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'Economic policy of the Orbán government:
a new strategy to solve old problems?'
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Challenges for fiscal policy in Hungary

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Main topics

- The fiscal landscape inherited by the Orbán government (debt, deficit, risk premium)
- Fiscal endeavours in 2010 and the budget for 2011
- Signs of a turn in March 2011 (structural adjustment programme)
- Outlook and challenges
- Fiscal issues in the draft of the new constitution

Some personal observations

- As a former member of the (former) independent Fiscal Council (FC)
- Our analyses and warnings have been neglected
- The recent structural reform programme confirms our assessment
- It was a serious mistake to destroy the staff of the FC
- The analyses are still accessible at:
<http://freepress.nuzoka.com/macroeconomic-analysis.html>
<http://freepress.nuzoka.com/fiscal-impact-assessment.html>

The state of public finances in HU – international comparison

- Dual nature:
 - Huge debt (past: fiscal irresponsibly) →
 - Deficit: relatively low, recent improvement
 - Cyclically adjusted (strongly pro-cyclical)
 - Overall vs. primary balance →
 - Interest payments →
- It took a long time for the gov. to realise: excessive interest payments (track record + lack of credibility) has to be addressed
- In mid-2010: prospects of fiscal sustainability relatively sound
 - need for 1-1,5% permanent fiscal adjustment

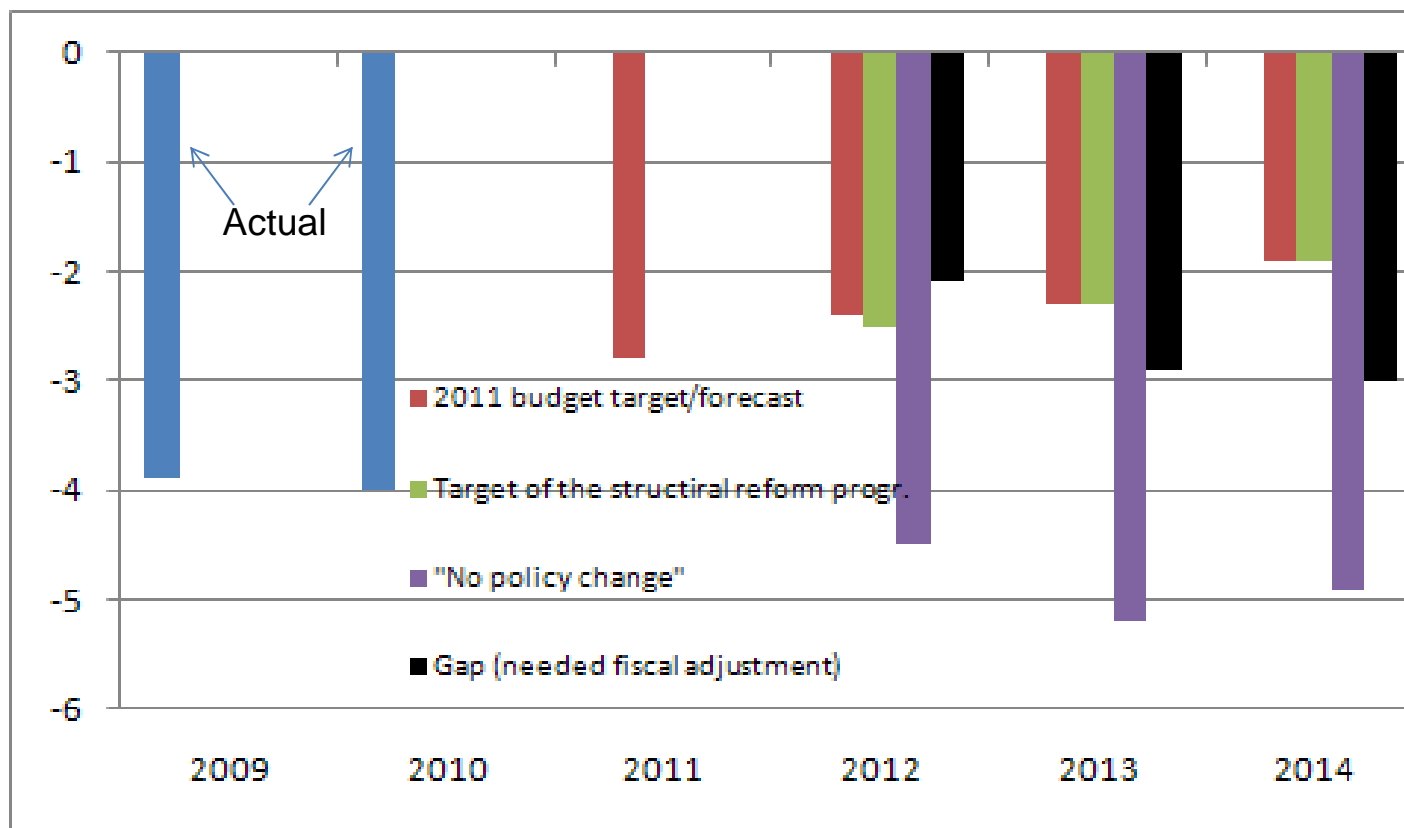
Some characteristics of the fiscal (and overall) economic policy of the new government

