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An outline of the determinations of the past two decades of Hungarian public finance

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From the beginning of the social-economic changes that took place in 1989 public finance functioned in the next twenty years organized into two – central and local – levels. From financing aspects it was organized into four subsystems; central budget, social security funds, separated state funds and local governments. Although the number, the organizational position, the relationship order of the public finance system have undergone continuous changes – contractions and „re-contractions" – public finance itself, regarding its role in the public law and its tasks, its so-called chapter-structure, functioning model and thus in the forms of its financing has changed very little until 2010, the coming to power of the new government. In the course of the past twenty years public finance provided its tasks within the existing structure managed to provide public services, development however its financial management was wasteful and under-financed at the same time. As a consequence, its functioning has been more and more expensive, less efficient and of low quality. As a result of a governance that lacked longer term goals, that was unwilling to undertake substantial modernization measures and that acted as „giver" and „drainer", periods of overspending and consolidating (restricting) have followed each other. However, public finance could be financed only by drawing on huge external resources and forceful restrictions. This study attempts to introduce the processes and their substantial reasons.

Key words: determination, governance, overspending, stabilizations, central budget, privatizations, public debt
JEL code: H30, H50, H61

1. Introduction: frames, possibilities of the topic and the risks of the outline

When we attempt to summarize the trends and the functioning of public finance in Hungary in the two decades that followed the 1989–90 transformation, we should also try to find answers to the "whys" - even if this means the risk of touching the borderlands of political and social sciences.

In anticipation, we should also mention that the years preceding the transformation of the regime brought more and more difficulties to maintaining public finance, which had been creeping towards the inability of financing the social provision systems -, even at the price of the considerable growth of public debt. This was the proof that, due to the uncompetitive nature of the "existing socialism" as a model, it could not be viable in Hungary, either. We don't have the opportunity to explain in more detail why there were so few, who could realistically size up the real consequences of the past four decades that we all wished to exceed. However, beyond explaining the regulatory and institutional solutions and, the fiscal processes, we cannot avoid describing the contents and reasons for *the changes (and lack of changes) as well* (Artner et al 2003).

Periods of over-spending were alternated by periods of consolidation – rather periods of –"forced stability" – with considerable delays and for brief periods only. Attempts at modernization brought merely partial results. Up to the last period, the public finance system established before the socio-economic transformations, the stiffened regime remained fundamentally unchanged. Although we produced results in the field of a more regulated financial management, there were still reserves in the "business management" solutions and *the regime itself was unable to function efficiently* (Laki 2006). The liabilities of withdrawals required for financing public finance also set back the development of the real economy. Thus *we have been spinning in a vicious circle* that has resulted in the consequence of having tax revenues that served the basis of the general and proportionate sharing of taxation that did not cover the financing of public finance in the given structure, even prior to the global financial crisis. To do so it was necessary to involve huge external sources. The social, public political, economic performance and, last but not least, financing causes of the established "regime" thus became their own effects.

The present outline is looking for answers regarding the motives, phenomena, and deeper determinations that burdened the past two decades, from the aspect of a starting point that, getting rid of the above – *the outbreak* – in itself offers a chance for those endeavors that wish to transform the course of public finance to *an angelic circle.*

2. Compulsions of the public finance, the determinations of the tasks and institutional functions

The financial-financing makings of the functioning of public finance, the trends of financing it, are rather subservient to the system of values and goals of the state and to the ensuing tasks, and are the consequence of "what and why" although they reactively influence the aforementioned regime. The *external* (the environment, the pressures and models of adaptability, the orientation) and the *internal* (funds of the real economy, of institutions that can be mobilized, the social adaptability skills) *system of* conditions as double determinations have transformed the functioning and the direction of public finance in the course of the past two decades (Báger–Kovács 2007).

The external and internal determinations affecting the secure state functioning system and the modernization possibilities of the services in Hungary followed a contradictory trend and, in respect of their origin, were more reactive. This affected very unfavorably the stability of the regulation of public finance, the calculability of the financing, the perspectives of the normative or the so-called, social organization of social provisions (i.e. provisions for those in need), and even the chances of the competition-related choice of goals that would result in real economy growth (Petschnig 2007).

The troubles of financing public finance and, the shortfalls of performance, are merely consequences; *due to the controversy of public policy, the state was unable to act pro-actively*, and its behavior was reactive, adjusting to the demands of the EU or various social embodiments of values, only occasionally. Altogether it was drifting.

2.1. External influencing factors

The system of conditions for the functioning of public finance is determined by *the extent of the state's undertaking of task provision and the money available for this purpose* – for all intents and purposes, the output of the economy. The reasons however, for in what harmony and form this was embodied in practice in Hungary finally from 1989 on, were such *external, social, economic and political factors*; like the changing political and economic system itself, the transformation from the planned economy to a market economy, the changing ownership structure and – by the significant gaining ground of foreign investors – the models, system of values, and the determinations that they had relayed. On the other hand and apart from the above, the system of conditions of the functioning of public finance was significantly influenced by the adaptation process of the EU accession, later by the EU membership and last, but not least, the affecting mechanisms of globalization. From the view of our topic it is not only our recent pressures originating from the global financial and economic crisis, rather the irreversibly changed conditions that demand attention, when we are looking back to the past two decades.

