

# BTI 2016 | Hungary Country Report

	scale	score	rank	trend
<b>Status Index</b>	1-10	<b>7.69</b>	# 18 of 129	
Political Transformation	1-10	7.60	# 25 of 129	➔
Economic Transformation	1-10	7.79	# 16 of 129	➔
<b>Management Index</b>	1-10	<b>4.67</b>	# 76 of 129	

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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**Key Indicators**

Population	M	9.9	HDI	0.818	GDP p.c., PPP \$	24498.5
Pop. growth <sup>1</sup>	% p.a.	-0.3	HDI rank of 187	43	Gini Index	30.6
Life expectancy	years	75.3	UN Education Index	0.805	Poverty <sup>3</sup>	% 0.0
Urban population	%	70.8	Gender inequality <sup>2</sup>	0.247	Aid per capita	\$ -

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

## Executive Summary

The defects of democracy in Hungary have persisted and become more entrenched during the period under review. The governing political parties won the national, European Parliament and subnational elections in 2014. Tailored electoral legislation, biased media coverage and the partisan misuse of state resources enabled the Alliance of Young Democrats – Hungarian Civic Union (best known as Fidesz) and the Christian Democratic People’s Party (KDNP) to regain a two-thirds majority in the 6 April 2014 parliamentary elections, although their vote share decreased from 52.7% in 2010 to 44.9%. While the democratic opposition remained fragmented and marginalized, a right-wing extremist party, Movement for a Better Hungary (Jobbik) increased its vote share to 20%.

Led by Prime Minister Viktor Orbán, the Fidesz–KDNP government consolidated its power by undermining and removing democratic checks and balances. The governing Fidesz elites and their affiliated business groups expanded their control over the media system by buying one of Hungary’s two largest private TV channels, TV2, and subjecting the other, RTL Klub, to a prohibitive tax. Independent print and online media continue to exist, but the government tried to tax access to the latter and selectively channels state advertisements to pro-government media outlets.

The governing parliamentary majority neutralized the Constitutional Court by replacing judges, restricting its review powers and overturning its rulings through constitutional amendments. The governing majority increased the power of the government-appointed National Office for the Judiciary and introduced government-appointed administrative-financial directors in universities to limit the autonomy of these spheres.

Using audits and criminal investigations, the government exerted strong pressure on civil society organizations (CSOs) charged with, and benefiting from, the distribution of Norwegian funds to support civil society in Hungary.

The government increased the state's influence over the economy by acquiring stakes in the banking and energy sectors, by introducing a large-scale public works program comprising 10% of total employment, and by offering state-subsidized loans for more than 20,000 small- and medium-sized enterprises (SMEs). Sector-specific taxes were imposed mainly on the Hungarian subsidiaries of foreign banks, multinational retailers, telecommunication, energy and tobacco companies.

High-level political corruption scandals affected the National Tax and Customs Office, the minister heading the prime minister's Chancellery and other Fidesz politicians, prompting the United States to ban six Hungarian government officials from entering the United States. In a July 2014 policy speech, Prime Minister Orbán declared his intention to build an illiberal state in Hungary and to learn from competitive, non-liberal states such as Singapore, China and Russia. Advocating an "Eastern opening" and an "interest-based" rather than a "value-based" foreign policy, Hungary criticized the EU sanctions on Russia and unilaterally agreed with Russia on upgrading its nuclear power plants and on continuing the Hungarian-Russian gas supply contract.

## History and Characteristics of Transformation

Hungary's transition to democracy took place after 40 years of communist rule. 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 regime. Not all spheres of social life were politicized, and private, economic and social life was partially liberalized. However, the communist leadership's primary legitimizing policy of 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.

Democratic transition was initiated by reformed communist elites. 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 negotiations were established between the communist leadership and the emerging opposition parties, following the Polish example. They resulted in the agreement to hold free elections in 1990 and to initiate the necessary constitutional amendments. The first democratic elections were won by center-right political opposition groups.

In the years that followed, Hungary was able to establish a stable democratic political system characterized by 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 underpinning democracy: public administration, the judicial system, media, non-governmental sector, education and social affairs. The democratically elected governments of the 1990s privatized state-owned companies, liberalized markets, attracted FDI and restructured the economy, which became 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 lasted from 1994 to 2008.

Hungary's governments successfully reduced the tensions with neighboring countries which had become homelands to sizeable ethnic Hungarian minorities after the First World War. Good neighborly relations developed that were not conflict-free, but were embedded in institutions and norms enabling the civilized resolution of disputes. The success of the democratic and economic transformation was acknowledged by the European Union when it decided to grant full membership to Hungary in 2004. The accession was preceded by intensive preparations, in the course of which Hungary implemented the full body of EU legislation and became deeply integrated into the European Union's internal market.

The global financial and economic crisis of 2008 hit Hungary harder than other East-Central European countries because of its successive large fiscal deficits, its high exposure to international financial markets, its dependence on foreign investment and its high levels of foreign exchange-denominated loans. These economic conditions and effects were compounded, firstly, by an erosion of confidence in the post-1989 political regime that had failed to deliver the mass prosperity benefits citizens had been expecting from democracy, by economic reforms and European integration. The leading right-wing opposition party, Fidesz, skillfully mobilized the widespread popular dissatisfaction against the governing socialist-liberal coalition, relying on a mix of antagonistic protest campaigns, populism and nationalism. Secondly, Hungary's mixed electoral system, designed to ensure stable governing majorities, produced an insurmountable polarization between the two major political parties and enabled Fidesz-KDNP to win a two-thirds majority in the 2010 parliamentary elections.

Fidesz-KDNP used this majority to fundamentally transform Hungary's constitutional, political and social economic system. The governing parties took control of the public media and numerous public sector institutions that had been designed to ensure accountability and the rule of law. The government weakened and destroyed the autonomy of the judiciary, the Constitutional Court, the National Bank of Hungary, the local self-governments and the remaining independent media outlets. It enforced a new constitution in 2011 that sought to "cement" Fidesz-KDNP policy priorities by making changes to the respective laws contingent upon a two-thirds parliamentary majority.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

There is no meaningful competition for the state’s monopoly on the use of force throughout the country. The New Hungarian Guard (estimated 200 members) and the Civil Guard Association for a Better Future (estimated 100–150 members), paramilitary groups associated with the extreme right political party Jobbik, have been active in rural areas of Hungary and have intimidated and provoked violent clashes with the Roma population.

A large majority of the population accepts the nation-state as legitimate. Individuals and groups enjoy the right to acquire citizenship without discrimination. In the 2011 census, 84% of the population identified itself as ethnic Hungarian. Roma are the most numerous minority community. While 3% of the population declared itself Roma in the 2011 census, their real share is estimated to be 8%. The Roma and other minorities are constitutionally entitled to establish self-governing bodies that were reelected in October 2014. However, Roma and other minorities have become frequent targets of harassment and hate speech.

The state is still largely defined as secular and the share of regular church-goers is relatively low (15% in 2012), but the government has tried to impose some religious – mostly Catholic – influence over public institutions. Zoltán Balog, a Calvinist pastor and advisor to the prime minister, has led the Ministry of Human Resources since 2012. This ministry has actively promoted Christian education in the public education system and the spread of schools managed by the Catholic and other major churches. Churches that are recognized by parliament receive more state funding, which enables the further growth of a religiously affiliated education system and other religious institutions. The “Christian course” – the name used by Hungary’s interwar period’s authoritarian regime to summarize their ideological stance of using religion to consolidate power – has made a significant return. The Catholic Church, and to a lesser extent, other “historical” churches, have played an eminent role in public media and in public events sponsored by the state.

Question  
Score

Monopoly on the  
use of force  
10

State identity  
9

No interference of  
religious dogmas  
9

The state maintains a differentiated administrative structure that provides all basic public services throughout the country. Hungary's central and territorial state administration has been completely restructured and centralized by the Fidesz-led government. The government abolished local self-governments in settlements with fewer than 2,000 residents, creating instead larger units of self-government. A newly established lower tier of district-level state administration took over some of the state functions that had previously been conferred to and exercised by local self-governments. County-level self-governments had to transfer their assets and important functions to the state administration. These changes replaced elected representatives with centrally appointed officials, weakened local self-government and strengthened patronage relations in territorial public administration.

Basic  
administration  
10

## 2 | Political Participation

During the period under review, parliamentary, European Parliament and subnational elections were held on 6 April, 25 May and 12 October 2014 respectively. The turnout was 63% at the national, 29% at the European Parliament and 44% at the subnational elections. The governing political parties, Fidesz-KDNP, won all three elections by tweaking electoral rules to their benefit and misusing state resources. The reforms increased the disproportionality of the electoral system. Whereas Fidesz-KDNP required 52.7% of the party list votes to control 68% of the seats in parliament in 2010, 44.9% of the votes were sufficient to control 67% of the seats in 2014.

