

# Hungary

<b>Status Index</b> (Democracy: 9.40 / Market economy: 8.93) <b>9.16</b>		<b>Management Index</b> <b>6.87</b>	
<b>HDI</b>	0.862	<b>Population</b>	10.2 mn
<b>GDP per capita (\$, PPP)</b>	14.584	<b>Population growth<sup>1</sup></b>	- 0.1 %
<b>Unemployment rate</b>	5.9 %	<b>Women in Parliament</b>	9.1 %
<b>UN Education Index</b>	0.96	<b>Poverty</b>	N/A
		<b>Gini Index</b>	26.9 (2002)
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. <sup>1</sup> Annual growth between 1975 and 2003.			

## A. Executive summary

Hungary has become one of the most stable parliamentary democracies among the new EU member states. Stateness is not a contested issue. Elections were free and fair and enjoyed high participation. The 2002 elected legislature and socialist-led coalition were able to hold office. In 2004, the coalition parties carried out a government reshuffle peacefully and according to constitutional stipulations. The Constitutional Court proved its independence by blocking the expansion of governmental power. Freedom of choice and civil rights are guaranteed. Both socialist-led governments (2002-2004; 2004-) made efforts to provide equal opportunities by introducing anti-discrimination programs. Civil society receives financial aid from the government; it has been incorporated within the policy implementation process, especially social welfare. Corruption is widely spread within public administration, but no effective countermeasures have thus far been taken.

Hungary's EU accession was a great achievement. As a result of their capacity to establish a functioning market economy and a democratic political system, the new Eastern European member states have finally been fully accepted by Western democracies. However, Hungary has yet to develop its own EU strategy and assert its profile within the new European borders. As the war in Iraq and the tensions between the United States and some EU member states have shown, this will be a constant challenge for Hungary's elites and their managerial and integrative capacity. EU membership will also influence the country's future economic and political performance while sustaining its further consolidation of democracy.

Unlike the first socialist-led government (1994-1998), the present coalition was not able to uphold Hungary's leading role in economic performance among Eastern European transition countries. Hungary does not stand out as it did in the mid-1990s, when it attracted the largest per capita share in the region of Western foreign direct investment and served as a model for successful economic and fiscal policies supporting stable growth.

Indeed, some competitors—such as the Baltic States and Slovenia—have improved significantly. However, the populist economic and welfare policies of the Fidesz government (1998-2002) were not decisively corrected by the succeeding Medgyessy government (2002-2004). The Hungarian economy has yet to recover from Fidesz's populism, and competitiveness and growth orientation must be fostered. The new Gyurcsány government (2004-) has not had enough time in office to manage the challenges to be met.

Despite Fidesz's polarizing effects, Hungary remained a stable parliamentary democracy. However, the failed citizenship referendum in December 2004 and Fidesz's populist nationalistic campaign divided Hungarian society along political left vs. right cleavages. The socialist-led government is trying to reunite Hungarian society on the basis of a European, republican and civic identity. However, the largest oppositional party, Fidesz, has moved increasingly toward Euro-skepticism and made appeals to Hungarian national identity and nationalism. Its populist-protectionist welfare and fiscal concepts enjoy wide support by the greater population.

The European, republican and civil society orientation of both socialist-led governments has restored the coalition parties' co-operation on domestic and foreign policies. However, problems persist that are not likely to be resolved within a short-term period: improving the Roma's situation; fighting corruption; decentralizing and regionalizing the institutional structures according to the subsidiarity principle; reorganizing the health care and educational systems, improving economic competitiveness and growth; strengthening political unity and providing social inclusion; assuring a sustainable future by investing in the environment and education; and integrating ethnic Hungarian communities abroad within the new European borders. While both governments have made sincere efforts, the results of the first socialist-led government fell short and the second has just recently come into office in September 2004.

## **B. History and characteristics of transformation**

Hungary's transition to democracy took place after forty years of communist rule. Unlike its neighbors, Hungary "liberalized" its 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 Kádár regime. Not all spheres of social life were politicized and private, economic and social life was partially liberalized. Consequently, Hungary experienced social calm, growing consent and dynamism in the 1970s “second economy,” which became known as “goulash communism.”