From 1989 onward, the unquestionable system of goals of Hungarian public policy, EU accession (at the time of the changes still called the European Community) and approaching the welfare system of the developed western countries as a social goal, offered the basic, external determination, by characterizing itself as a *social market economy* that became an enactment in the Hungarian Constitution in 1989. In the significant segments of the Hungarian public finance, adjustment *to the European Union meant a compulsion to move forward*. Thanks to this, significant modernization changes took place in several fields, thus in developments, the possibilities of auditing culture and of obtaining resources and, last but not least - due to the changing approach – also in the field of thinking regionally. The balance is positive, even if in fields like tenders, public procurement, allocating investments and their direction was halting and, occasionally, counter-productive.[1] Beside the altogether *favorable* effects, however, it is common knowledge that for those shaping domestic public policy the different ways of thinking of the new European and overseas partners, raised *issues of choosing orientations and models*, already in the period of preparing the changes in the regime. The picture of the service-providing responsibility and economic role of the state remained uncertain and obscure, as it was indicating the unfinished status of the political and economic changes and, following the turn of the millennium, the situation in this respect rather grew instead of receding.

For those shaping policy in the regime-changing Hungary, but also for the wide social strata of the country, the economic and social *system of values and arguments* of the European integration as well as the – *"social market economy"* representing the above, served as *direct models* encompassing the *need to converge to the welfare provisions* undertaken by the state as well as the determination fed by it. This meant the acceptance of the prevailing legal system (i.e. the *acquis communautaire*) of the obligatory adjustment to the system of rules and institutions of the EU. However, we cannot speak about the consequent following of the European model - neither in regard to social services (social policy, healthcare and pension provision), nor in respect to the state acting as organizer of the society and of the economy (managing, governing, directing). Namely, the so-called *main-stream* models relayed from overseas, propagated the efficiency of the *"state as the night-watch man", the advantages of marketing of social services, and the self-care of the citizens*, and were conceived as keys of joining the mainstream for a decision-shaping segment of the political-economic elite, as a *quasi* dogma. Apart from this, the fact *of what kind of business models were relayed* by professional and later business investors in the course privatizations and of green meadow developments also exerted strong influence on the functioning of public finance. Their system of demands, entrepreneurial culture, growing economic presence, and the system of values and conditions[2] brought to the surface, ever more forcefully, the weak functioning of the institutional system financed by public finance resources, its slow and insecure adaptation, the inconsistency of the regulation and enforcement of will.

In selecting the *imported adaptation* model, the general uncertainties[3] regarding the choice between the European or the Anglo-Saxon course apart from

[1] For example, building took place not where it was necessary or was what was needed, rather what and where they could get the resource, because they were available.

[2] See the respective SAO (State Audit Office of Hungary) reports and studies on privatization, concerning the budgetary funds and, innovations, used for the support of the economy: www.asz.hu

[3] It would be unfair to cite here representatives of one or the other approaches. However, we might probably indicate that people getting into leadership positions brought along with them the characteristics of their own orientation. Apart from their schooling, experiences, occasionally their professional relationships built while working in foreign research institutes and the views collected in the course of their respective scientific careers, the fact which foreign partners, investors, economists, scientists, whom they

professional conviction, the changes in respect of the influence (power relations), deriving from authority, and the ability of enforcing political interests, were also playing important roles. All of the above brought into governance o obscurity in respect to creating harmony and determining our own path to be followed – such as "what" and "why" should we undertake and "how" are we going to deliver it – and this resulted in zigzags in governance and choosing the action scenario. And this was to be attributed not only to the political rotation system, but also to the open or hidden shifting of the balance of governmental coalitions. Beyond the fact that this made it impossible to reform the big provision systems, it also affected negatively the modernization of the aforementioned provision systems on the business management or technical levels. *Consequently, the public finance system was functioning with inadequate efficiency which also limited the output of the real economy.*

2.2. Internal determinations

The growing fragmentation of the social structure and the growing political divisions became barriers to the implementation of the changes. These days, the consequences concerning the timing of the implementation, the collision of interests, the reception of the society, and even the strong sense of disillusionment etc. are playing an ever growing role in the process. A number of excellent studies (Bogár 2009, pp. 12–15.; Jenei 2008, pp. 44–66.; Laki 2008, pp. 67–85.; Stumpf 2006) discussed in detail the above ideas, the burdens of past bed experiences and mistakes which influence today's acts and that often extinguish or immobilize each other, overwrite rationality. These factors have considerably limited any acts aiming at implementing changes. At the same time, pitting against each other the neo-liberal, the conservative and social and economic views in an unforgiving way such that they were stiffened like dogmas, constituted the limits of modernization. This approach also deteriorated to mere zigzags, the feasibility of steps that, under different circumstances, could have been relatively easy to harmonize (Erdős 2006).

Although the internal determinations, the *controversial* internal relations of the trend of Hungarian public finance, its *missing picture of the future* that can be partly regarded[4] also as reflections of the external troubles of following models, can

considered or believed to be dominant experts and whose voice carried weight, they happened to be consulting.

[4] When judging the crisis of values, the period leading up to 1989 and the personal adaptation process, beyond political polarization the society has been burdened with a number of very serious conflicts of interest that Hungarian public policy has been unable to dilute, rather these conflicts are growing deeper. Such controversy that is also endangering the basis of harmonic and purposeful acting is a basically different system of goals and values and is causing strain between the active and inactive social groups, between those who are facing the risk of falling behind and those who have already fallen behind, between the employers and employees, between those being employed in public service and those working in the real economy or between the "poorer and the wealthier". These divisions are becoming deeper in respect to the division of burdens related to the expenses of the crisis.