Free and fair  
elections  
7

In its monitoring report on the national elections, the OSCE noted that “the main governing party enjoyed an undue advantage because of restrictive campaign regulations, biased media coverage and campaign activities that blurred the separation between political party and the State.” Parliament adopted a Law on Election Procedures in April 2013 and amended this law three times during the period before the elections; the Law on Elections of Members of Parliament was amended four times between December 2011 and July 2013. These changes included a reduction in the number of parliamentary seats from 386 to 199, modifying the allocation of seats, redrawing the boundaries of electoral constituencies and changing the appointment procedure of the election administration. The reform increased the share of seats allocated in single-member constituencies from 46% to 53%. Out of the 106 new constituencies, the size of five constituencies deviates by more than 15% from the national average, undermining the equality of the vote. District boundaries were gerrymandered so that most opposition strongholds tended to be more sizable districts, giving individual votes less effect. By abolishing the second round of voting, the reforms favored the governing Fidesz-KDNP, since the opposition parties lost the chance to agree on a common most popular candidate after the first round. The electoral legislation facilitated the registration of candidates and parties that contributed to splitting the opposition vote.

The new electoral system transferred the surplus votes of winning candidates (that is, the number of votes by which the winner exceeded the second-best candidate) in each constituency to parties participating in the national proportional contest, providing an additional six seats to Fidesz-KDNP. The government tried to make active registration as a voter mandatory for participation in the elections, but this attempt was thwarted by the Constitutional Court.

According to the OSCE election observer report, the government unduly disenfranchised 38,000 prisoners and 57,000 citizens with mental disabilities. To enfranchise approximately 550,000 ethnic Hungarians from abroad, the government simplified access to Hungarian citizenship and removed the previous eligibility requirement of a permanent residence in Hungary. While these new voters could cast a postal vote, out-of-country voters with permanent residence in Hungary could only vote in person at diplomatic missions. Aided by pro-Fidesz parties in neighboring countries, the Hungarians “over the borders” overwhelmingly voted for Fidesz (95.5%) and increased the party’s total vote share by approximately 1.5 percentage points. The balloting and counting procedure for these votes provided numerous opportunities for manipulation.

Since a constitutional amendment of March 2013 prohibited paid political advertisement in private broadcast media, and no private media program provided free airtime to the competing parties, political advertisements were only broadcast by public TV and radio stations. During the election campaign, government bodies employed advertisements that resembled the advertisements of Fidesz. Due to numerous government advertisements and the additional media presence of Fidesz-KDNP politicians as public officeholders, the governing parties clearly dominated the scheduling of the public broadcasters. According to an OSCE/Office for Democratic Institutions and Human Rights media monitoring, “three out of five monitored television stations displayed a significant bias toward Fidesz by covering nearly all of its campaign in a positive tone while more than half the coverage of the opposition alliance was in a negative tone.”

Elected rulers have the effective power to govern. Business elites, multinationals, the political representations of Magyar minorities in neighboring countries and the clergy have some influence on government decisions, but no veto power.

Effective power to govern  
10

There are no formal restrictions to association or assembly rights. However, the governing parties have sought to limit and influence activities of independent CSOs by withdrawing financial support or by placing their own supporters at the helm of formally independent associations, creating a government-allied civil sphere.

Association / assembly rights  
7

In August 2013, the government initiated a campaign against leading human rights groups and watchdog NGOs, arguing that these organizations were paid by “American speculators” to attack the Hungarian government, Fidesz and the prime

minister. In July 2014, Prime Minister Viktor Orbán labeled CSOs “paid political activists ... trying to help foreign interests.” In 2014, a government agency launched audits and criminal investigations against Ökotárs Foundation, which manages Norwegian funds to support civil society in Hungary, and numerous CSOs that benefitted from the funds. The Hungarian government raised charges of fraud and embezzlement, and in September 2014, police raided the offices of Ökotárs and DemNet, another foundation involved in the distribution of the funds. Government officials also claimed that Norway would use the funds to support the opposition party Politics Can be Different (LMP) and thus interfere with Hungary’s internal affairs. The government announced that it would introduce a legal requirement for CSOs funded from abroad to be specially registered.

Amendments to the constitution in 2013 enabled parliament to recognize certain religious communities as churches and grant privileges to these recognized churches. Since the constitution does not specify the criteria guiding this recognition, the parliamentary majority is given unlimited discretion to differentiate between religious communities and could even base such a differentiation on political grounds. This provision violates the principles of neutrality and impartiality that the state should respect vis-à-vis religious communities and the sphere of religious freedom. In a related decision, the European Court of Human Rights ruled in April 2014 that Hungary violated freedom of religion and freedom of association when it made the church status of religious groups contingent upon parliamentary considerations.

Opposition parties and organizations have been able to hold regular protest demonstrations against the government. In October 2014, approximately 100,000 people in Budapest and other Hungarian cities demonstrated against government plans to tax internet service providers. The demonstrations caused the government to withdraw its plan.

Freedom of expression is subject to interference and government restrictions. Public and privately owned media are supervised by a Media Council that is exclusively composed of persons appointed by the Fidesz-KDNP majority in parliament. The media law authorizes the Media Council to monitor whether media outlets ensure a “balanced coverage” of political views in their programs and to impose heavy fines on non-compliant outlets. This vague and broad criterion provides the council with a wide margin of discretion to sanction media outlets.

Freedom of  
expression

6

In March 2013, parliament amended the constitution to ban hate speech against national, ethnic, racial or religious communities and the Hungarian nation. The Venice Commission of legal scholars at the Council of Europe voiced concerns that the unclear terms of the amendment would enable authorities to widely apply the prohibition “to curtail criticism of the Hungarian institutions and officeholders,” thereby unduly limiting the freedom of speech. Amendments to the Criminal and

Civil Codes increased prison sentences for defamation and restricted criticism of public figures. Risks of politically motivated, potentially ruinous interferences and economic dependencies have undermined media pluralism and fostered practices of self-censorship among journalists and editors.

In June 2014, the independent news portal Origo published a story that revealed the excessive costs of official trips made by the state secretary heading the prime minister's Chancellery. The Hungarian subsidiary of Deutsche Telekom, the owner of Origo, subsequently dismissed the portal's editor-in-chief, causing most of Origo's editorial staff to resign in protest.

According to the Media Council, 3,359 print media outlets, 212 radio and 492 TV channels existed in Hungary in 2014. Most media outlets are associated either with the governing parties or with the opposition. Since 2010, the government has completely restructured and purged public TV and radio programs, whose reporting became biased in favor of the governing political parties. The audience for public TV decreased significantly – the average audience of the evening prime time news fell from 800,000 (2007) to 350,000 (2015).

During the period under review, Fidesz-affiliated business interests have increased their ownership of private media outlets – for example, by purchasing the popular TV2 channel. State advertising is selectively allocated to pro-government media. In March 2014, parliament amended the constitution to prohibit the broadcasting of paid political advertisements by private media. Following a wave of critiques from the European Commission and others, parliament again amended the constitution, but only to enable private media outlets to broadcast political advertisements free of charge.

In June 2014, parliament introduced a strongly progressive taxation of advertisements in media that set a tax rate of 50% for media outlets with revenues exceeding HUF 20 billion (\$90 million). This tax was targeted at the largest independent TV channel, RTL Klub, because only RTL Klub had revenues on this scale, and the Ministry of National Economy estimated that RTL Klub's contribution to the expected total revenue from this tax would amount to 87% (although RTL Klub's share of the advertising market was only approximately 14%). The CEO received threats of violence and decided to move his family out of the country and to hire bodyguards. In early 2015, the European Commission prohibited Hungary from applying the progressive tax rate and began to investigate whether the government had broken state aid rules and unfairly discriminated against certain media companies.

In October 2014, the government announced a plan to levy the usage of the internet, charging users HUF 150 (62 cents) per gigabyte of data. This triggered large demonstrations with tens of thousands of participants who protested against the additional financial burden and the restrictions to informational freedom rights associated with the tax. The scope of the protests caused the government to withdraw this plan.

### 3 | Rule of Law

The separation of powers is formally established but weak in practice. The executive has largely undermined all checks and balances. To tie the hands of possible future opposition-led parliamentary majorities, the governing Fidesz-KDNP have adopted a constitution (called the “Fundamental Law”) that requires two-thirds majorities to change cardinal laws regulating over 50 issues and sectors.

Separation of  
powers  
5

The Fundamental Law was amended five times between January 2012 and September 2013. During the period under review, parliament adopted two amendments in March and September 2013. The March amendments deprived the state president of the right to request a constitutional court review of bills on substantive grounds. In addition, the amendments constrained the powers of the Constitutional Court to check the parliamentary majority. The Court is no longer entitled to examine constitutional amendments on substantive grounds and may no longer base its jurisdiction on rulings from the period prior to the Fundamental Law. These restrictions contradict established practices of constitutional review in many European democracies.

Relying on its two-thirds majority in parliament, the government several times assigned constitutional status to law provisions that had previously been found unconstitutional by the Constitutional Court. This method effectively withdrew these provisions from constitutional review and thus disabled an important institutional check on executive power. It reflects, as the Venice Commission of legal experts at the Council of Europe noted, “an instrumental view of the constitution as a political means of the governmental majority.”