However, the communist leadership’s primary legitimizing factor, the rising standard of living, was short-lived. The lack of industrial output had to be compensated by extensive borrowing from the West, which meant increasing external debt. By 1982, Hungary already owed some \$9 billion to foreign creditors. At the end of the 1980s, Hungary’s “socialist market economy” had accumulated external debts of approximately \$20 billion. This was the price Hungary paid for opening its economy so early. However, doing so not only laid the microeconomic foundations for competitiveness, it also prepared significant parts of the Hungarian population for the demands of transformation.

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 discussions were established following the Polish example. These discussions were intended to fundamentally change the political system and its constitution. However, given the prevailing circumstances—a demobilized and apolitical society—the talks had an exclusive character and resulted in a compromise negotiated by the elites. The compromise consisted of the agreement to hold free elections in 1990 and to initiate the necessary constitutional amendments. The process of changing the system in Hungary was largely run from above by old regime elites.

In the years that followed, Hungary was able to establish a democratic political system that was cemented by several successive democratic governments. The administrative system was decentralized and made more effective. Local self-administration was established as early as 1990. Democratic transformation brought with it the change of the economic system. The democratically elected governments of the 1990s privatized state-owned companies, liberalized foreign trade and helped increase the privately held share of all productive property from 35.2% (1992) to 72% (1997). During the same period, industrial

relations were reformed in Hungary; free trade unions were established, as were employer and trade associations. Different platforms, such as the “tripartite” committees, were established to coordinate and integrate interest groups into a stable cooperative neo-corporatist framework including the government. Democratic transition and economic transformation spurred economic growth, which increased significantly from 1996 onward.

## **C. Assessment**

### **1. Democracy**

#### **1.1. Stateness**

There were no problems of territorial integrity or contestations of the legitimacy of the state’s monopoly on the use of force that could endanger the consolidation of democracy. Hungary has an active policy on protecting national minorities within the country and the Hungarian minority in neighboring countries. Hungary has fully implemented the minority protection articles of the EU Constitution.

Church and state are clearly separated; politics and policy-making are secularized. The Gyurcsány government criticized the Catholic Church for its political interventions during the citizenship referendum campaign in 2004.

#### **1.2 Political participation**

In Hungary, both the right to vote and the right of candidacy for public office are guaranteed. Despite accusations from the center-right opposition party, (Fidesz – Hungarian Civic Union), international observers and national authorities did not register any serious distortions during either the 2002 elections or the 2004 referendum. Electoral participation reached its peak in the 2002 elections (70%) and has declined steadily since then: it dropped to approximately 65% in the 2003 EU referendum, plummeted to 38.5% in the EU elections and to 37.5% in the referendum on citizenship and privatization in health care. Because this “double” referendum did not reach the constitutionally required quorum, its results were not considered valid.

The socialist-led governments—the first elected in 2002 and headed by Péter Medgyessy; the second headed by Ferenc Gyurcsány following Medgyessy’s resignation in 2004—enjoyed full authority during their terms without challenge from veto powers among the church, the security apparatus, or the military. Both governments have respected human rights and freedom of speech. While the opposition has been pointing at imbalances in the media

policy since it lost the elections in 2002, social democrat policies do not pose any serious threat to the media.

### **1.3. Rule of law**

In Hungary, there is a well-established system of checks and balances. Although the socialist-led governments have upheld this system, they, like the Fidesz-led coalition headed by Victor Orbán that preceded them, have continued to increase the authority of the executive branch. The office of the prime minister became the effective center of government during the Orbán era (1998-2002), this was upheld – even extended – under the socialist-led coalitions. While Prime Minister Gyurcsány has been able to extend his authority to give general orders, his minister of education's higher education reform bill was nullified by the Constitutional Court in December 2004. The court did not accept the government's attempt to regulate basic civil rights and duties by a ministerial decree rather than by law.

There is an independent judiciary with a working self-government. The Constitutional Court and, to a certain extent, the president's office are functioning as judicial reviewers, e.g. as early-warning systems against the legislation initiated by the government and passed by the socialist-led-dominated parliament. This is due to the fact that the president of the republic has the right to send bills back to parliament to modify them. The Gyurcsány government's former minister of justice stepped down when he saw his concept and planned policy of judicial and administrative reform endangered by the government's austerity policy. Other persistent problems are the judiciary's fiscal dependence on the government and the blockade of the re-election of judges to the Constitutional Court by the political parties whose candidates have not been able to obtain the required two-thirds majority. By the end of 2004, this seriously distorted the rulings of the Constitutional Court. Also problematic has been a conflict between the chief attorney and the socialist-led coalition. Despite all of this, the functioning of the courts and the judicial system itself are not endangered, and the rule of law is guaranteed.