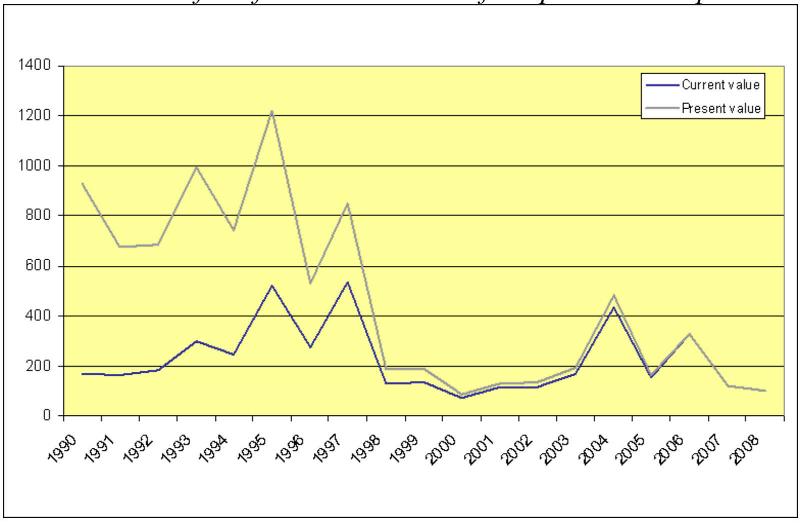
be attributed basically not to the above, rather to the *conciliatory* character of the changing of the regime[5].

The basic feature of the turn that took place in 1989 and which aimed at the goals of establishing a market economy, a multi-party democracy and the rule of law, was that the laws adopted at the time and that served as the basis of the economic and political changes ensured the transition (Simon 2007). The process that started in 1989 and that was divided into several stages, proved to be irreversible, but *far from complete*. The then existing cooperation of the determining forces (the developing opposition that was far from being secure in obtaining power, and the falling-apart state party) played a fundamental role in establishing the legal and market economy institutional framework of the rule of law, the multi-party democracy and the market economy, as well as the ability of looking for political consensus that many regard nowadays as excessive. The „correctness" of the above can be questioned; one thing, however, is certain, that is that the cooperation of the two sides ensured a solid, constitutional public law framework for the transition process that involved relatively small convulsions and offered a free – maybe too free – course for the economic transformation. As the privatization process was fundamentally determined by the financing needs of public finance and less by the endeavors of the adaptation to the technologies, innovations and market requirements, by the second half of the 1980ies a dual structure[6] of the economy was established that presented limits not only for competitiveness and the GDP trends, but also – by retroactively influencing the economic performance – for the growth of budgetary revenues. Privatizing the assets of the state, existing in market enterprises was practically completed by 2008, while the selling of assets embodied in servicing organizations and properties, were put off the agenda, partly due to the lack of demand brought on by the worldwide economic crisis and by the changing views regarding the role of the state.

[5] The "conciliatory" character is being used in various meanings. One, most obvious approach, is when they emphasize the peaceful, negotiating character that established new rules while keeping in their old function a considerable part of the elite of state officials. The other interpretation is when establishing a view they focus on the fact that the former elite could change its political power to economic power when a means of such transition was also the privatization process that otherwise contributed to the changes in the economic structure. Here, both the former relations with western countries as a "tailwind" and the managerial experiences gained during the "socialist market economy" have assisted the prominent persons of the former system to become capitalists or – to "convert" themselves to top managers of foreign properties.

[6] By the dual structure of the real economy, we mean that while half of the economic output originates from a couple of dozen of multi-national firms, the other is made up from thousands of domestic small and medium business, and the crucial revenues from export and taxes are due to businesses belonging to the former group.

Figure 1. *The outline of the financial balance of the privatization process*[7]



Source: own construction on the basis of data from SAO and of László (2007)

At the same time the modernization[8] of the great communal welfare provision systems was cancelled, due to the earlier mentioned model adaptation uncertainties regarding the role of the state, and this contributed to the peculiar torso of the changing regime. *They left unchanged such crucial social services like the pension system, the health care provision system or education, all of which were built on the provision responsibilities of the state*. At the same time, a growing financing obligation was taking shape that was submitted to new needs as a result of technological development, the aging society, and the developing medical technology. The overburdened system was made even more difficult to manage, thanks to the dumping of offerings to potential supporting groups, age groups, and social strata, closely tied to the election cycles. The social provisions that, in many respects, originated in the former, paternalistic regime and were considered as social achievements or simply, considered as such, occasionally due to familiarity or fear of the unknown, constituted the basis of the structure that has been functioning since the 1991s[9].

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[7] Following 2008 the privatization process essentially stopped.

[8] In the latter, the aim of safekeeping the peaceful character of the transition undoubtedly was also playing a role, but also the fact that the promise of maintaining and developing social services made the switching of the former political-governance powers to economic positions more acceptable, too (Steiger 2008).

[9] All this enjoyed legal protection without a deeper, more precise theoretical clarification of the changing social and economic role and tasks of the state, while they did not analyze substantively whether the just given, legally regulated solution represented real modernization or not. Were there

The financing form that appeared from 2002 onward and was built on the public and private sectors' cooperation – while representing theoretical possibilities regarding the opening up for modernization and involving resources – also brought along new determinations and "asymmetric' risks for public finance. Namely, the state would be responsible for task provision even if the company, undertaking the outsourced task, cannot meet its undertaken obligations. The fact that, apart from the rebirth of the needs for entrepreneurial supports provided by the state, a growing circle of entrepreneurs was counting on getting positions not in the competitive sector but rather - by employing their respective abilities of enforcing their political interests - in the field of public or local governmental commissions, in the market of public services realized in the form of the cooperation of public and private capital (Pitti 2004). The entrepreneurial strata in a way expected the widening of such markets that represented fewer risks than the real economy, while they were using 'modernization' slogans to support the existence of their businesses. *This was the entrepreneurial circle that was linked to political parties, occasionally acting as their representative, but rather, composing the parties' supporter's background that influenced, "modulated" the market move and, the expenditures related to the functioning of the social provision systems, by using their respective relationship capital and system of values* and not in the least, the daily and the long-term professional-management activities that determined the trends of modernization. As a consequence, up to spring 2010 the outlining of public tasks with the pretence of assigning a longer-term public finance development course for public tasks proved to be unattainable[10].