- „Non-conventional measures”
 - Special taxes on financial institutions and other service sectors, combined with
 - overall corporate and personal income tax cuts („flat tax”)
- „New economics”
 - Against standard macroeconomic reasoning and accounting (IMF, EU, ...)
 - (not the same as Blanchard’s self-criticism)
 - Distinction between „productive” sectors and services etc.
- Budget for 2011:
 - feasible in itself, but
 - medium-term sustainability problems; underlying assumptions:
 - rapid growth (in 2012: 3,5%, from 2013 above 5%)
 - huge increase in employment (1,8 % in 2012; 3% thereafter)
 - View of the FC: though not impossible, very risky
- Reversal of the pension reform
 - First (with other countries): requesting different treatment of transfers to pension funds
 - Economic essence:
 - One-time cut in public debt (8-9 % of GDP)
 - Permanent cut in public deficit (**transfers + interest** on public debt: -1,5% of GDP)
 - Reasonable

The structural reform programme (March, 2011)

- (Personal interpretation): a radical break with economic policy/notions communicated by the gov. until recently
 - Keyword: public debt reduction (somewhat overdone: from by 80% in 2010 to 50 % in 2018)
 - Details – to be announced later
 - fiscal adjustment of 3% of GDP by 2013 (of which 2% in 2012)
 - Mainly expenditure side (unemployment benefits, disability pensions, drug and public transport subsidies)
 - Postponement of announced tax cuts
 - Feasibility, implementation: unclear, however:
 - a major step from overly optimistic fiscal forecasts ideas toward the real world
- **Acknowledgement, *for the first time***, of structural reforms (measures to sustainably reduce the deficit) *by the former government*

Projections for 2012-14: medium-term outlook of the 2011 budget vs. the *recent* „no policy change” scenario – two fundamentally different stories
 (General government balance in % of GDP)



The SRP acknowledges a gap of 2% for 2012 (and 3% for 2013 and 2014) – this indicates the size of the necessary fiscal adjustment relative to projections in the budget for 2011

Major challenges

- Fiscal policy:
 - Extending the tax base
 - Decreasing the relative size of public expenditures
 - Demonstrating the medium-term sustainability of Public finances in HU (possible virtuous circle)→
 - Fall in risk premium + lower debt , lower interest, improving fiscal outlook etc.
- Overall: extending the basis of economic growth beyond exports

