets

public administration is not competitive enough by EU standards. The hope is that under the pressure of the global crisis, these reforms can be passed in 2009 in order to have a more efficient public administration.

In general, the government has had difficulties with policy coordination, and even more so with respect to conflicting objectives. This limited success was visible during the coalition government, as the partners publicly criticized each other in discussing their conflicting objectives. In fact, there was only a very narrow sphere for policy activity given the two major objectives of balancing the budget and maintaining social protection for the needy. Policy coordination is also minimal throughout the state administration, since the ministries oversee about two dozen fragmented “deconcentrated agencies” in the regions and counties that are unable to harmonize their activities efficiently. Although Hungary did develop a mid-term strategy for harmonization with the EU, the conflict between this strategy and the measures devoted to crisis management created serious problems for policy coordination in many policy fields.

Policy  
coordination

To prepare for its EU team presidency with Spain and Belgium, Hungary’s government and public administration increased their management capacity for cooperation. Preparations for the execution of the rotating presidency have had a visible modernization effect, and have included EU training for core administration personnel. Europeanization has in fact appeared as a component in the process of “integrative balancing” that has characterized the team presidency preparations. In mid-January 2009, Spain, Belgium and Hungary agreed on a set of common team priorities for 2010 – 2011.

So-called black corruption, with its direct exchange of money, is not the major issue in Hungary. However, its milder form of behind-the-scene exchange of mutual benefits is widespread. In fact, despite the presence of conflict-of-interest legislation, political life and business activities have not yet been properly separated, and many politicians use their political activities to benefit their business interests. Legal regulations are often formally met, but the mixture of political and business actors’ interests permeates Hungarian society. The corruption problem in Hungary can be traced in part to a lack of proper regulation of party financing; thus, party funding comes partly from illegal business partnerships. The government has repeatedly made serious efforts to contain business-related political activities, but with only mixed success.

Anti-corruption  
policy

## 16 | Consensus-Building

All major political actors agree on the goal of building a market-based democracy. But this fundamental goal is no longer the main issue.

Consensus on goals

Reformers can successfully and permanently exclude anti-democratic actors. Fidesz, the main opposition party, cannot be deemed a true anti-democratic actor, but in fact has initiated a street campaign against the government's reforms, and has directly and indirectly protected the manifestly anti-democratic actors.

Anti-democratic veto actors

The political leadership has to some extent been successful in preventing cleavage-based conflicts from escalating, or has at least managed to marginalize those extremist groups with the potential to escalate conflicts. In this respect, Fidesz has engaged in double-talk, encouraging extremist groups in their anti-government activities to some extent, but also condemning violent actions on the other. It is very sad that following the events of September 2006, when an extreme-rightist mob attacked the public television building, Hungary has become known in the international media for regular acts of violence in the streets of Budapest, usually on the national holidays (15 March and 23 October). Conflict management concerning the Roma population has been worsened by the emergence of the "Hungarian Guard" paramilitary organization; the judicial process has proved too slow to block this group's activities, although a sentence at the lowest court level has been passed. During the period of review, it became clear that the government and opposition did not consider each other as partners with respect to conflict management, and that they lacked even a minimal degree of mutual respect.

Cleavage / conflict management

In spring 2008, the Hungarian European Business Council (HEBC; the Hungarian section of the European Roundtable of Industrialists) published its 10th annual report: "Progress is the only way." This report indicated that the March 2008 referendum initiated by Fidesz signaled a "start of a protracted crisis," since important reforms were thwarted by the referendum. HEBC invited the Hungarian parties to reach a new consensus "with respect to strategic long term policy matters." It also asked business circles to examine how they could contribute to the development of societal culture, and pointed out that societal culture and social trust were very important factors in international competitiveness. On 18 October 2008, as a reaction to the emerging global crisis, the government convened a national summit of parties, business leaders and public figures, but this reached no consensus.

The political leadership assigns an important role to civil society actors in the process of deliberating and determining policies. However, it does not take into account the high asymmetry in these groups' capacity for interest representation, and does not extend its institution-building process to these "meso-level" actors.

Civil society participation

Therefore, dialogue between the government and civil society actors is often erratic. Powerful actors on the employers' side push the government to act according to their interests, while weaker actors are silent or resort to aggressively anomic or irrational reactions. Organized civil society has nevertheless played a positive role, perhaps most of all in the National Interest Reconciliation Council that has played a significant part in managing crisis late in the review period. The Economic and Social Council (GSZT) has also become an important public actor, developing contacts with partners in the other EU member states as well as with the European Economic and Social Committee.