solutions socially more justified, but in respect of technology and organization more modern or cheaper? And anyway, can what is there be financed at all or (possibly) does all this serve merely the purpose of covering the dwindling of financing resources and the purpose of "improving the way we feel"? Antal Stark wrote:"Aproaching the 1994 general elections the government was determined to make bold steps. By increasing the welfare and economic expenditures of the public finances, by boosting the outflow of wages and salaries it induced an artificial speeding up of the pace […] that finally meant a 3.1 % GDP gain. Real wages grew in a significantly bigger pace, by 7.2 %. As a consequence the balance of payment kept declining, out GDP related internal public debt increased to 91%. Foreign public debt increased from USD 20,4 billion in 1989 to USD 28,5 billion" (Stark 2009).

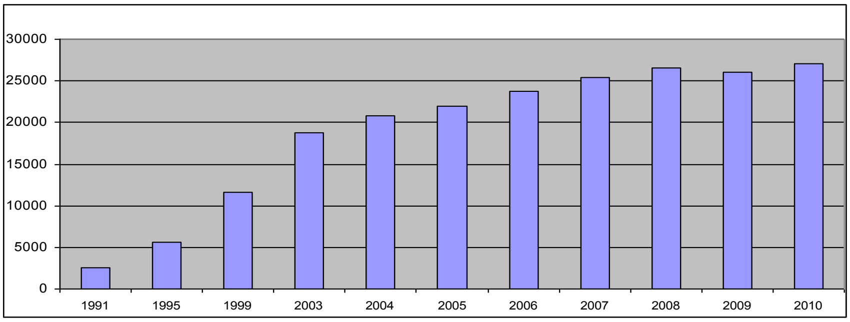
[10] In Chapter VII dealing with the government, the Constitution speaks about the tasks of the state. It declares that the government identifies the tasks of the state in the field of scientific and cultural development, ensures the conditions necessary for the respective implementation, additionally identifies the state system of the social and healthcare provision, and takes care of the financial backing of the provision (at the same place). Henceforward in Chapter XII titled Fundamental rights and duties – although the Constitution does not use the concept of public task – it indirectly touches upon the services (tasks) bearing guarantee-like character in this respect to be provided to the citizens by the state, without more closely limiting the contents and extent of them. Act XXXVIII of 1992 (Act on Public Finances) then returns to this issue in the part dealing with budgetary organizations, by saying that budgetary organizations - provide public tasks that are determined - by the law, resolutions, and deeds of foundations and serve the purpose of providing for the common needs of the society as an obligation. It is not known, either in the technical literature or among those dealing with the reforming of the public finances that the clarification of public tasks ever happened, even if in general, nobody

3. The breaking points of the functioning of public finance

With respect to the fact that in the course of the past twenty years the revenues of public finance, the approximately 50% proportion of redistribution, as well as the deprivation have not changed up to the end of 2010 in essence, they have naturally followed the GDP trends.

Figure 2. The total of revenues produced in the country (GDP)

(Value, at current price in HUF billion)



Source: own construction on the basis of Hungarian Central Statistical Office (HCSO)-Ministry of Finance (MoF)-State Audit Office (SAO) database.

In the case of Hungary, the bottom line of the economic performance occurred in 1991when the GDP fell back by 12%. The economic output that significantly determined the *revenue* side reached the level prior to the change of the regime only in the second half of the 1990s. Looking at the public finance expenditures, it is obvious that the changes in the major fields' appropriations annually followed practically only the changing inflation – disregarding smaller fluctuations and effects of ad-hoc measures. Despite the smaller and greater changes, the *expenditures*' structure in a decade-long time frame has been extremely inflexible. The reasons for this are manifold: on the one hand these are related to external orientations, and on the other hand, to the widely and deeply ingrained experience of considering the social security mechanisms of the former regime as achievements (Kovács 2005).

ever questioned the necessity of doing so. In the valid Act on Public Finances the substantial definition of public task is missing – contrary to the original purposes. The definition of public tasks in Hungary concerns not only the central level of public finances but it is a dominant factor in respect to the local governments' sub-system as the implementation of a considerable amount of public tasks is realized via the local governmental institutional system.

The expenditure proportions related to social welfare, education, law enforcement, support for business organizations and health care provisions, essentially have not changed since the change of the regime. Among the conditions of a system that works with weak efficiency, ensuring the resources for providing the above services was possible only partially, even among conditions of continuously high concentration of revenues – continuously fluctuating between 42% and 48%[11], high tax burdens, in comparison to similar indicators of the EU partner countries, and marked social security contribution. It was a continuous necessity to involve external funds (borrowings, bond issues, running through revenues from selling assets), even if to a varying extent (Hungarian Central Statistical Office database).

The trends of redistribution and income concentration were shaped by the external and internal determinations – transmitted by public policy – as well as by the real process of the operation. These could have been mitigated essentially and in a lasting way only if they had substantially changed the public finance structure, the limits of provisions attached to the individual tasks, and functions. This did not happen[12]. Although the proportions of welfare expenditures drastically diminished in the years 1995–1996 and remained practically the same up to 2001, alas, beginning with 2001 these proportions started to raise again and surpassed the capacity of the economy (Kovács 2007).