Finally: two controversial fiscal issues

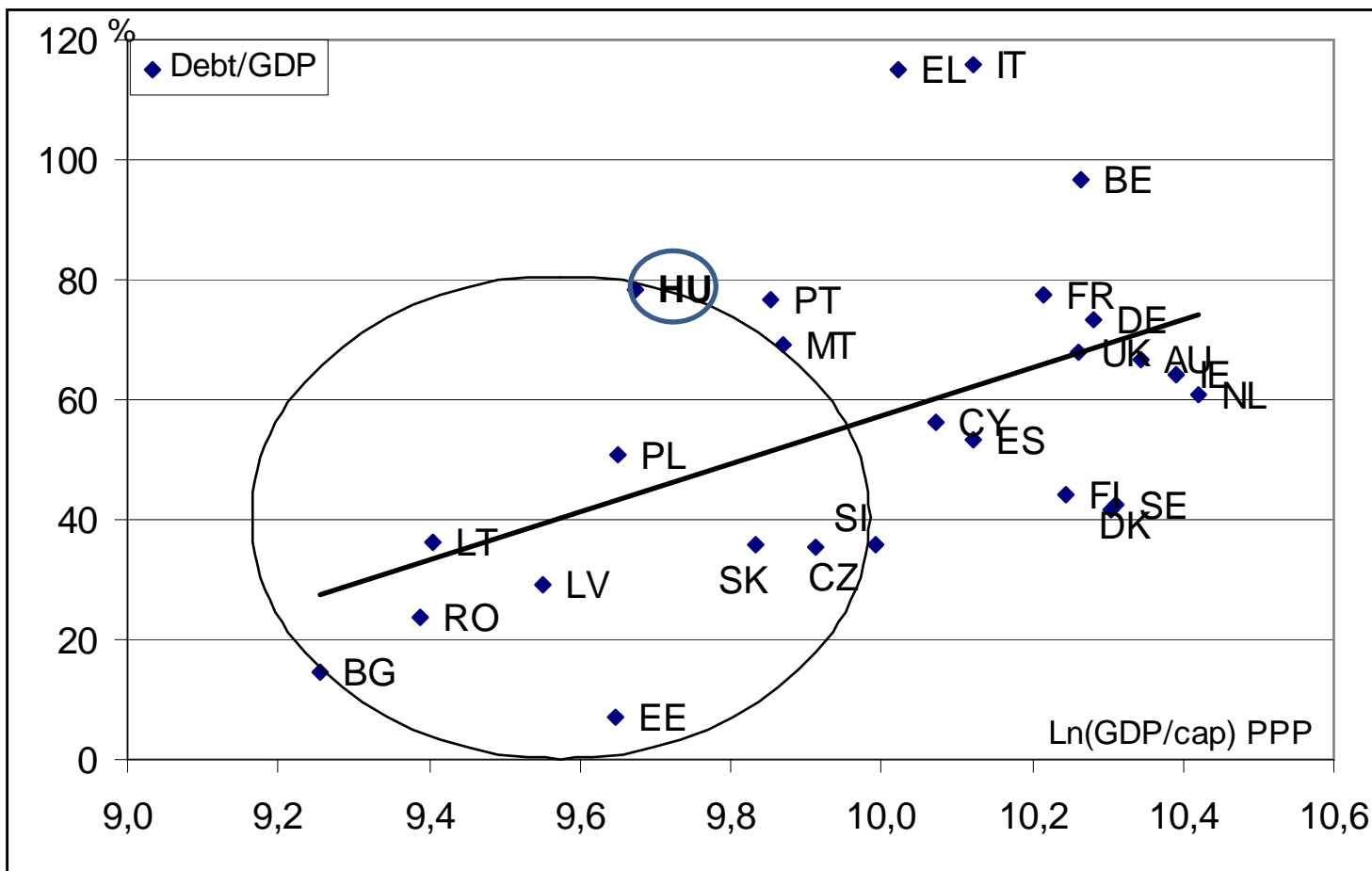
- The withdrawal of the pension reform
 - On the one hand: increase in future liabilities
 - On the other hand: decline in present liabilities and deficits
 - The net effect: early to say
- Fiscal rules in the constitution
 - On the one hand: the idea is sound
 - On the other hand: the suggested rules are unsound and inferior to the present fiscal rules