Despite the current government's promises to fight corruption, no effective measures have taken to this purpose.

Although human rights are generally upheld, control mechanisms are weak, and NGOs report serious violations against the Roma, drug addicts, prostitutes, immigrants and petty criminals.

An anti-discrimination law has caused heated discussions among the political parties. At the time of this report, the law had been passed and was to be

enacted January 2005, but was under judicial review by the Constitutional Court. If parts were to be declared invalid, this may endanger its planned implementation.

#### **1.4. Stability of democratic institutions**

In Hungary, there are stable institutions that largely guarantee democracy and the rule of law. The central organ of the parliamentary democracy is parliament itself. However, the strong polarization between left- and right- leaning parties hinders consensus-building. Parliamentary debates are rhetorical and ideological; concrete discussion of policy occurs only in the committees. Opportunities for a consensus such as the EU referendum, EU accession, EU elections, or even the referendum on citizenship were missed. It has proved impossible to establish a pragmatic national interest or public cause beyond the interests of the political camps.

The national government and prime minister have steadily accumulated power. The top-down bureaucratic-elitist approach that marked Orbán's center-right government (1998-2002) has also characterized the socialist-led governments since 2002.

While the administration is relatively efficient, the tasks for EU accession were, at times, overwhelming and led to administrative mismanagement and political rivalries. The Orbán government's shortcomings in regional and local governance persist. Governance on these levels must be refashioned according to EU norms.

There can be no doubt that, fifteen years after Hungary's transition to democracy, no relevant veto actor challenges the legitimacy of the country's democratic institutions.

#### **1.5. Political and social integration**

As the Hungarian party system is relatively stable, there have not been any significant newcomers since 1989. While there is a tendency toward polarization between the left and right (which have to some extent crystallized into political blocks) the arrangement is not that of a two-party system. The left is led by the Hungarian Socialist Party (MSzP) and accompanied by the (SzDSz) while the right is led by the Hungarian Civic Alliance (Fidesz) and accompanied by the Hungarian Democratic Forum (MDF). However, former Prime Minister Viktor Orbán has been trying to build a unified party on the right, a move that led to the annihilation of the Smallholder party, its coalition

partner from 1998-2002. It also endangered MDF's existence as an integrated political party in the autumn of 2004, because the faction in favor of maintaining independence from Fidesz – led by Dávid Ibolya – and the pro-Fidesz faction nearly split the party in two.

The orthodox Hungarian Workers' Party has not been able to gain influence on the national level, except for their initiative for the referendum on the Gyurcsány government's "third way" privatization plans, which Fidesz effectively supported. Small groups and networks of right-wing radicals have been articulating provocative but non-violent protest that mobilized counter-movements from the left in 2004. As these activities are at the fringes of the political spectrum, they do not destabilize Hungarian democracy.

Hungary is a secular parliamentary democracy. Generally, the churches are politically inactive, although they supported a "yes" vote in the referendum on citizenship. This move was criticized by Prime Minister Gyurcsány. Trade unions are politically weak. Popular initiatives such as referendums are ineffective if they are not supported by political parties. Regions and regionalism are weak to non-existent. Except for the Roma, ethnic minorities are not numerous. The Roma have a predominantly parochial and passive political behavior that prevents them from mobilizing or establishing a unified political identity.

After the intensely polarized 2002 elections, political participation – as well as the satisfaction with political elites and institutions – has weakened considerably. In combination with the declining economic situation and the socialist-led government's austerity policies, this has led to a further deepening of Euro-skepticism and other negative attitudes toward the European Union. A considerable part of the less-educated segments of the Hungarian population associates EU membership with endangered welfare standards and therefore regards the European Union less and less as a stabilizing and enriching partner. The population generally feels alienated from the new EU institutions. However, a distinction should be made between educated and less-educated groups, between generations, as well as between regions. Urbanized areas—first and foremost the capital city, Budapest—are the decisive areas for political mobilization, while the farm districts and villages with Roma population in the East and South are the least mobilized areas in the Hungarian society. The elites, urban middle classes, and the well-educated tend to approve of Hungary's EU membership.