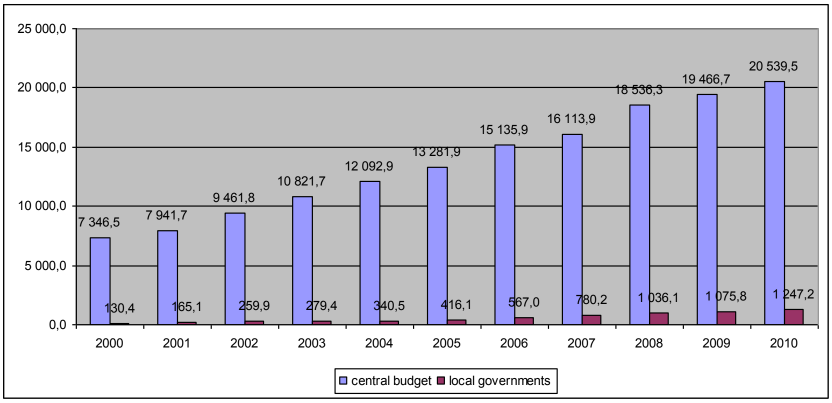
Although public dues have more than doubled in the first five years following the changing of the regime, due to substantial inflation, in reality, this represented an approximately 40% decrease. Thus, altogether the GDP proportionate public dues were perceptively mitigated, but were followed by the expenditures of public finance only in 1996. Although public dues grew as well in the subsequent period of consolidation, self-restraint regarding expenditures did exist up to 2001. After this, in the period up to 2007, the mitigation of public dues and the increase of expenditures co-existed. Comparing income centralization and redistribution as well as the indicators expressing public dues to the data of revenues, expenditures and indebtedness – with the exception of a relatively brief periods spilling across different governments – these data continuously are showing a smaller or greater

[11] The revenue concentration that was about 48% at the beginning of the period, decreased to 42% by the middle of the same period and after a small scale fluctuation rose to 45- 47% by the years of 2007 – 2008. Tax cuts and the raising of taxes (VAT tax cut and raise, changes in the ratings, raising personal income tax limits, cutting the number of tax keys, introduction and termination of tax exemptions) related to the changing governments, the EU accession and the convergence program, together with the weak performance of the economy, especially in the last years of the surveyed period, mostly as a result of the worldwide economic crisis, were playing an important role.

[12] Apart from a number of other factors, the fact that in Hungary the number of people employed by the state and thus living on income originating from the state is high – as János Kornai pointed out on the basis of the model set up by Swedish economist Lindbeck - and the so-called dependence indicator that can be explained in connection with the above, lack of the structural renewal of the central budget counteracts to the considerable mitigation of redistribution. (Kornai 1995, 1996)

lack of harmony, the lack of harmony between opportunities and the undertaken tasks, every year.

Figure 3. The trend of public debt



Source: own construction on the basis of Hungarian Central Statistical Office (HCSO)-Ministry of Finance (MoF)-State Audit Office (SAO) database.

From the aspect of being able to finance public finance, mistaken acts of two periods proved to be nearly "fatal". This was the period directly preceding the 1994 general elections and then the years following the 2002 - 2006 parliamentary elections, especially the period between the latter elections when *counter-productive steps were made that completely lost touch with the performance of the real economy*. In 1994 they induced a speeding up of the growth pace by boosting the welfare and economic expenditures of public finance that resulted in a 3,1% growth of GDP, while real wages and salaries were multiplied by more than the double of this proportion. As a consequence, the balance of payments kept worsening and, the GDP proportionate internal public debt of Hungary rose to 91%. External debt increased from USD 20,4 billion in 1989 to USD 28,5 billion (Stark 2009, p. 39.).

Due to the stabilization measures that were introduced in 1995 and 1996 and that brought serious burdens for the citizens[13] (the introduction of the so-called sliding-devaluation of the Hungarian Forint, resorting to the introduction of one-off customs dues), and first of all, thanks to the very significant privatization revenues, the situation of public finance was consolidated and then followed by a period of balanced public finance policy that also undertook some modernization endeavors. In the year 2000, the Hungarian budgetary debt was below 3%, however, we should

[13] As Antal Stark wrote in his aforementioned note: "Restrictions and curtailments reached every corner of the society despite the fact that the Constitutional Court [Á K.: just on the basis of the principles of social market economy and the protection of social security included in the Constitution] annulled it."

add that part of the items that contributed to the deficit were handled by the system outside the realm of public finance.

The deficit started to increase in 2001 (it made up 4,1% of the GDP) then, in 2002 a sudden decline took place in the fiscal position of Hungary. Namely the changing governments decreased public dues within a short time by resorting to the ambitious slogans of “European welfare” and “Falling into line with in the economy”. Thus they significantly increased social expenditures, wages and new provisions, launched the introduction of pensions for the “13th month”, and even, at the same time, they increased state spending as well. Consequently we became at once the country among the Visegrád group with the largest deficit (9% of the GDP). Yet, even at this point, regarding our position we were on the same rank as the others. The improving public finance balance started after 2003 in the region and the Hungarian fiscal policy followed this tendency up to 2004[14]. In 2004 there was still an opportunity to not only going on with the decreasing of the deficit but also to even lightly speed up the process of establishing a balance without introducing any special reforms, yet this did not happen.