Tank you for your attention

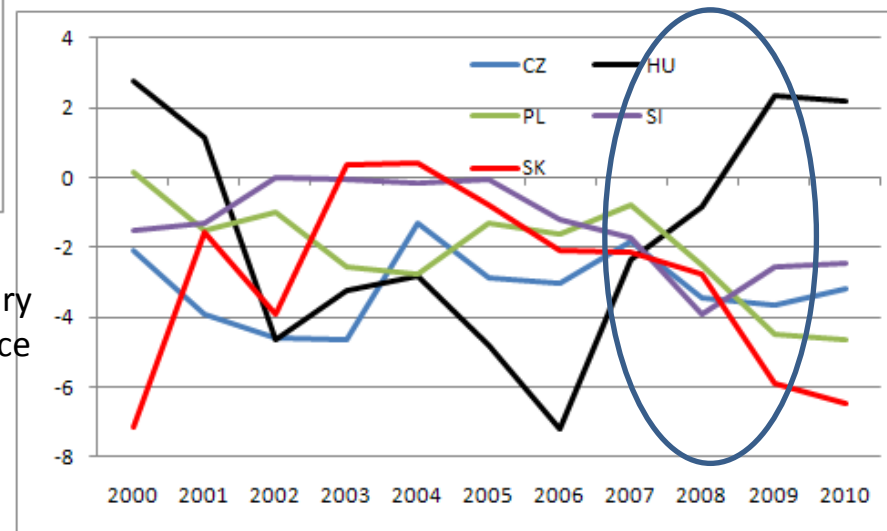
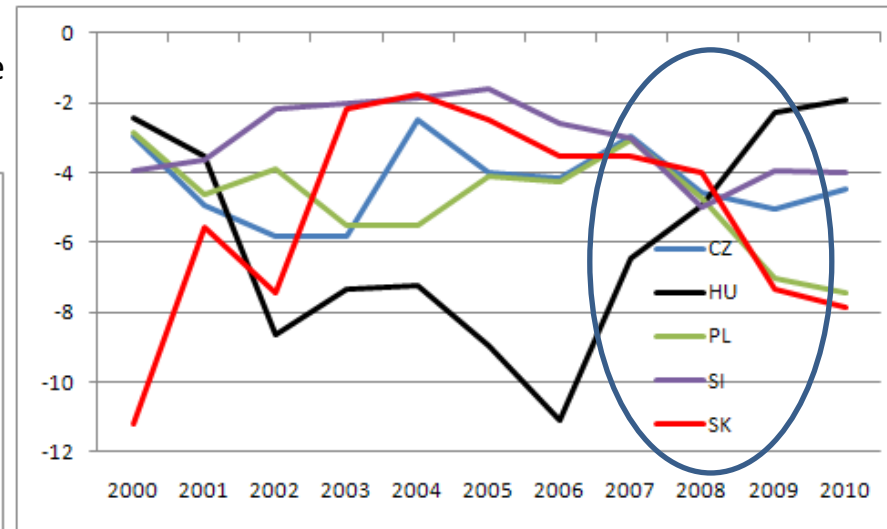
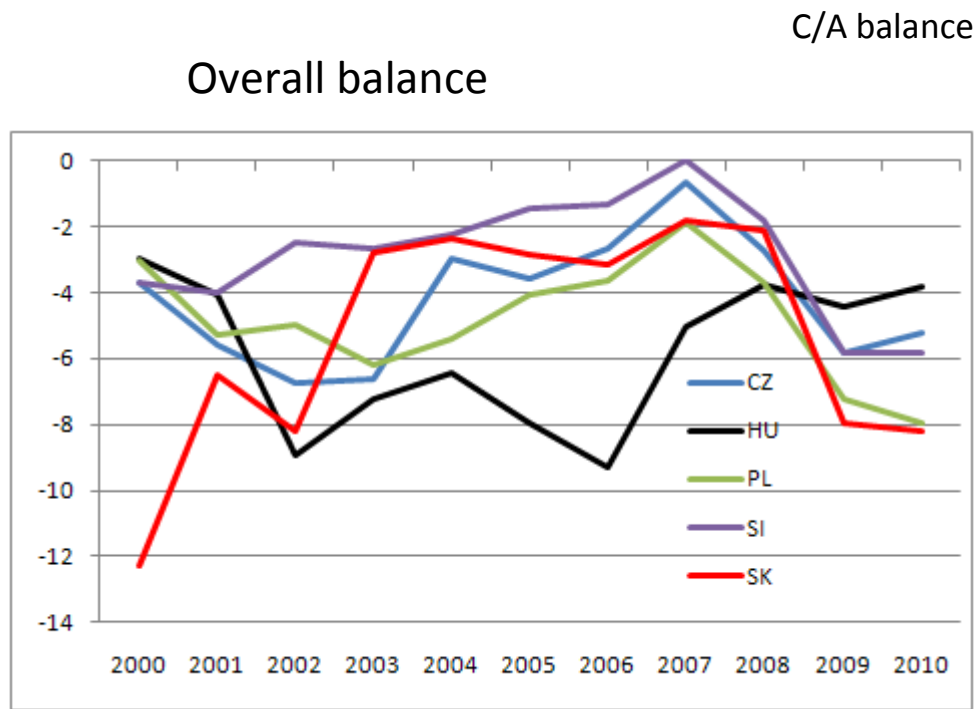
Inserts