The state president is a loyal Fidesz politician who returned several bills to parliament for revision, but did not question problematic major bills. The government has replaced the leadership of numerous supervisory, whistleblower and watchdog institutions – such as the State Audit Office, the Public Prosecutor’s Office, the Hungarian National Bank (MNB), the Monetary Council supervising the MNB and other bodies – with its own supporters. In 2013, the government replaced the ombudsperson on basic human rights with a new officeholder who has exercised more restraint than the previous ombudsperson in advocating citizens’ concerns vis-à-vis the government.

The governing parties have weakened the roles of parliament and the parliamentary opposition as checks on executive authority. For example, they have restricted the rights of opposition deputies to access government documents. According to Kim L. Scheppele, a legal scholar, Fidesz retained its two-thirds majority after the 2014 elections only by changing the rules of parliamentary procedure to enable the speaker of the house to participate in voting.

While several referenda were held under the socialist-liberal government, the new constitution has restricted the scope for using this instrument to check executive power. The constitution endows the (government-controlled) National Election Committee with wide discretion to reject referendum initiatives, and the committee has refused several opposition-led initiatives, for example, on the construction of a new nuclear power plant in Paks.

The judiciary's independence is constrained by the political authorities. In March 2013, parliament amended the constitution to restrict the Constitutional Court's scope of review. The court may no longer substantively examine proposed constitutional amendments and may not refer to its jurisdiction predating the current constitution's entry into force. Its previous prohibition on reviewing laws related to public funds was extended. At the end of 2014, 11 of 15 Constitutional Court judges had been appointed by the governing majority unilaterally, ignoring the views of the parliamentary opposition. CSOs that compared the court's rulings in 23 high-profile cases prior to and after the replacement by government-selected judges found that the court's jurisdiction clearly shifted toward favoring the government.

Independent  
judiciary  
6

The 2011 Fundamental Law and a subsequent law on the organization and administration of the courts have established the Kúria (the successor institution of the Supreme Court), a National Judicial Council (OBT) and a National Office for the Judiciary (OBH) as bodies governing and managing the judicial system. While the OBH's president, who is elected by a two-thirds majority of parliament, is responsible for the administration of courts, the OBT, which is elected by judges, was initially supposed to supervise the OBH. A constitutional amendment in March 2013 downgraded the OBT to a consultative body and reinforced the OBH's power "without any indication of the necessary limitations and the checks and balances to which it must be subject" (Venice Commission of legal experts at the Council of Europe). The constitutional amendment of September 2013 reassigned a supervisory role to the OBT and reduced the power of the OBT president.

As the wife of the author of the new constitution, József Szájer, OBT President Tünde Handó belongs to the upper echelons of Fidesz leaders. The OBT and Kúria presidents have made a series of politically biased decisions, ordering and influencing court business against former government officials.

In May 2014, the European Court of Human Rights (ECHR) ruled that the former president of the Supreme Court, András Baka, was deprived of his right to a court hearing when the government decided to dismiss him by transforming the court into the "Kúria." The ECHR also found that the government violated the rule of law when it averted a judicial review of this institutional reform by giving it a constitutional status.

In 2012, the government forced 274 judges and prosecutors into early retirement by reducing the retirement age. Since the European Court of Justice then ruled that this action unduly discriminated against the judges according to their age, in March 2013 the Hungarian parliament postponed the reduction of the retirement age and entitled the judges/prosecutors who had reached the new retirement age to decide for themselves whether to retire or stay in office.

Corrupt officeholders are generally prosecuted under established laws, but occasionally slip through political, legal or procedural loopholes. In 2013, parliament amended the Law on the Operation and Financial Management of Political Parties to restrict the scope of donations parties are allowed to accept. Yet the law does not define maximum limits for private donations to political parties and does not regulate campaigning by party-affiliated CSOs. Fidesz used this legal loophole to organize an advertising campaign that was run by a government-allied NGO called Civil Unity Forum (CÖF) and aimed to discredit the Socialist Party leadership. A 2014 report by the Group of States Against Corruption (GRECO) at the Council of Europe noted that the government had not implemented six of its 15 recommendations from the previous evaluation round. In particular, Hungary had not established a transparent accounting of political parties, and had failed to ensure independent auditing and efficient monitoring of party accounts.

In November 2013, András Horváth, then an employee of the National Tax and Customs Office (NAV), claimed that NAV assisted several large companies, in particular large retail chains, in evading HUF 1 billion VAT payments. The government refused to investigate the matter, and instead the police raided Horváth's flat, suspecting him of having abused his office. In early 2015, the State Audit Office confirmed Horváth's allegations when it reported that NAV did not act against major VAT payers that did not fulfill their tax obligations in the 2009 – 2013 period. This time the Minister of the National Economy called on NAV to investigate the violations. Observers explained the government's U-turn by the simultaneous outbreak of a row between Prime Minister Orbán and Lajos Simicska, the most influential Fidesz-affiliated businessman to be closely linked with the head of NAV.

In October 2014, the U.S. government banned six Hungarian government officials from entering the United States because it considered them engaged in or benefiting from corruption. Referring to data protection rules, U.S. diplomats neither disclosed the names of the officials, nor substantiated the charges. The head of the NAV, Ildikó Vida, later identified herself as one of the Hungarians affected.

Several leading Fidesz politicians did not correctly declare their assets. For example, the president of Fidesz, Lajos Kósa, and the minister of Foreign Trade and Foreign Affairs, Péter Szigjártó, did not fully report their real estate holdings, and Antal Rogán, the Fidesz faction leader, has adjusted the size of his assets several times. Officials also avoided declaring their assets by registering them under the names of close relatives.

Prosecution of  
office abuse

7

Civil rights are codified by law, and mechanisms and institutions to address violations of civil rights are in place, but are not consistently effective. Instances of violence, intimidation and hate speech against Roma people (approximately 8% of Hungary's population) continued during the period under review. There were also manifestations of xenophobia against refugees and asylum seekers. Right-wing extremists frequently used anti-Semitic cues in their public statements. The Hungarian authorities have condemned anti-Semitic incidents, but have also rehabilitated representatives of the Horthy regime known for their collaboration with the Nazi regime in deporting Jews from Hungary during the Second World War. Hungary's legislation against hate crimes and hate speech has been reinforced, and several steps have been taken to combat hate crimes more effectively. According to a 2014 report by the European Commissioner for Human Rights, the Hungarian police prosecuted 30 cases of hate crimes or speech in 2013.

Civil rights  
8

In March 2013, parliament amended the constitution to empower local self-governments to criminalize homeless persons loitering in public spaces.

Roma and other minorities (including LGBTI people) and vulnerable groups were subject to discrimination. Women are underrepresented in leadership positions. For example, the share of female deputies was only 9.5% in the 2014 parliament and 9.1% in the previous legislature.

#### 4 | Stability of Democratic Institutions

The dominance of Fidesz-KDNP and its policy of systematically weakening the institutions that surround and check the executive has prevented an effective scrutiny of legislation. In 2013, parliament continued to adopt a huge number of laws – 252 in total. The 2014 elections decreased the legislative output to 97 laws. Some laws were amended several times, indicating the lack of due diligence in lawmaking.

Performance of  
democratic  
institutions  
7

Individual deputies of the governing parties submitted approximately one third of all Fidesz-KDNP bills. Deputy-sponsored bills were frequently used to speed up the legislative process, because such bills do not require consultation with experts and interest groups. During the 2010 – 2014 legislative term, 95% of all government-sponsored and 78% of Fidesz-sponsored bills were adopted. Of 859 adopted laws, only two were submitted by opposition parties (LMP and Jobbik). In the period between May and December 2014, no opposition-sponsored bill was adopted.

The introduction of the cardinal laws requiring a two-thirds majority did not lead to a consolidation of Hungary's legal order or to improvements in legal certainty. According to parliament's activity reports, between May and December 2014, Hungary's parliament decided 14% of all votes according to the qualified majority rule. This share was not significantly lower than the 18% of qualified majority votes

during the 2010 – 2014 legislative term, indicating the persistent need to revise and complement laws of key importance.

In a 2015 report on Hungary, the European Commission found that “the quality of Hungarian legislative processes suffers from lack of transparency, compromised ex ante impact assessments and the short transition periods given to those affected by the legislation to prepare for its implementation.”

The majority of Hungarian political parties are committed to democratic institutions, or at least pay lip service to the ideals of democratic institutions. In August 2014, Prime Minister Orbán declared his intention to build an “illiberal state” that “does not deny foundational values of liberalism, [of] freedom” but that also “does not make this ideology a central element of state organization.”

Commitment to  
democratic  
institutions  
8

The right-wing extremist party Jobbik was supported by 20.2% of the voters in the 2014 national elections and became the second-largest party in 18 of 19 county assemblies in the October 2014 subnational elections. Jobbik promotes a vision of an ethnic Hungarian nation-state that transcends Hungary’s current borders by encouraging the self-determination of ethnic Hungarian minorities in neighboring countries. The party has revived historical symbols once used by Hungarian fascist groups, and has repeatedly instigated anti-Roma and anti-Semitic conflict. Jobbik is allied with several radical CSOs including paramilitary groups that have succeeded the Hungarian Guard, which was banned in 2009. Fidesz has tolerated, accommodated and sometimes even cooperated with Jobbik.