Civil society focuses on welfare and culture and does not exercise political "watchdog" functions. The participation of NGOs in policy implementation has been strengthened by new government measures and EU programs. The groups engaged in civil society are mostly socialist and liberal in orientation, while the

more nationalistically oriented segments of the population prefer to participate in Fidesz's protest campaigns and political action committees. Despite being the targets of both socialist-led governments' inclusion and anti-discrimination programs as well as of several EU programs, the Roma, women, and the youth do not have any distinct culture of political activism.

## **2. Market economy**

### **2.1. Level of socioeconomic development**

According to international surveys, Hungary is performing well among the new EU members. Income inequality is low, while levels of education are high. There is no systematic exclusion of women from the labor market. According to international surveys, poverty is not particularly high. However, as these figures are aggregated from macro-level data, they hide the rather divided picture that characterizes Hungarian society. Many of Hungary's Roma population are living under the poverty line. With the East and the South still struggling for development, there are also considerable regional disparities.

### **2.2. Organization of the market and competition**

The basic principles of market-based competition have been established in Hungary and the economy is based on the rule of law. While a number of national regulations have recently been replaced by EU regulations, many of the latter have yet to be fully implemented. While the country's currency policy is aimed at membership in the European Monetary Union (EMU), there is a heated debate on the introduction of the euro (envisaged for 2008-2010). The free flow of goods, services and labor within the European Union has been established in Hungary with some transitional regulations and restrictions. Competition policy is scrutinized by an independent authority that is more closely linked to new multinational companies than to the remains of the planned economy.

Today, Hungary is one of the most stable and consolidated market economies among the new EU member-states. Multinational companies, attracted by low corporate taxes and the cheap skilled labor, have invested in the country and thereby contributed considerably to economic growth. The dynamic growth of the service sector is transforming the economy into a modern service economy. Multinational companies are investing in this sector as well and providing the country and its neighbors with advanced services.



Through their investments, multinational companies are thus reconstructing the former economic, infrastructural and service unity of Central Europe and integrating the region into Europe and the global market. This trend was further strengthened by EU accession. The dynamically developing information technology sector is also making an important contribution to Hungary's economic growth. Agriculture, heavy industry and mining have been the losers in Hungary's transformation to a market economy.

Recently, Hungary's economic dynamism has slowed considerably. This is partly due to the government's fiscal policy, which was oriented toward internal consumption and supported by a credit policy for housing investments that recently had to be stopped. Other important factors in this slowdown include the wage increases related to EU membership and EU competition policy that forced Hungary to abolish certain tax privileges for multinational investors. Another factor for losing its leading position in foreign direct investments is growing competition among other new EU member-states.

Hungary's banking sector is well-developed and dynamic and is well-controlled by an autonomous agency. There are more problems with investment companies. As a part of its plan to introduce public-private partnerships in the fall of 2004, the Gyurcsány government asked this rapidly developing sector of the Hungarian economy for a special contribution to national welfare and growth. Hungary's capital market is increasingly stable and transparent.

### **2.3. Currency and price stability**

While inflation rates have decreased since the 1990s and are now more stable, the irresponsibility of the Fidesz government's "electoral budget" in 2002 has carried over into both socialist-led governments. The Medgyessy government made the fiscal and economic policy mistake of upholding all populist measures taken by Fidesz, including state credit for students, cheap housing credits, and generous financial support of Hungarians abroad. The socialist-led governments had also planned to raise the salaries within the public sector, provide maternal allowances, and increase some of the social welfare benefits. However, the Medgyessy and the Gyurcsány governments had to abandon these policies, because they endangered competitiveness and growth.

The independence of the central bank is now threatened due to the Gyurcsány government's decision to reorganize its monetary council, opening it to the government's fiscal policy demands. At the end of 2004, the bill was sent back to parliament by the president. As the majority of the parliamentary deputies

overruled the president's decision to return the law, this may be submitted to the Constitutional Court for review.

On the macroeconomic level, there is still not sufficient stability. As the measures against public debt did not succeed, Medgyessy was forced to replace his finance minister in 2003, and to resign from his position as prime minister in 2004. The Gyurcsány government retained Finance Minister Tibor Draskovics, though his concept to consolidate the budget and raise competitiveness under the present conditions has yet to bring the desired results. Another serious problem is the tension between the economic and fiscal policy of the socialist-led governments and the currency policy of the central bank. The latter increased the stability of Hungary's currency, the forint, by recent revaluation against the euro. The revaluation contributed to diminishing foreign debts, but it also curbed the export of consumer goods.