Falling behind the neighboring countries (the increasing deficit) started in 2005. At the time we made parallel steps with the result of decreasing budgetary revenues (VAT) and started ambitious development projects. Thus we managed to further increase social expenditures – without coverage. *This spending spree that exceeded all previous measures* [15] *led to a 10% deficit in 2006, and to serious fiscal*

[14] Éva Palócz wrote:”In Hungary it was not the lack of radical reforms, rather the overspending that was exceeding any former extent, that resulted in the 2006 annual deficit of 10% and all the subsequent negative consequences. Namely, the Hungarian Government made parallel steps to decrease revenues (social security dues, VAT), started ambitious development projects (motorways and other), increased social expenditures and left (supported) the significant overspending in the fields related to the operational expenditures’ appropriations of budgetary institutions. All the above led to serious fiscal inconsistency. Without the aforementioned steps, the GDP proportionate deficit would have slightly decreased by itself, not to the extent it did in Slovakia, rather like in Poland or the Czech Republic. In Hungary it was the misguided economic policy of the past 5 - 6 years that led to the problems we are facing these days and it was not the result of some ”thousand-year old curse”- again. Should we explain the origins of today’s problems with some sort of Hungarian specialty or the negative inheritance of the Kádár regime then we should also pose the question, of why these effects didn’t emerge at the turn of the millennium (2000), when the Hungarian economy was standing out among the Visegrád countries by its high growth rate but also with its low budgetary deficit. And if it is so, then the theoretical troubles would be relatively easy to redeem at least in a foreseeable future.” (Palócz 2008, pp. 198–202.)

[15] By 2006 the debt rose to 66% of the GDP (thus the trend even for the years 201–2012 is still growing, exceeding 80%) while according to the so-called basic scenario, the debt should have been only 36,9% of the GDP in that year. Between 2001 and 2006, by the annually 4% GDP growth, borrowing in average was increasing by 2,5% more than the expansion of domestic production. Thus the GDP proportionate public debt rate rose from 52% to nearly 66%. We should mention here also the fact that between 2003 and 2006, in none of these years did we manage to fully perform the changing public debt deficit target (in the annual budgets it was fluctuating between 4 to 6%) stipulated by the so called convergence programs and thus getting closer to the goal off accessing to the Euro zone.

inconsistency in such a way that we have not managed to overcome the effects of the comprehensive budgetary-political slackness up to now and this will mean serious burdens even in the coming years. (Ohnsorge-Szabó–Romhányi 2007, p. 265.)

Following this breaking point, additional consolidation steps became unavoidable that were urged also by the criteria of accessing the Euro zone. In its given form however this remained "one sided". Thus, although budgetary overspending on the expenditures' side created bearable financing conditions with marked restraints, at the same time, by increasing public (entrepreneurial) dues and the decrease of gross accumulations – that increased the risks of building the future because from the aspect of improving competitiveness this was a limiting factor – by cancelling certain developments or by postponing them, this was restraining the output and the closing up of the real economy, the real convergence.

Under the circumstances of the worldwide economic crisis that erupted in the meantime, the *actualized* continuation of the convergence program, which was accepted in the second half of 2008, naturally could not take place. At the most, the aim could be the avoidance of state bankruptcy and maintaining the functioning of public finance; all this, at the price of worsening provision of services, the withdrawal of allowances and benefits, the freezing of wages, the raising of taxes, the interruption of development projects, etc. All this was possible only thanks to the fact that in late fall of 2008 the Hungarian State could get a stand-by loan worth EUR 20,5 billion via financial brokers and the assistance of IMF, the European Union and the World Bank, avoiding public finance, yet, indirectly, debiting it nevertheless.

It was the consequence of the events that took place between 2002–2006 that after twenty years, in respect to the absolute (compared to itself) indicators of the position of public finance and also relatively speaking (in comparison to the majority of the neighboring countries that started from similar situations, respectively to the older member states of the EU) *they are worse than at the time of the changing of the regime*. The fundamental reason for this is that – apart from a relatively brief period that spanned different governments (1995–2001) up to 2007 the financing was ensured practically independently from the performance of the real economy. The additional needs of different social services were ensured from loans and from the revenues of selling communal assets. Due to the worldwide economic crisis, growth has significantly fallen behind. Thanks to the shrinking economy, public debt has increasingly risen to the annual rate of the GDP, a third of what was embodied in securities denominated in foreign currency, thus further increasing the risk of financing. Thus the management of public finance has become a key issue from the aspect of the functioning of the whole national economy (Tóth 2009, Vigvári 2006).

Standard international organizations and foreign investors equally resented the "shifting" of some of the budgetary expenditures, their respective rescheduling to the next year to thus "exempt" the central budget of the given year.

4. The central budget and its planning

The framework of this summary affords the opportunity to only mention as a practical example that, as a result of the internal and external determinations outlined in the earlier chapters, what limited possibilities the structural transformation of the central administration did have and how the zigzags of following foreign models led to "modernization experiments" that cost a lot of money but were lacking substantial improvements or, rather, to transformations and restructurings, to the over-development of higher education or to the stimulation of the economy that proved to be counterproductive in its effects, and to the insignificant results produced by the use of EU resources when it came to the equalization of the gaps of development level[16]. Henceforth I wish to outline a single issue, instead of a detailed explanation of the aforementioned problems and results. And this is *the issue of budget planning*. It was an obvious experience that the weak *planning*[17] *that diverted from real possibilities and that often exceeded the regulations itself, was one of the reasons of poor execution*.