## 5 | Political and Social Integration

Hungary’s party system has been characterized by high levels of polarization, high vote–seat disproportionality, a fragmented opposition and a major right-wing extremist party. At the end of January 2015, the governing right-wing parties – Fidesz and the KDNP – controlled 133 of 199 seats in Parliament, although they obtained only 45% of the (constituency and party list) votes in the April 2014 elections, eight percentage points less than in the 2010 elections. The main opposition alliance had 19% of the seats (26% of the votes) and consisted of five parties: the Hungarian Socialist Party (MSZP); Together 2014 (E2014), headed by former Prime Minister Gordon Bajnai; the Democratic Coalition party (DK) of former Prime Minister Ferenc Gyurcsány; the green liberal Dialogue for Hungary party (PM) and the Hungarian Liberal Party (MLP) led by Gábor Fodor. This alliance increased its vote share by six percentage points compared to 2010. 12% of the seats (20% of the votes, up from 17% in 2010) are held by the right-wing extremist Jobbik, rendering it the largest single opposition party. The smallest opposition party, the green-liberal LMP, has 3% of the seats (5% of the votes, two percentage points less than 2010). A scholarly study from 2012 estimated the share of party members to be 1.54% of the

Party system  
7

Hungarian electorate in 2008, which is one of the lowest shares in Europe. The number of party members decreased by 28.6% between 1999 and 2008. Electoral volatility (the sum of changes in vote shares of legislative parties between the 2014 and 2010 elections, divided by two) declined to 9.9%.

Hungary has an average range of interest groups, which reflect most social interests. Business interests are represented in the Hungarian Chamber of Commerce and Industry, the Hungarian Agrarian Chamber, the National Association of Entrepreneurs and Employers, and the Confederation of Hungarian Employers and Industrialists. These associations and the major trade unions cooperate with the government in the framework of a Permanent Consultation Forum.

Interest groups  
7

Following the 2014 parliamentary elections, several trade unions asked the government to negotiate the reform of the labor code, early retirement regulations and other social economic issues, but the government did not accept their proposal. The three largest trade unions of Hungary – the National Federation of Hungarian Trade Unions (MSZOSZ), the Cooperation Forum of Trade Unions (SZEF) and the Alliance of Autonomous Trade Unions (ASZSZ) –formed an umbrella organization in December 2013. In early 2015, ASZSZ and MSZOSZ decided to merge.

Approval of democratic norms and procedures is fairly high. In a Eurobarometer survey conducted in November 2014, 35% of respondents declared they were satisfied with the way democracy works in Hungary. The share of satisfied citizens had declined by five percentage points since November 2013 but was the same as in May 2010, when the Fidesz-KDNP government first took office. According to the Eurobarometer surveys, popular trust in the government and parliament increased from 21% (July 2012) to 33% and 29%, respectively, in November 2014.

Approval of democracy  
8

In the European Social Survey conducted in 2012, 90% of Hungarians declared that living in a democratically governed country would be important for them. The turnout in parliamentary elections continually declined from 70.5% in 2002 to 62.8% in 2014.

There is an intermediate level of generalized social trust, and engagement in civic associations is relatively limited. According to the European Social Survey conducted in 2012, 58.4% of the citizens declared that most people can be trusted. This share had increased by 13 percentage points compared to 2010, and was close to the unweighted average of 61% for a sample of 28 European countries. The same survey also found that the share of citizens involved in work for voluntary or charitable organizations was 20.4%, significantly lower than the unweighted average of 36.7% in a sample of 28 European countries. According to the Hungarian Statistical Office, the number of social organizations was about 65,000 in 2012.

Social capital  
6

Increasing socioeconomic disparities have widened social distances between different milieus and segments of Hungarian society. The omnipresent government ideology and practice of dividing society in “we/friends” and “others/enemies” (a

differentiation which may target ethnicity, religion or political affiliation), leaving no room for a “neutral status,” has pervaded Hungarian society down to family and personal level. The constant over-politicization (which is now much stronger than it was under communism in the 1960s) of all spheres of life has destroyed a considerable amount of social trust in Hungarian society. The larger political parties have tended to create associations to represent interests that are affiliated with the party’s interests – yet these structures are not as stable as in the Dutch pillarization system, for example. Apart from these semi-official associations, grassroots civil society is weak.

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Poverty and inequality are limited, but structurally ingrained. In 2013, Hungary’s HDI score was 0.818 (43rd in the rankings), placing the country higher than Croatia but lower than Poland, the Czech Republic or Slovakia. In 2013 the country’s Gini coefficient was 28 (Eurostat figures), which indicates that income inequalities are lower than the average of 30.6 for the new EU member states. But since 2010, the coefficient has increased by nearly four points.

In 2013, according to the European Statistical Office (Eurostat), 33.5% of the population had disposable incomes that were under 60% of the national median equivalized disposable income, or the at-risk-of-poverty rate as defined by the European Union. This rate had increased by 5.3 percentage points since 2008 and has exceeded Poland’s at-risk-of-poverty rate since 2009, but declined to 31.1% in 2014. The poverty headcount ratio, denoting the share of persons who live on less than two dollars per day at purchasing power parities, was 0.17% of the population in 2011 (World Bank data). Roma, low-skilled workers, unemployed persons, single parents, and people living in rural areas and in the eastern regions of Hungary are particularly vulnerable to impoverishment. Hungary’s employment rate increased from 62% (2012) to 67% (2014), largely due to large-scale public works programs started by the government.

Question  
Score

Socioeconomic  
barriers  
8

Economic indicators		2005	2010	2013	2014
GDP	\$ M	111890.1	129583.0	133423.9	<b>137103.9</b>
GDP growth	%	4.3	0.8	1.5	<b>3.6</b>
Inflation (CPI)	%	3.6	4.9	1.7	<b>-0.2</b>
Unemployment	%	7.2	11.2	10.2	-
Foreign direct investment	% of GDP	7.6	-16.2	-3.1	<b>8.8</b>
Export growth	%	12.9	11.3	5.9	-
Import growth	%	7.8	10.1	5.9	-
Current account balance	\$ M	-7883.4	346.3	5314.9	<b>5392.4</b>
Public debt	% of GDP	60.8	80.9	77.3	<b>77.0</b>
External debt	\$ M	86226.1	215935.4	196739.1	-
Total debt service	\$ M	24439.5	104381.6	128224.0	-
Cash surplus or deficit	% of GDP	-7.3	-3.5	-	-
Tax revenue	% of GDP	20.0	22.8	-	-
Government consumption	% of GDP	22.3	21.7	19.9	-
Public expnd. on education	% of GDP	5.4	4.8	-	-
Public expnd. on health	% of GDP	5.9	5.2	5.1	-
R&D expenditure	% of GDP	0.94	1.17	-	-
Military expenditure	% of GDP	1.4	1.0	0.9	<b>0.8</b>

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

## 7 | Organization of the Market and Competition

Market competition is guided by state-guaranteed rules, but the informal economic sector in Hungary is large, estimated at 25% of GDP. The government has imposed special taxes on financial institutions, energy service providers, telecommunications, and retail and advertising companies. Their share in GDP increased from 1.4% (2010) to 1.8% in 2013 (data from the OECD). While these taxes are particularly aimed at foreign and multinational companies, the government has supported domestic and in particular Fidesz-associated firms through public procurement tenders. For example, in December 2014, parliament adopted a law that obliges large retail businesses to close on Sundays, whereas small, family-owned shops may remain open.

Market-based  
competition  
8

In a 2015 report on Hungary, the European Commission noted that “the unstable regulatory framework, the lack of transparency in decision-making procedures and inadequate consultation of interested parties are, together, weighing heavily on the business environment.” According to the Doing Business Survey conducted in 2014, registering a business in Hungary takes, on average, four procedures, five days, and involves costs amounting to 8% of Hungary’s per capita income. While these figures place Hungary above other East-Central European countries, the capital required to register a business is much higher than in other East-Central European countries (54% of the country’s per capita income). Whereas an average Hungarian SME spent 277 hours per year fulfilling its tax obligations, the average time for member states of the OECD was 175 hours.

Comprehensive competition laws and the Hungarian Competition Authority (GVH) try to prevent the abuse of dominant market positions as well as the formation of cartels and monopolies. The government has levied substantial taxes against foreign multinationals and banks. High barriers to market entry have limited competition in sectors such as retail, professional services, energy and telecommunications. A 2013 amendment to the competition law enabled the government to bypass GVH in authorizing mergers considered to be of national interest. The government used this provision in 2014 to permit 13 mergers. In April 2014, the European Commission opened infringement proceedings against Hungary, because its parliament had adopted a law preventing GVH from sanctioning cartels on agricultural products.