For years, historical reconciliation appeared to be a success. However, in recent years the main opposition party has reopened public discussion on the evaluation of systemic change, accusing the government of representing the old communist elite. In fact, the negative side of the long, evolutionary and negotiated transition is that the population did not feel a historical turning point, or a big event that marked the end of the former regime. In Hungary, there was rather continuity in the negotiated transition, and the radical political and economic changes took place not overnight but in several steps. Thus, there is an opportunity for demagogues to argue that no real systemic change took place, even though the country is now basically a consolidated democracy and market economy. However, those who feel harmed by economic and social transformations tend to identify their problems as stemming from a lack of systemic change or elite turnover.

Reconciliation

## 17 | International Cooperation

International support for Hungary appears in the form of EU transfers. Although the opposition has criticized the government's practice of absorption of these funds, in fact Hungary has proved itself to be one of the most efficient countries in using transfers in its long-term catching-up strategy. The government has developed a fairly efficient system of institutions for the absorption of EU funds, and has a relatively well-organized sector of micro-level firms and civic organizations.

Effective use of support

The government is considered credible and reliable by the international community. However, in the European Union context, the government has to fight for the recognition of the special position of the new member states, and it has not always been successful in clarifying its approach for the older EU states. In general, Hungary and its government have been very active and have taken initiative in transnational EU organs. Credibility problems have been caused by the country's extreme political polarization, which has led the opposition party to use all means at its disposal to undermine the government's international credibility.

Credibility

The political leadership has actively and successfully built and expanded cooperative international relationships. The country's work in the Visegrad Group

Regional cooperation

framework is one such example. The government has promoted regional and international integration, and the country's relationships with its neighbors are fairly good – certainly with Austria, but also increasingly so with Romania. Joint government meetings have been held with Austria, Romania, Croatia and Slovenia. Hungary supported Serbia's approach to Brussels and, in January 2009's collapse in energy supplies, it delivered extra natural gas from its own reserves to Croatia and Serbia. Good political relations have been accompanied by excellent transnational business contacts. Slovakia is an exception in this regard, but the populist Slovak government has to bear the most blame for these bilateral tensions. This conflict reached a peak in autumn 2008, and can be expected to persist through the middle term, until the Slovak nation-building process becomes more balanced.

## Strategic Outlook

Hungary's main strategic objective is to become a successful EU member state, and to catch up rapidly with the EU average. This strategic objective presupposes the launch of new radical reforms beginning early in 2009. Reforms should not be left for "good times," since those good times will never arrive without these reforms. In recent years people in Hungary have suffered both because of reforms and the lack of reforms. There have been many reform efforts, sometimes successful, but sometimes erratic; this has created reform fatigue. People have felt that further reforms may still be needed in many walks of life, but a certain "not in my backyard" syndrome has taken effect.

The socialist-liberal coalition governing in 2007 – 2008 underperformed with respect to reform management mostly because of the Liberals' dogmatic belief that the market could work miracles. Moreover, Fidesz mobilized successfully against the necessary reforms in the hope that it could regain power "from the street," taking advantage of increasing mass discontent both with ongoing reforms and the lack of reforms. The result was a paralysis in early 2008, broken in late 2008 by the global financial crisis. This crisis has shaken Hungarian society, but has offered a chance to relaunch radical reforms. In early 2009, Hungary is thus in a situation of creative crisis. This crisis poses substantial danger, but also provides an opportunity to design and implement a new reform strategy. This strategy must first of all stop the escalation of the financial crisis, and create the preconditions for further sustainable growth. Returning to sustainable growth will require further Europeanization, including the introduction of the euro, efficient absorption of EU transfers, and modernizing or Europeanizing the public sector and public administration. In Hungary, public sector reforms are the key issue. The most difficult tasks ahead will be reforming the health care, education and pension systems, and radically decentralizing public administration by means of regionalization and multilevel governance. Last but not least, there is also need for successful social engineering or effective reform management.

At least two preconditions must be met in order to remove the roadblocks to reform. First, coalitions reflecting a national consensus must be built in parliament, supported by a written or tacit social pact. Second, this pact must have broad social support among the Hungarian population, which can only be produced by a process of reform discourse. Altogether, this means building a coalition for the support of reforms with political and social partners and negotiating with all stakeholders, and possibly with all larger strata of citizens. For successful reform, Hungary's government must develop a road map for reforms and ensure that this plan is well understood by the population at large. In this way, the public can be mobilized, and expectations can be met. The main difficulty will be avoiding the populist trap by integrating a diversity of stakeholders in the decision-making process.

Hungary's experience has shown that cycles of consent and dissent may come one after another; thus a switch from the present period of dissent to popular consent is still likely, as this kind of change took place in the late eighties.