When we compare the planned, the amended and the factual revenues-expenditures corner numbers of the past twenty years then – apart from brief, consolidation periods – we can detect an annually growing gap between the original ideas and the reality, especially in the course of the past five years. The years of 2009 and 2010 brought only changes – partly at the price of the burden of the "skeletons" of a number of postponed development projects, maintenance and unpaid obligations. At the same time, it would be a simplification and a mistake if we attributed this 2009 process merely to the undisciplined utilization of the expenditure limits or to the forced course of the "determinations". *Consecutively, the problem was that the planning of revenues was over-optimistic.* Apart from this yet also related to this, additional and typical planning errors have exerted their recurring influence: the judgment of the processes of the basic year *successively* proved to be more favorable than reasonable, the evaluation and prognosis of the macroeconomic processes of the subject year of the planning also have been over-optimistic and – not in the least – the estimation of the effects of the planned measures was often over-optimistic, as well (P. Kiss 2007, p. 376.). In the meantime – as various SAO audits kept recurrently reflecting[18] – well founded impact assessments were missing and the budget bills did not contain, or did not fully contain, data, charts and evaluations that could have been used for mid-range

[16] See: several hundred SAO reports (www.asz.hu)
[17] It is part of the legal mandate of SAO to give an opinion on the fairness of the central budget and prepare a report on this for the National Assembly. This report is a legal requisite of discussing the budget bill. Following the crisis situation in the years 2006–2008 the Research Institute of SAO also assisted the work of the lawmakers by macroeconomic analyses. From 2009 this task became superfluous with the foundation of the Fiscal Committee. See the documents annually at: www.asz.hu
[18] See: the reports concerning the fairness of budgetary planning at the bilingual website of SAO: www.asz.hu

outlooks and substantive parliamentary decision-making, otherwise stipulated by the Act of Public Finance.

Under the circumstances of the decline, brought on by the first years of the social-economic transitory period (beginning of the 1990s), and those of the new worldwide economic crisis that erupted in the planning period of the 2009 budget, all this could have been explained, yet, this was not typical in the "normal" years. Contrary to the appeals of professional circles and, researchers – and far from the least – of the State Audit Office of Hungary, *what got into the central budget was what – on the basis of their short term political and vote maximizing interests- the decision-making majority wanted to see there*. At the beginning, corrections took place in the form of supplementary estimates (as a result of the dawning economic realities and the facing of the fact that the plans were not realizable in the given year). This, however, was essentially cancelled by amending the Act on Public Finance by stipulating that for the submitting of supplementary estimates it was a precondition to have diversions the occurrence of which was practically zero. Instead, they created rules that ensured a wide room to move for the acting government and its parliamentary majority to submit arbitrary amendments.

In the ensuing system that practically lacked mature goals and preferences, the organizations financed from the central budget could not really have other, direct (operational) goals than delivering their obligatory (public) tasks annually, by getting a growing share of resources and personnel (Báger 2006). Although it was possible to technically improve the order of financing and, to introduce new methods – as we have witnessed in the course of the past years - this in itself could not be the answer to the lack of a harmonized planning process that was trying to adjust to the realities. Additionally, the parliamentary majority tacitly and consecutively acknowledged that they had not observed the technical stipulations of the Act on Public Finance; no budget guidelines available for the wide circle of those concerned were prepared that could have been a starting point for the debates and that would have outlined the major priorities, goals, possibilities and conditions, etc. The major numbers of the budget were developed on the basis of select conciliations, by by-passing earlier published analyzes, and impact assessments.

The process and its result did show well every year in the form of the often referred to *'stiffened structures'*, the limits of the intentions to change and, naturally, the fact that this planning mechanism could not be maintained any longer; together with the missing often heard modernization plans (health-care, local governments, etc.), the lack of priorities, and their respective realities. (By the period of planning for 2011, it became obvious that it is impossible to maintain the functioning of public finance, if within it we are not creating priorities; in the given situation, regarding available resources, the former practice of evenly cutting back sources and thus spreading the burdens of former consolidation attempts cannot be continued.)

The most important conditions of the stability and consistency of state measures have not always succeeded in the financial management of public finance and the regulatory practice that did not examine, or did not examine with adequate circumspection, the effects of the individual measures, orders, the respective financial consequences of their implementation or the ensuing financial conditions[19], even though the Act on Legislation[20] stipulated that impact assessments should be submitted in connection with draft bills. These however, often have not been prepared or were built on modeling conditions that proved to be useless after introducing them, or which were simply disregarded when creating the conditions for their implementation.

From the loose fiscal discipline, the deficit of public finance and the inflation of wages, via monetary limitations and the real valorization of the Hungarian currency, the road led straight to the slowing down of economic growth (Erdős 2003, p. 475.). The position of public finance and, apart from this, the extent of redistribution, and additionally the structure of the revenues and expenditures of the budget and the fiscal policy shaping the former, became more and more the central issue of sustainable development. The importance of the observance of the international requirements related to public finance, the so called Maastricht criteria (GDP proportionate deficit, inflation, GDP proportionate public debt) has grown, and the undisciplined Hungarian fiscal policy is not a "private affair" anymore[21]. After the "fiscal alcoholism" of periods of overspending and consolidation[22], the

[19] See the 1996 Government Decree on the managing and, selling of treasury assets and other obligations related to such assets, and Chapter 2 of the Treasury Assets Recording Rules where, contrary to the objections of SAO no changes were made for a decade. Another outstanding example for this is also Act 1996/I on Radio and Television Broadcasting, the so-called Media Act.

[20] Act 1987/XI. (Act on Legislation)

[21] The problem of overspending, the sustainability of the central budget and the growing debts have emerged during the past two decades also in up and coming and developed countries that could be regarded as stable and not only in the "new democracies" of East Europe that have started their respective transition processes regarding their social, political and economic systems from the former party state framework to a social market economy, and which suffered very significant setbacks in real economy. In a number of countries these processes have been accompanied by bank and currency crises as well. In some of these countries, due to the shocks to the balance of the central budget, they introduced various temporary (for longer or shorter periods of time) rules to restrain expenditures. These were occasionally successful and, sometimes they did not bring positive results. In professional lingo, rules promoting rules-based fiscal policy are often referred to as rules-based budgetary systems. These fiscal rules have three pillars: numerical targets, procedural rules and independent institutions influencing the budgetary processes.