Anti-monopoly  
policy  
8

The government concluded “strategic partnership agreements” with 52 multinational companies in order to promote investment and employment in Hungary.

Foreign trade is liberalized within the European Union as well as with third countries. The limitations and restrictions that do exist, mostly over “dangerous goods” such as weapons or dual-use products, are in line with EU law.

Liberalization of  
foreign trade  
10

The banking system and capital market are differentiated and oriented in principle to international standards. Banks and other financial institutions are supervised by the Hungarian National Bank. During the period under review, the government imposed specific taxes on banks and has increased its share in bank assets. The ratio of regulatory capital to risk-weighted assets improved from 16.3% (2012) to 17.9% in September 2014, providing banks with sufficient liquidity. The ratio of non-performing loans to total loans increased from 10% in 2010 to 16.8% in 2013, and decreased only slightly to 16.3% in September 2014. The government created an asset management company to relieve banks from non-performing loans amounting to 1.3% of GDP.

Banking system  
8

In 2013, parliament introduced a fee on financial transactions that burdened banks, which, however, succeeded in shifting the tax to their clients through increased service fees. In September 2014, parliament adopted a law forcing banks and leasing companies to compensate borrowers for past unilateral contract modification and for the use of foreign exchange spreads in calculating FX loan disbursements and repayments. A November 2014 Law on Fair Banking restricted the unilateral interest rate and cost increases set by banks and strengthened the rights of borrowers. Banks have responded by restricting their credit supply, which has contributed to a decrease in private investment.

In November 2014, the Hungarian National Bank and the Association of Commercial Banks agreed to convert foreign-exchange mortgages to forint loans in order to reduce the exposure of private debtors to exchange rate risk. These mortgages comprised approximately 25% of all household loans. Previously, FX debtors had been allowed to repay their debt early at a non-market exchange rate in 2011/2012.

The government intends to increase the domestic bank ownership to 50% of Hungarian banks' total assets. In September 2014 and in early 2015, the government acquired the Hungarian Trade Bank (MKB, Hungary's fifth largest commercial bank) and Budapest Bank (the eighth largest). In early 2015, the government agreed with the European Bank for Reconstruction and Development (EBRD) to decrease, among other taxes, the bank tax to EU levels by 2019, and to transfer all direct and indirect majority equity stakes held in local banks to the private sector by 2017. The agreement was linked to a deal between Erste Group, the EBRD and the government, according to which the two latter institutions would each acquire 15% stakes in Erste's Hungarian subsidiary, and Erste would disburse loans for public sector employees, agricultural producers and energy efficiency programs.

In addition, the government has begun to establish a financial center comprising the Hungarian Post, the restructured system of savings associations and the Hungarian Development Bank Group.

## 8 | Currency and Price Stability

The National Bank of Hungary (MNB) maintains a floating exchange rate regime and a monetary policy targeting inflation. The Hungarian forint depreciated between 2010 and 2014, with the price of one euro increasing from HUF 265 to more than HUF 300. The average annual consumer price inflation rate decreased from 3.9% in 2011 to -0.3% in 2014 (IMF data).

Anti-inflation /  
forex policy

8

In March 2013, parliament appointed the previous minister of National Economy to head the MNB. According to critics, this replacement finally enabled the government to take full control of the MNB. In October 2013, the MNB became responsible for the micro-prudential supervision of the Hungarian financial sector as the former Hungarian Financial Supervisory Authority (PSZÁF) was dissolved and integrated into the bank. In its 2014 Convergence Report, the European Commission raised concerns that the MNB was not fully insulated from financial obligations resulting from PSZÁF's activities, which might lead to monetary financing prohibited under EU law. In addition to this supervisory function, the MNB was also charged with managing the conversion of foreign currency into forint loans, providing subsidized loans to SMEs and cleaning up the portfolio of the Hungarian Trade Bank. Moreover, the MNB in 2013/14 transferred approximately €70 million to five foundations its leadership had established to educate banking experts.

The government's fiscal and debt policies generally promote macroeconomic stability, but lack institutional safeguards and are prone to populist policy changes. Hungary has the largest public sector in East-Central Europe, amounting to 50% of GDP in 2013. The fiscal deficit was -2.4% of GDP in 2013 and an estimated 2.6% of GDP in 2014. In June 2013, the European Union closed the excessive deficit procedure because Hungary had met the convergence criterion of a maximum fiscal deficit of three percent of GDP. The nominal gross public debt gradually decreased to 77.3% (2013) and 76.9% of GDP in 2014. Official reserves comprised €34.6 billion in 2014. The gross external debt decreased from approximately 150% of GDP in 2009 to 116% at the end of 2014. In March 2015, Standard & Poor's upgraded its long-term foreign and local currency sovereign credit ratings for Hungary from BB+ to BB, which is, however, still a non-investment grade.

Macrostability

6

According to the European Commission, the high level of government debt remains an important source of vulnerability for Hungary's economy. Moreover, increasing state interventions and acquisitions in the banking sector are associated with significant fiscal risks. Following the insolvency of the partly state-owned Széchenyi Bank and the resolution of the likewise state-owned Hungarian Trade Bank in December 2014, two Hungarian brokerage firms crashed in early 2015.

## 9 | Private Property

Property rights and regulations on acquisition, benefits, use and sale are well-defined, but the government has weakened the protection of property rights. In its 2014 Doing Business report, the World Bank ranked Hungary 52nd out of 189 countries in the registration of property. The same report ranks Hungary 20th out of 189 countries with respect to the time and costs required to enforce a contract through the courts. In October 2014, the European Commission opened an infringement procedure against Hungary, because restrictions on the rights of investors to use farmland would, as the Commission argued, violate the free movement of capital and the freedom of establishment.

Property rights  
9

Private companies are viewed institutionally as important engines of economic production. They are given legal safeguards, and the private sector accounts for more than 80% of GDP. However, the government has increased its influence in the economy and over private enterprises. The state acquired stakes in the banking and energy sectors, subsidized public works and introduced numerous sector-specific taxes.

Private enterprise  
9

In 2013, the Hungarian National Bank introduced a Funding for Growth Scheme to improve the credit conditions for SMEs. The volume of the scheme was about four percent of GDP, and more than 20,000 SMEs participated in its first two phases (2013 – 2015).

## 10 | Welfare Regime

Social safety nets are well developed, but do not cover all risks for all strata of the population. In recent years, the gap between society at large and economically marginal groups has become more marked, and the reintegration of these groups into the mainstream more difficult, since the trap of social exclusion has been deepened by the global economic crisis. The at-risk-of poverty rate and other poverty indicators have increased since 2008.

Social safety nets  
8

While the government has introduced a flat rate tax on incomes to the benefit of higher income groups, increases of consumption taxes disproportionately affect lower income groups. The government promotes a workfare model of social policy and has massively extended the scope of public works since 2010. The number of participants increased to ten percent of total employment at the end of 2013. While the official aim of the public works scheme is to facilitate the return of long-term unemployed to the labor market, an IMF report based on 2013 data indicated that only 13.3% of the participants were able to find jobs on the primary labor market within 180 days of leaving the program. The scheme has contributed to an increase in Hungary's

employment rate (the proportion of working age population in employment) to 58.4% in 2013, but this level is still the lowest among the East-Central European countries. The government restricted access to early retirement and reformed the system of disability benefits in order to increase labor market participation.

The government has centralized the management of hospitals, which were previously administered by municipalities. Public spending on healthcare declined to 5.1% of GDP in 2014. The average life expectancy at birth was 75.1 years in 2012, lower than in other East-Central European countries. According to a 2015 IMF report, Hungary has a comparatively inefficient health sector. Efficiency improvements in this sector and in the education system could save the country three-percentage points of GDP. Hungary's pension system combines a pay-as-you-go scheme with a funded compulsory second pillar and voluntary individual retirement schemes.

In principle, all citizens have equal access to higher education and public office; women enjoy equal opportunity, although they do not receive equal pay. The difference between the average gross hourly earnings of male and female paid employees increased from 17% to 20% between 2009 and 2012; between 2007 and 2010, Hungarian households have become more dependent on male sole income earners (European Commission data). The main reasons for this inequality have been prevailing traditional views on gender roles in society and the extension of the maximum duration of parental leave from two to three years. The government introduced flexible childcare benefits and compulsory early childhood education to increase female participation in the labor market. The Roma and other minorities continue to be discriminated against, although there are public programs to support Roma integration. In 2014, parliament adopted an amendment to the public education law that authorizes the minister of Human Resources to approve schools that segregate classes consisting of Roma pupils from classes attended by other pupils. While the government claims such classes would enable Roma students to catch up with other pupils, critics have argued that the segregation has a racial discrimination.

Equal opportunity  
8

## 11 | Economic Performance

In the wake of the 2012 recession, GDP grew by 1.5% in 2013 and an estimated 3.6% in 2014, mainly due to increased investment and private consumption. In a 2015 report on Hungary, the European Commission expected growth to slow down because it attributed 2014's higher growth rate to temporary effects resulting from an increased absorption of EU funds, subsidized loan schemes and regulated utility price cuts.

