Hungary: Reasons to worry?

Ever since the conservative party FIDESZ had been swept to power in a landslide victory in April 2010 – giving it a two-thirds majority in parliament and with it the possibility to pass constitutional amendments – the government has caused considerable disturbance and uncertainty among the EU-Commission, EU-Member states, foreign investors and the markets alike.

From the onset of assuming office, the populist FIDESZ leader and Prime Minister - Viktor Orbán - has begun implementing his election promise of "a new system of power". To this system belong a return to traditional values, an apparent unwillingness to bow to EU and IMF demands, a shift towards stronger parliamentary and government control over all aspects of political and economic life (and thus a stronger centralization of politics), far-reaching fiscal reforms and forcing public buildings to display official government (party) propaganda.

In 2010, the government had made clear its intentions of increasing its authority over the constitutional court, the media system and the central bank. A new bill passed by parliament provided the majority party a significant say in choosing the constitutional court's judges, prompting fears that the government is attempting to erode the country's democratic checks and balances. The proposed new media law largely aimed at transferring an increasing amount of powers of public radio and television stations directly into the prime minister's office. The current governor of Hungary's central bank – András Simor – had maintained central bank autonomy too strongly for the liking of FIDESZ, the party making it clear that it intends to acquire more control of the bank after the term of the current governor expires in 2013.

In October 2010, the government introduced a so called "crisis tax" retroactively for 2010, intended to last until 2012. The problems with the tax were not so much the extent of the extra company levy, but instead the retroactive aspect of the tax and its seemingly discriminative nature; as foreign companies and investors appear to be the prime targets.

The government also passed a law changing Hungary's pension system. At prima facie, the law simply gave Hungarians the possibility to leave the private pension funds and return to the state pension system – however, in effect – it amounted to a nationalisation of the pension system in order to finance the state budget on the short term. This as people who decided not to leave the private funds and to re-enter the state system, would loose the pension contribution their employer will continue to pay to the state, which would come at a very high price: they would loose around 70% of their retirement payouts. As a consequence, most people felt forced to leave the private funds and return to the public system. Insurance group AXA, for example, lost 96 % of its clients as a consequence of the pension reform; as a result of which, it will lay off a major part of its 800 employees in Hungary, as the pension fund operations had been the groups largest business unit in Hungary.

In March 2011, the government presented a new economic plan as well as a new draft constitution. The former, much-awaited revelation of the reform plans contained a lot of generalities and very little actual specific details; hence the initial market reaction was marked by disappointment (at least until the government unveils its exact plans in the coming months). The latter appears more problematic. Apart from imposing the conservative and traditional values important to the ruling party over all of society - highlighting Hungary's roots in Christianity, its respect to the Holy Crown as a symbol of national unity, stating that marriage is between a man and a woman and declaring its support of families (paving the way for FIDESZ's controversial plan to give families with Children extra votes at elections) – the new constitution intends to limit the fiscal autonomy of future governments while at the same time eliminating some core democratic checks and balances. According to the draft, the Government intends to constitutionally curb the jurisdiction of the constitutional court over budget issues and taxes. Additionally, the government intends to change the way the governor of the central bank and his deputies are chosen, in effect giving the prime minister's office the right to choose its own candidates.

As a consequence, Hungary faces heavy objections of EU-members states and the EU-commission over not just the media law: the EU has also begun an infringement procedure over the crisis tax on the telecoms industry. Additionally, Hungary has felt the uncertainty it has caused vis-à-vis foreign investors and the markets. Given the fact that Hungary had been dependent on a EU and IMF loan worth some 20 billion Euros in 2008 and that it remains dependent on foreign investments, recent moves alienating investors and the EU make not just doom-mongers worried about Hungary's financial stability. In December 2010, the Credit rating agency Moody's cut Hungary's sovereign debt rating considerably, stating government failure to put public finances on sustainable grounds as the main reason.

So what will the future hold? Despite Orbáns rhetoric that Hungary would not bow to any dictations from Brussels, the EU is a major factor in Hungary's political and economic life and it actually has significant clout and leverage over Budapest. In March 2011, the Hungarian parliament amended the country's controversial media law in line with EU standards (albeit many EU-partners remaining unhappy). Additionally, if the EU-Commission finds that the crisis tax on the telecom sector is not in line with EU regulation, Hungary will have to change it.

Furthermore, one of the main reasons for the economic reform plan announced in March, was to convince the EU and the markets, that Hungary was firmly on track to keeping its budget deficit gap below of 3 per cent of GDP beyond 2012.

Additionally, the European Central Bank and the European Commission have stated their unhappiness with plans of the Hungarian government to limit the autonomy of the Hungarian central bank, stating that the Commission would observe the next steps and would legally challenge Hungary if deemed necessary. This too will limit the Hungarian governments scope of action. Although the EU cannot contain the nationalistic, populist and at times anti-foreign business tendencies of Orbán completely, it will be able to tame it to a large extent.

An important factor also is, that Orbán is facing increasing opposition at home. In March, Hungary faced one of the largest-ever civil demonstrations since 1989, as tens of thousands of people demonstrated in support of freedom of the press and against the controversial media law (even after the amendments had been passed by parliament). Hailed by some as Hungary's "liberal awakening" - undoubtedly - this vocal opposition will have certain leverage over the government.

The Hungarian government therefore does not stand isolated to do what it wants, and sooner rather than later it will find itself dictated by the need to regain investor confidence even more strongly. Nonetheless, Hungary finds itself more than ever in a position of social and political polarisation; combined with increasing nationalistic and populist tendencies. This cocktail may yet prove toxic, further damaging the overall investment climate, especially as previous action on the side of the FIDESZ (such as the de facto expropriation of Suez environment of the waterworks in Pécs in 2009) had shown that these are both willing and able to implement their often awfully populist rhetoric - even at the cost of further alienating its much needed foreign investors.

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