So far, the two socialist-led governments have not been able to break completely with Fidesz's populist economic and fiscal policy. Medgyessy's policy was criticized as inactive, unimaginative and soft. Gyurcsány is trying to establish a Hungarian "third way." It was still not clear how this would appear at the time this report was written. At the end of 2004, the Hungarian budget was criticized by the European Union for exceeding the EMU deficit criteria. According to the European Union, this was due in particular to the lack of health care reform.

#### **2.4. Private property**

Private property has a clear legal basis in Hungary. The private sector dominates the economy (the "strategic" branches of the economy were privatized during the 1990s), and government has expressed intentions to pursue further privatization. Today's discussion on further privatization concerns those branches whose organization—private, public or mixed—differs among those in Western societies as well. Both socialist-led governments have shown a tendency for privatizing even traditional public sectors like transport, education, health care and the prison system. However, as a clear majority showed in the referendum on December 2004 regarding the privatization of health care, the electorate rejects further privatization. Extending privatization to higher education as planned by the minister of education is also rejected by the public. In line with the Communist Party, Fidesz (which regards itself as the "middle class party") is considering the prospects of imposing a general stop on further privatization through a new referendum initiative. This could block the "third way" economic policy in

Hungary: inspired by Giddens' theory and Blair's practice, this means giving up traditional socialist-led public policies by reducing the role of the state and deregulating the economy.

## **2.5. Welfare regime**

Officially, about a quarter of the Hungarian population lives on the level of minimal wage. However, the high number of early retired persons—a common feature in post-Communist societies—and the fact that even entrepreneurs and professionals declare themselves and their families as living from the minimal

wage as a means to be entitled to welfare services should be considered. The actual figure of people living on the minimum wage is somewhat lower than official figures indicate.

Hungary has a welfare system targeted to fight poverty and provide equal opportunities to all citizens. There is a health care system, unemployment insurance, pensions, a system of social assistance and a governmental program for the handicapped currently in the process of expansion. Although some elements of the former Communist system remained, the present system is comparable to the continental European welfare system, albeit on a lower level. While in government, Fidesz provided extended social benefits and family allowances, but socialist-led governments reduced social welfare for the upper classes. In their opinion, because welfare should follow the principle of need, income-based benefits were recently introduced as a guiding principle for welfare entitlements. Different welfare models are being discussed, but the present government clearly favors more privatization and more income-based and targeted welfare policies. The churches' charity system and institutions have partly been re-established, but they do not have expansive coverage. According to the principle of subsidiarity, local governments and municipalities are being given increasing responsibility in the provision of social welfare. Corporate citizenship is a marked characteristic of the multinational companies' activities in Hungary. Like in other countries, they run their own supplementary welfare schemes.

The pension scheme has been partially privatized, but welfare reform will not be complete without the health care system undergoing general and conceptual renewal. While the health care system has undergone some changes since 1989, it requires a dramatic reorientation. The quality of health care is very low, and services are provided often arbitrarily to the well-off through a

corruption network within the health care system. As the wages of health care personnel are low, it is considered normal to pay them bribes for what are supposed to be public and free health care services.

The constitution guarantees equal treatment and opportunity for all Hungarian citizens. The socialist-led governments have made considerable efforts to better include neglected groups. To ensure equal rights for women, the handicapped, the Roma and others, a EU-oriented comprehensive reform was initiated and a special governmental agency for equal rights—connected both to welfare policy and to human rights policy—was founded. However, this agency's financing, political prestige and administrative power has not yet been clarified. This has led to a rapid change of its administrative and legal status, including the personal replacement of its leader. The aim of equal opportunity legislation and action, nonetheless, brings Hungary closer to EU standards. The

Roma issue is handled with care politically and within the framework of the EU minority policy concept. However, discrimination of the Roma in Hungarian society and in some local branches of the public administration has not fully disappeared.