Hungary's public debt/GDP ratio is extremely high relative to its level of development (especially in CEE comparison)

Debt ratio and GDP per capita (in PPS), 2009



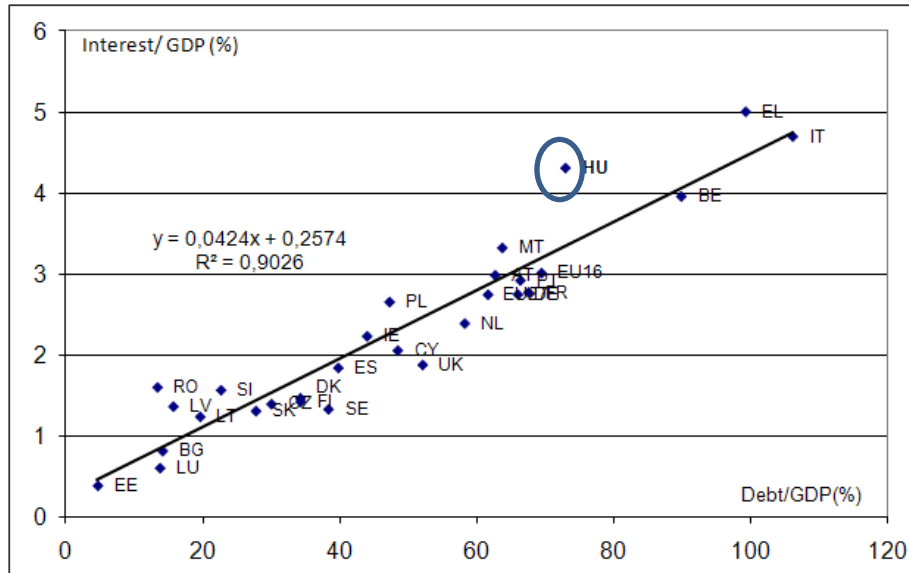
General government: balance and the cyclically adjusted overall and primary balance (% of GDP)



- HU's fiscal policy strongly pro-cyclical (before and during the crisis)
- primary vs. overall balance: huge interest burden



Public debt/GDP (2008 average) vs. interest payment/GDP in EU-countries



HU: outlier: interest payments have been significantly higher than implied by its debt ratio