Output strength  
7

The unemployment rate declined from 11.1% (2012) to 7.8% in 2014 (IMF data), largely because of the expansion of Hungary's public works scheme since 2011. Inflation also fell from an average consumer price inflation rate of 5.7% in 2012 to -

0.3% in 2014. Growing exports, the deleveraging of bank credits and EU transfers generated a current account surplus that widened to 4.1% and 4.2% of GDP in 2013 and 2014 respectively.

Hungary's gross public debt declined to 77% of GDP in 2014, which is still the highest rate in East-Central Europe.

Net FDI in Hungary decreased from 8.3% of GDP (2012) to -3.2% of GDP in 2013 (according to World Bank data), partly due to the uncertainty created by Hungary's heterodox economic policies, and partly because investors have been affected by additional tax burdens. Greenfield FDI inflows – i.e., investments increasing a country's production capacity – fell from approximately \$7.5 billion in 2010 to \$2.1 billion in 2013 (European Commission data). Hungary's share in world exports has declined since 2009 and its export performance also fell in comparison with other East-Central European countries.

## 12 | Sustainability

While environmental regulations are in place, their enforcement is deficient. According to the EU Statistical Office (Eurostat), the share of renewable energy in gross final energy consumption was 10% in 2013, below the EU average of 15%. Hungary's resource productivity – i.e., the ratio of GDP to the total amount of raw materials directly used by an economy – increased from 1.6 (2010) to 1.9 in 2012, which is equal to the average resource productivity of 27 EU countries. Between 2010 and 2012, Hungary reduced its per capita emissions of greenhouse gases from 6.82 to 6.2 tons (of CO<sub>2</sub> equivalents). According to a 2013 report by the European Environmental Agency, this reduction kept the country on track to meet its Kyoto target. Hungary's average annual growth rate in renewable energy consumption in the period between 2005 and 2011 was too low to reach the target of 13% of renewable energy in gross final energy consumption agreed in the Europe 2020 strategy.

The new constitution stresses “sustainability” on many levels, including environmental issues. A deputy ombudsperson is responsible for the interests of future generations and is supposed to advocate “green” issues. However, recent legal changes have made it easier for the government to set aside rules geared to protect natural as well as cultural treasures when an economic project, usually of a large scope, has been deemed to be of “increased importance.” In public debate, “green” arguments have never greatly captured the public's attention, and since the deterioration of economic conditions in general in Hungary, they are even less heard.

Environmental  
policy  
7

Education policy ensures a nationwide system of education and training, and the research and technology sector is advanced in some areas. Public spending on education declined to 4.5% of GDP in 2011. In the 2012 PISA survey measuring mathematical, scientific and literacy skills of pupils, Hungary performed more weakly than the other East-Central European countries, with an average score ranking it 39th out of 65 states.

The government has centralized the education system by assigning functions of municipal self-governments to central government agencies. In October 2014, the government announced that it would halve the number of pupils in grammar schools and confine their function to preparing students for university education.

The European Commission noted that the intensity of R&D spending, which comprises government expenditure and higher education expenditure on R&D, decreased from 0.46% of GDP in 2007 to 0.41% in 2013, deviating from the EU trend and the EU average of 0.72%. By amending the constitution in March 2013, parliament enabled the government to determine and supervise the financial management of universities and institutes of higher education. In addition, parliament may now temporarily restrict the right of state-subsidized university graduates to freely choose a job. In 2014, parliament amended the Law on Higher Education to enable the prime minister to appoint administrative directors responsible for managing universities' finances. Between 2010 and 2014, the government reduced the budgets of universities by 25%.

Education policy /  
R&D

7

# Transformation Management

## I. Level of Difficulty

The structural constraints on governance are low in comparison with other transitioning or developing countries, as Hungary has initially been able to rely on a relatively homogeneous 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. However, social, cultural and political polarization has grown in recent years. The economic crisis has led to the decoupling and segregation of impoverished groups whose reintegration into society is severely constrained. While the country is aging and the state of public health has deteriorated, Hungary's geographical location has become more advantageous with the potential for EU enlargement to the Balkans and the western Balkan pre-accession process. Infrastructure deficiencies have decreased, with highway construction and with the north-south development of gas and oil pipelines.

Structural  
constraints

1

Hungary has a considerable tradition of civil society, represented in the different opposition milieus that existed under the state socialist system, as well as the role of reform-oriented technocratic elites encouraged by Hungary's liberalized authoritarianism. 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 opposition milieus were rooted in pre-war and nineteenth-century intellectual cleavages between urban liberals and national conservatives. The reorganization of Hungarian civil society took place in the wake of regime change in 1989 and 1990. The quantitative extension and qualitative development of civil society according to the Western model has been one of the main tendencies of social transformation in Hungary. However, there have also been opposite tendencies of decline and fragmentation. Many associations and organizations that appear to belong to civil society are, at closer inspection, far from grassroots activities but are much rather organizations originating from power circles, state authorities or similar agents. True grassroots activities are not very frequent and often asymmetrical.

Civil society  
traditions

2

A decade of increasingly confrontational politics and the 2008 financial and economic crisis have deepened the political, socioeconomic and cultural divides in Hungarian society. Populist political campaigns and political extremism have found significant support among voters. Extreme right-wing political and paramilitary groups have been involved in instances of violence, intimidation and hate speech against Roma people.

Conflict intensity  
3

## II. Management Performance

### 14 | Steering Capability

Question  
Score

The government sets many strategic priorities and regularly subordinates them to the demands of office- and vote-seeking. The governing parties' political savvy in maintaining power is in stark contrast to their inability to craft or enact any sort of complex policy strategy for the country. While Fidesz did not create a program for the 2014 parliamentary elections, the government has emphasized its commitment to strategic planning and coherent policy-making. The prime minister relies on a powerful Chancellery to formulate policies, mobilize parliamentary support, coordinate line ministries and monitor policy implementation. There are numerous strategy documents that are, however, neither well-integrated nor linked to assessments of the financing needs, options and resources. In a 2015 report on public governance in Hungary, the OECD noted that “[s]trategic plans and planning in Hungary has been characterized by: a short term focus, heterogeneity and fragmentation in terms of content, a lack of guidelines and/or standards for developing and articulating strategic plans, lack of associated financing, and difficulty in monitoring implementation.”

Prioritization  
6

The government has had only limited success in implementing its policies, as there is a stark contrast between its centralized decision-making and its inability to adequately determine the feasibility of those decisions. The only response of the Orbán government to this weakness has been further centralization. In the period under review, the overwhelming tendency of the government has been “statization” or the absorption of all sectors by the state.

Implementation  
6

The government introduced an integrity management system for public administration and improved legal protection for whistleblowers, but these measures had little effect in preventing corruption. In 2014, the government imposed a highly progressive advertisement tax on media outlets without considering EU competition rules, which led the European Commission to prohibit the application of this tax.

Policy implementation is driven less by policy problems in need of a solution, than by the logic of power struggles among the governing elites. For example, the government abruptly stopped the construction of the new M4 highway, referring to its excessive costs. This decision was taken after a conflict erupted between the prime minister and Lajos Simicska, a Fidesz-affiliated business tycoon, who owns the construction company tasked with building the motorway.

The government demonstrates little willingness or ability in policy learning. Prime Minister Orbán was unable to recognize that his foreign policy of “opening toward the East” and teaming up with Russia’s President Putin not only irritated the United States and European Union, but was also poorly received by Fidesz’s core electorate. The prime minister and the Ministry of Foreign Affairs failed to properly interpret and act upon the warning signals that preceded the entry ban imposed by the United States on Hungarian government officials suspected of corruption.

Policy learning

4

The government has not been interested in independent scholarly advice. In public debate, the government denounces constructive criticism as untrue or, if the criticism comes from Fidesz affiliates, “treason,” thus creating an atmosphere where innovative ideas or constructive criticism are unlikely to be formulated. Regulatory impact assessments have a rather formal character, are confined mainly to environmental policy-making, and do not rely on regular consultations with stakeholders. EU budget regulations that require Hungary to keep its deficit low have been the main inspiration for the government’s constant improvisation, as it changes its financial strategy seemingly from day to day.

## 15 | Resource Efficiency

The government makes efficient use of only some of the available human, financial and organizational resources. In 2011 the Ministry for National Economy estimated that Hungary’s economy would have administrative costs of 10.5% of GDP, which would be significantly higher than in other European countries (source: OECD). According to media reports, the number of central government employees grew from 283,000 (2009) to 574,000 in 2013. The government adopted programs aimed at cutting bureaucratic red tape, simplifying public administration, creating a network of one-stop shops for public administration services and introducing e-government.

Efficient use of assets

5

In a 2015 report on Hungary, the OECD found that the budgeting process in central government tended to focus on short-term objectives and inputs rather than desired outputs or outcomes. This traditional budgeting technique does not allow movement toward a more performance-oriented model. In December 2013, parliament strengthened the medium-term budgetary framework by obliging the government to justify differences between the framework and the annual draft budget plans. However, the 2015 budget did not contain justifications referring to the medium-term

budgetary framework. Although the Fiscal Council is entitled to assess public finance issues and may even veto budget drafts, it has not published its own analyses of the official micro-fiscal projections.