[22] György Kopits used this expression in May 2006 at the conference organized by the SAO, the Hungarian Central Bank and the Ministry of Finance, where they were dealing with professional issues of budgetary responsibility. In his presentation, Kopits underlined that in the course of the past one and a half decades Hungary was displaying gradual and strong fiscal debt inclination. Lack of the culture of stability, that we can refer to also as "fiscal alcoholism", can be recognized by the well-known symptoms (denial, postponed tapering-off cure, blaming others, etc.). The budgetary responsibility system (BRS) should be introduced by the building of political determination and social consensus including transparency, the strengthening of the rules of procedure (planning of mid-range budget included) and launching comprehensive reform steps (especially focusing on the transformation of the social security and the health care system). Concerning the structure and functioning of (BRS there are

creation of self restraining fiscal rules took place in 2008[23]. The act represented a stepping forward when compared to the former regulations and quality conditions of the planning[24].

We should note: employing fiscal rules reached its goal in those countries (Chile, Sweden, etc.) where they recognized that in their respective positions *it was impossible to artificially stimulate the economy and thus the growth of consumption and revenues – when lacking reserves and resources – thus they were focusing primarily on the mitigation of the expenditures* and the modernization of the structure of the central budget. Characteristically, we can detect the success of such consolidations where the introduction of rules based fiscal policy was not motivated by external forces, rather, by public policy, the professional circles and the internal decision of state governance and, where this was supported by the decisive majority of the society.

5. Conclusion: The criticism of the past, the possibility of the ”angelic circle”

The crisis reached Hungary in the middle of a stabilization program that followed a period of limitless overspending. The serious budgetary shortfall that evolved in the period of 2002–2006 and the ensuing high level of public debt does not make it possible to follow an anti-cyclic economic policy. In the short run, budgetary expenditures should be aligned with the dramatically decreasing revenues and only then can we proceed with growth stimulating economic steps by implementing structural reforms. Both tasks require the supervision of state expenditures and of the role of state institutions, even of the role of the state itself.

One of the fundamental questions of the future is whether it will be possible to restore both the external and internal trust. Up to the recent past, from among

several solutions; however, it is indispensable to limit primary expenditures, to be supported by a cautious macro-fiscal warning system and ensuring that it should be audited by an independent authority (for example the SAO) (P. Kiss–Kékesi 2006, p. 384–385.).

23 Act LXXV of 2008 on Fiscal Responsibility, otherwise referred to as the “Budgetary Ceiling Act” is a macro-level guarantee regulation, respectively, on micro level it was Act CV of 2008, the so-called “Status Act” that put the budgetary institutional financial management on a new basis. We should note, however, that, a number of institutional conditions were missing at the time of finishing this manuscript that would have been necessary for the enforcement of the Act and it can only evolve its role in the process of planning the 2010 central budget. In the submitted bill that bears the signs of less usual technical solutions, we can find all the elements that have already been employed successfully in other countries. The bill is introducing certain “ceiling” rules that put an obstacle in the way of having expenditures getting out of control, and by detailed calculation, rules and institutional assurances of the Fiscal Committee attempts to achieve that the budget act and other acts influencing the budget could be discussed and endorsed only after certain analyses, prognoses and impact assessments.

24 The institutional conditions mentioned in the regulation were changed at the end of 2010. The composition of the Fiscal Committee and that of the backup office has been changed and the functioning of the earlier macroeconomic analyzing team was terminated. At the same time, the sphere of authority and the range of the Committee’s intervening possibilities have been strengthened.

plans, promises, and undertakings regarding Hungarian public finance, none have materialized ever, so the big question is whether we will succeed at all, and if so, to what extent.

The other, fundamental question is, when and how effectively it would be possible to put forth the structural reforms that influence the position of the central budget (and, naturally, that of the production sector), first of all the modernization of the big providing systems, thus the pension system, the health care system and education, the developments that would strengthen competitiveness by relying on EU resources and by aligning these to the reform-scale modernization of public administration and within this the modernization of the local governmental system, in the respective regions. In the interests of sustainable development and, growth that is financeable, it is necessary to introduce changes that cannot be postponed any longer and to a level of conformity that meets the principles of the social market economy; and by assisting the performance of the real economy it should also undertake financeable social provisions.

Under such circumstances, Hungarian economic policy should cope with several priorities and fundamental tasks that – in many respects – might cross each other. By keeping the results of the newly born stabilization and, consolidation so far and by effective crisis management we should handle the consequences of the fiscal tensions and of the recession; in order to avert further fiscal and currency crises and we should take steps to alleviate the growth of unemployment and, at the same time, to improve the liquidity and the rating of the actors of the economy. Additionally, apart from the above, establishing the possibilities of looking for various ways out and, the conditions and chances of sustainable and financeable growth and development should be (and should already have been) established (Kovács 2010).

In transitory economies and societies like Hungary, consolidation and development depend to a greater extent on the resolute harmonization of interests and on the value creating undertaking of responsibility, than in other, European countries. Breaking out of the established compulsory course requires changing such social expenditures and, social transfers that also interact with each other and that cannot be realized without re-thinking the fundamental constitutional rights (pension, health-care, education and other tasks earlier undertaken by the state), and without establishing such new, social and political compromises like territorial management, local governments, redefining the role of the state and the "re-building" of the state.

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