Organizational resources have been lost in many institutions, due to repeated and drastic reorganizations – institutional memory, valuable experience and best practices have vanished. The most common problem has been the loss of human capital through the politically motivated dismissals of public servants

The government fails to coordinate conflicting policy objectives. Upon re-entering office in 2014, the government reduced the number of line ministries to eight and increased the number of state secretaries and undersecretaries in the Chancellery to approximately 30. The cabinet is hierarchically structured, with ministers and line ministries executing decisions taken by Prime Minister Orbán. The new large ministries have, however, remained internally fragmented into departments that lack a culture of trans-sectoral cooperation. Formal coordination and arbitration powers are concentrated in the prime minister's Chancellery, the head of which obtained the status of minister in May 2014. The Chancellery exercises far-reaching powers within the executive, including, for example, the approval of appointments in line ministries down to the level of heads of departments.

Policy  
coordination  
6

The informal center of government consists of Prime Minister Orbán, János Lázár, the minister heading the Chancellery, Péter Szijjártó, the minister of Foreign Trade and Foreign Affairs, Antal Rogan, the head of the Fidesz parliamentary group, Fidesz Vice President Lajos Kósa, and Árpád Habony, Orbán's chief advisor. The resulting informal coordination mechanisms have undermined the authority of ministers and the division of task areas between line ministries. The strongly personalized institutional setting around the prime minister often leads to voluntary decisions and a lack of coherence.

In October 2014, the government established a National Communication Office (NKH) to coordinate and integrate public communication for all government ministries and the central state administration. By January 2015, ministry officials did not yet know the exact scope and types of functions to be performed by this new body, which is supervised by the Prime Minister's Office.

Among the existing integrity mechanisms aimed at preventing corruption, the systems of party financing and public procurement are the weakest. Political life in Hungary has been full of scandals, chronicling the government's favoritism in creating Hungarian "oligarchs" as the new national bourgeoisie. The government has allocated significant public funds and leading positions to persons with close ties to the ruling political elite.

Anti-corruption  
policy  
6

In a 2015 report on Hungary, the European Commission noted "the existence of 'close contractual relationships' between business and political elites." Restrictions

on public access to information would effectively constrain transparency. According to the Commission, “partiality appears to be frequent in case of major infrastructure investments.” Competition in a public procurement was limited by low numbers of tenders and the frequent use of direct awards of contracts.

The government adopted a National Anti-corruption Program and is planning its implementation. According to Transparency International, this program will not substantially reduce corruption because “the program completely ignores the role and responsibility of the current governing political elite for the corrupt affliction of the country.” The State Audit Office failed to effectively monitor the financing of parties and election campaigns.

In 2013, the government adopted a comprehensive code of ethics for civil servants and a decree establishing an integrity management system for state administration and the regulation of contacts with lobbyists. The decree created integrity advisors responsible for addressing concerns about corruption, but it does not ensure the independence and effective powers of these new institutions. Parliament also adopted a law to protect whistle-blower reporting. However, the law does not effectively protect whistle-blowers against retaliation. According to the European Commission, there is no evidence as to whether these reforms have effectively prevented corruption.

The government systematically obscures the state of public finances and refuses to provide transparent information on its financial management. In 2013, parliament amended the Law on the Right of Informational Self-Determination to restrict public access to information. This prompted Transparency International to leave the anti-corruption dialogue between the government and civil society. In October 2014, independent think tank the Budapest Institute for Policy Analysis published a progress report noting persistent non-transparency with regard to fiscal data and public procurement as well as a lack of high-level political leadership to ensure the legitimacy of monitoring and enforcement measures.

According to a representative survey of 310 business managers carried out by the European Bank for Reconstruction and Development (EBRD) in 2013, 9% of respondents said that firms in their line of business had to pay bribes to get things done with regard to customs, taxes, licenses, regulations, services, etc. Approximately 30% of the respondents saw corruption as an obstacle to their firm’s operations. These shares were lower than the unweighted average shares for the five East-Central European countries.

Below the large-scale political corruption, there is a broad layer of daily small-scale corruption, practices inherited from the communist era. For example, to gain access to health care services, individuals must often offer “thanks payments” to providers, even though such services ought to be provided as part of compulsory health

insurance. This way, corruption pervades the daily life of many citizens which could, in the long run, change social attitudes in a way that favors corruption or at least tolerates it. There have been occasional government initiatives to fight this sort of daily corruption, but usually such efforts are short-lived or inefficient, more propaganda than serious action.

## 16 | Consensus-Building

Hungary's political elites agree to name the country's political system a democracy and to retain core institutions of a democracy. But there are deep divisions regarding key democratic values, the meaning of democracy and the functions to be performed by democratic institutions. The Fidesz-led government rejected Hungary's democratic constitution of 1989 – 1990, as they believed it represented a “Stalinist” legal document that was adopted when Hungary had not regained its full sovereignty. According to Fidesz, a full change of the political system was only achieved in 2010, through the electoral victory of Fidesz. The Orbán government has used this ideology to legitimize radical changes of all existing political institutions.

Consensus on goals  
7

Hungary has unquestionably arrived at a crossroads, as the concept of democracy held by the Fidesz-dominated government has been markedly different from that advocated in the two prior decades, and also of that held, if not insisted upon, by the European Union. In a programmatic speech in July 2014, Prime Minister Orbán declared his intention to reject the moral permissiveness and egoism he associated with Western liberalism and to build instead an “illiberal state” in Hungary. Rather than looking to the European Union and Western countries, he called on Hungary to learn from competitive, non-liberal states such as Singapore, China and Russia.

Political elites in Hungary adhere to the principles of the market economy, and no major political force advocates a return to a centrally planned economy. However, the elites are deeply divided about the scope of the state and political intervention in the economy, the desirable model of economic development and the norms that should guide the behavior of economic actors.

Political reformers committed to a liberal, Western-style democracy are in the opposition and have very limited influence on the incumbent government. The Fidesz-led government is not seriously committed to liberal democracy and the rule of law. The governing political elites cannot completely control the political party Jobbik, but have managed to limit Jobbik's influence significantly. Jobbik is in fact an extreme right party, although the party labels itself a national radical party. Fidesz and Jobbik aim, in part, to capture the same electorate, as many voters support both parties or are undecided in between the two. Therefore, Fidesz has introduced several measures and issued declarations to appease this extreme right group and to weaken Jobbik's popular support, channeling this support to Fidesz. At the same time, under international pressure Fidesz leaders have condemned the racist statements of Jobbik representatives.

Anti-democratic  
actors  
7

The government has sought to accommodate voters holding right-wing extremist and nationalist views in order to weaken the right-wing extremist party Jobbik. However, this strategy has not been successful, because Jobbik increased its vote share by three percentage points in the 2014 parliamentary elections, while Fidesz-KDNP lost eight percentage points. The strategy has also had the collateral effect of introducing far-right symbols and ideas into mainstream political discourse, thereby increasing their acceptance in society.

Cleavage /  
conflict  
management  
6

Fidesz leaders have systematically transformed interest-based conflicts into conflicts based on identity in order to mobilize support and to symbolically exclude political rivals. They have drawn on Euroskeptic and nationalist sentiments, promoting and popularizing such ideas in Hungarian society. The European Union has been linked to the Soviet Union and the Habsburg Empire. Fidesz politicians have portrayed themselves as defendants of the Hungarian nation against the “colonizing” efforts of the European Union, the international financial institutions, banks and multinationals. Fidesz has always used military rhetoric to present its case, with words such as war, fight and power used often in Prime Minister Orbán’s speeches.

The most important symbolic change in Hungarian politics is that the government has renamed Hungary as a country, from the Hungarian Republic to simply Hungary. The term “republic” has disappeared from official vocabulary. Another important symbolic change is that almost all official institutions have been renamed as “national.” In Hungarian, this term is loaded, as there is a neutral term that means “countrywide” (országos, or covering the whole country), while “national” means that an institution is connected with “national” (nemzeti) interests. So ministries and state agencies under the Fidesz-led government have turned from “országos” to “nemzeti.” The nationalistic preamble of the 2011 constitution and the newly erected monument commemorating the victims of Nazism were widely perceived as attempts to rehabilitate the interwar authoritarian regime of Miklós Horthy.

The political leadership neglects civil society participation. It frequently ignores civil society actors and formulates its policy autonomously. The governing parties have submitted approximately one third of their bills through individual parliamentary deputies, thereby excluding consultations with civil society.

Civil society  
participation  
5

The government has tried to build a comprehensive system of state corporatism, covering all fields and sectors of society with state-organized and loyal pseudo-civil organizations. The new organization can consult, make proposals and provide advice but cannot make any decisions, unlike the former tripartite council of interest representation.

Social actors have been marginalized not only by the government’s neglecting interest consultation but also with the reorganization and “statization” of the National Civil Fund (Nemzeti Civil Alap, NCA) that distributes state support to civic

organizations. The Civil Solidarity Forum (CÖF) has been organized and is indirectly financed by the Fidesz-led government. This forum and its associated Civil Cooperation Council may be considered twin phantom organizations that simulate dialogue with civil society.

In 2014, a government agency investigated several hundred CSOs that were subsidized by the European Economic Area and Norway Grants NGO Fund, a foundation of the Norwegian government. The Hungarian government claimed that Norway would use the funds to support the opposition LMP and thus interfere with Hungary's internal affairs. In July 2014, Prime Minister Viktor Orbán labeled CSOs as "paid political activists that were trying to help foreign interests."

In 2013, Hungary joined the Open Government Partnership, an international initiative aimed at promoting government transparency, empowering citizens, fighting corruption and strengthening public governance. To implement the partnership, the government established a consultation with civil society and business representatives. However, apparent favoritism in the public procurement of sales licenses for tobacco products and restrictions to the Law Regulating Access to Public Information caused four leading CSOs to leave the consultation.

The government-controlled National Election Committee rejected several opposition-led initiatives to hold referenda on issues such as the construction of the new nuclear power station in Paks – although, during its time in opposition, Fidesz had actively promoted referenda on disputed political issues.

The political leadership addresses historical acts of injustice in its campaigns against political rivals, rather than as a means to coming to terms with the past. In March 2013, parliament amended the constitution to define the MSZMP and all its organizations as criminal, holding all its successor parties responsible for a wide range of MSZMP actions. This provision exposed one of the leading opposition parties, the Hungarian Socialist Party (or MSZP) and its members to the threat of criminalization. According to the Venice Commission of legal experts at the Council of Europe, introducing provisions on individual responsibility more than 20 years after a democratic transformation raises "doubts as to their actual goals. Revenge should not prevail over protecting democracy."

In April 2014, the government erected a new monument in Freedom Square in Budapest close to parliament to commemorate all victims of the German occupation. According to representatives of the Jewish community, this monument constitutes a "historical lie" because it suggests that the Hungarian state carries no responsibility for the mass deportation of Jews, who were portrayed as victims only of German Nazism. Civil society activists organized regular demonstrations against the monument.

Reconciliation

4

In early 2015, Lajos Simicska, an influential businessman affiliated with Fidesz, claimed that Prime Minister Orbán had worked as a secret informer for the Hungarian security service during his military conscription. The prime minister denied this allegation, arguing that he was contacted by security officials, but refused to cooperate with them.

## 17 | International Cooperation

The political leadership tries to use international assistance for its own development agenda, but has a clear deficit in devising consistent, long-term strategies to integrate this support effectively. The government has adopted several development strategies and has created agencies to manage EU assistance from the Structural Funds and other EU programs. In a 2015 report on Hungary, the European Commission noted that a lack of stability and transparency in these arrangements hampered the effective delivery of investments and that institutional changes did not follow unarticulated strategy.

Effective use of  
support  
7

By the end of 2014, Hungary had absorbed approximately 70% of the EU resources provided for its economic convergence in the period between 2007 and 2013. This lag resembled the absorption lags of other new EU member states, but may entail a loss of EU transfers. The European Commission suspended EU assistance payments to Hungary in 2013 and in 2014 due to financial irregularities and a lack of transparency in the management of EU funds. In 2012, Hungary had not yet transposed 0.5% of the Single Market directives that should have been transposed by that date. This transposition deficit was close to the average of 27 EU states, but higher than the deficits of the Czech Republic (0.2%) or Slovakia (0.6%). The number of new infringement cases opened against Hungary rose from none (2011) to four in 2012. This amount was above the EU average for that year (2.1).

While the government tries to present itself as a credible and reliable partner, it is not trusted by many international partners, including European Union leaders, the IMF and the financial community. The government is unpredictable and uses double-talk in delivering its promises. Prime Minister Orbán described this strategy as a “peacock dance” (*pávatánc*) in a 2012 speech. This can be interpreted as pretending to behave according to agreed-upon rules and making publicly visible concessions, while obstructing and subverting Hungary’s international commitments as far as possible.

Credibility  
5

Hungary’s prime minister criticized EU sanctions on Russia. In April 2014, the Hungarian government agreed on a €10 billion 30-year loan from Russia to rebuild Hungary’s nuclear power station in Paks. The government did not involve the European Commission and the other EU member states in the negotiations, thereby completely ignoring their concerns over Russia and European stability in the wake of the Ukraine crisis. In September 2014, Hungary stopped re-exporting gas to

Ukraine in defiance of a prior EU agreement to facilitate reverse flows in order to supply Ukraine with gas during the conflict. Russia had objected to reverse flows.

Hungary's loss of international credibility became apparent in October 2014, when the U.S. government decided to ban six Hungarian government officials from entering the United States due to suspicions of corruption. Such a gesture is highly unusual in relations between NATO allies and constitutes a massive diplomatic affront.

After the European Parliament voiced concerns about the competences of the Hungarian Commissioner-designate during the hearings on the new European Commission in 2014, the president of the Commission withdrew EU citizenship issues from the commissioner's competency area, confining his work to education, culture, youth and sports affairs.

Frequent and unpredictable regulatory changes hampered the business environment and caused foreign banks to step up deleveraging, and foreign investors to cancel or downsize their Hungarian projects.

Hungary's political leadership cooperates with neighboring states but has been reluctant to comply with rules set by regional and international organizations. Hungary continues to cooperate with the states of the Visegrad Group (Czech Republic, Poland, Slovakia) on technical issues. However, the government's policy of "opening toward the East" has damaged Hungary's relationship with Poland in particular. Prime Minister Orbán supported a peaceful resolution of the crisis in Ukraine, but appeared to be more concerned about the rights of ethnic Hungarians in Ukraine than about Ukraine's territorial integrity.

Hungary's government opposed EU sanctions on Russia and the Energy Union, an EU project intended to engender close cooperation between EU member states in securing their energy supplies. The government did not involve the European Commission in its negotiations with Russia about the construction of a new nuclear power plant in Paks. It unilaterally negotiated with Russia about the continuation of the Russian-Hungarian long-term gas supply contract. László Kövér, the speaker of parliament, said in an interview in October 2014 that a plan "to withdraw from the European Union slowly and cautiously" had to be taken into consideration.

## Strategic Outlook

Hungary represents the deconsolidation of a democracy that was deemed to be one of the most stable and successful political regimes in Eastern Europe throughout the 1990s. Hungary constitutes an extreme example of the broader democratic backsliding observable in several East-Central European countries since their accession to the European Union in 2004 and since the global financial crisis in 2008. The crisis has been detrimental for popular trust in the new democratic institutions and has challenged the prevalent model of economic development through transnational integration. With EU membership achieved, the external constellation of incentives and conditions has partly disappeared and partly become less effective in anchoring domestic policies, actors and institutions.

These changes and shocks have provided opportunities for populist, anti-establishment political parties and reshuffled existing party systems. Fidesz has so far been the most effective of these parties and has relentlessly sought to monopolize power. However, the deconsolidation of democracy in Hungary may also be viewed as a sign of the increasing political influence gained by right-wing populist parties across Europe. These parties have effectively articulated widespread fears about globalization and immigration and they have expanded their electoral support by mobilizing nationalist resentments during the crisis of the euro zone and European integration. They have been able to mobilize particularly effectively in younger democracies with less stable party systems and in party systems with dominant sociocultural cleavages, such as Hungary. In this view, Hungary may be leading a trend that will take root in other European countries.

Accumulating policy failures and observable rifts within the governing Fidesz elites may, however, challenge the political legitimacy of the current government. In early 2015, four scenarios appeared to be particularly likely:

First, the ruling political elites could retain power through unfair elections, state-controlled media, a state-dominated economy, “rule by law” and a constrained civil society, using low-level conflicts with the European Union as an effective strategy to mobilize sufficient voters by appealing to nationalist sentiments. Intra-elite dissent would be limited and overcome by replacements from among the beneficiaries of the status quo.

Second, conflicts within the governing elite could escalate and lead to the resignation of Prime Minister Orbán. He might be replaced by a Fidesz politician who would seek to broaden the party’s electoral base by positioning the party either further toward the center or toward the extreme right currently represented by Jobbik.

Third, the escalation of intra-Fidesz conflicts could result in the government losing its majority in parliament. This could lead to a Fidesz–Jobbik coalition government, either by the co-option of Jobbik or through new elections that would entail further gains for Jobbik, giving it a pivotal role in coalition building.

Fourth, the anti-government protests could grow into a broader movement with a core of activists ready to organize and sustain a Euromaidan-style permanent protest. This would put the governing parties under pressure and could lead to increasing defections, resulting in a power shift toward the current opposition.

Given the determination of the governing parties to cling to power, the first status quo scenario appears to be the most likely. However, none of the alternative scenarios can be excluded and none of the scenarios provides an answer to how the deep political divisions in Hungarian society can be overcome and a democratic consensus built among the different political elites.