Anti-discrimination legislation and an office for equal opportunity were established, but these are only legal and administrative answers to deeply rooted socioeconomic problems. There is an enormous contradiction between the legal norms of anti-discrimination and equal opportunity and the reality of exclusion and discrimination against the poor, the Roma, refugees, the homeless, the handicapped and women. This is especially true for access to health care and education. There is a social selection bias in the distribution of the public goods of education, health care and welfare, the result being massive exclusions (the Roma, the homeless, refugees, peasants) and softer ones (the handicapped, women, the elderly). The “same wage for the same work” principle has been difficult to implement. The government's efforts have brought some institutional and procedural gains for women in respect to domestic violence and discrimination and the handicapped with a program to improve infrastructure. To raise the Roma's standard of living is an almost unattainable task, considering their unemployment rates and their traditional family and kinship structures. Current government programs do not provide sufficient resources to address these issues; they have not been very effective.

## **2.6. Economic performance**

The Hungarian economy has had stable growth rates since the mid-1990s, but they are lower than most of the other new EU member-states in Eastern Europe. While the unemployment rate is somewhat lower than the EU average,

national debts are above the EU average. Foreign direct investment is declining, as some of the other new EU member-states and the accession candidates in Eastern Europe offer similar working conditions as Hungary, but lower wages and more tax privileges. Fiscal policy has been trying to regain equilibrium for years, but no decisive improvements can be reported. However, even though Hungary has lost its leading role among the new EU member-states, it is still among the most well-performing economies in the European Union.

## **2.7. Sustainability**

Hungarian environmental policy is slowly reaching EU benchmarks, though still far from standards of many EU member-states. In order to accelerate this process, the ministry of environment was replaced in 2003. However, environmental policy still has to fight for prestige and resources in the budget debate. In fact, Hungary's "third way" has not forgotten the central role environment and education played in the British concept, for both issues have lost funding because of Gyurcsány and Draskovics' new austerity policy. Current environmental issues include waste separation, the reorganization of natural park management based on public benefit foundations instead of bureaucratic state administration and the import of pollution from non-EU countries through the rivers. In these matters, the Ministry of Environment is cooperating with environmental NGOs. This is easier in Hungary than elsewhere: due to the lack of a successful green party, these organizations are rather de-politicized.

Infrastructural development is being financed not only by the state, but increasingly also by private investments and EU projects. According to statistics, the city of Budapest is losing ground in comparison to the capitals of other new EU member-states because of rising prices, insufficient infrastructure, and precarious security. The construction of a new underground line has been postponed since 1989. Without infrastructural investments in the further development of roads, railways, and public transport, the traffic system will continue to worsen.

According to some international surveys, Hungary is performing well in education. The PISA study, however, came to a different conclusion. The educational system from the interwar period—especially the classical lyceums that produced several Nobel Prize winners—belongs to the past. Surprisingly, the communist system upheld parts of that system, although it abolished church-based education. While the churches are starting to play a role in education again, the fifteen years they have been active is too short to evaluate performance. The public educational system is not only in a fiscal and

economic crisis, but also in a personnel crisis, as talented teachers are leaving the schools en masse. After transition, higher education was one of the first things to be reformed. Since then, Hungary's old elite universities have been going through a rapid transformation process to public universities. The registration quota in Hungarian universities now resembles that in Western Europe, but only at the price of an overloaded infrastructure and rising financial needs, especially student loans and teaching staff salaries. After rapid expansion, the SzDSz-headed ministry of education tried to introduce the Austrian model for university financing and autonomy. This is now fiercely disputed, as it is coupled with the rapid implementation of the Bologna principles and a drastic cutback in government subsidies. Higher education reform has been subject to debate recently and the Constitutional Court—called in on the initiative of the MDF, a conservative opposition party closely allied with Fidesz—already invalidated the first set of ministerial reforms, ruling that the new system is unconstitutional. For its part, Fidesz has promised to fight the Europeanization and privatization trends in higher education and thereby meet the demands of many vested interests. As in the case of health care, Fidesz is using communitarian arguments to defend the communist legacy against the Europeanizing and privatizing influence of the liberal democrats and “third way” Socialists. There are also short-term interests to be served in denying priority for environment and education matters and blocking progressive investment for the future.

### **3. Management**

#### **3.1. Level of difficulty**

Hungary's democratic consolidation was one of the easiest and fastest in post-communist Europe, and the structural constraints on governance are correspondingly low. The starting conditions were favorable, both in economics and in politics. The starting conditions for economic development were better and more fairly balanced than in other COMECON countries. A well-performing educational system provided skilled labor; the country's borders were safe; there were neither violent political conflicts nor the danger of social unrest. All of this benefited Hungary's transformation process and democratic consolidation. Another asset was the country's tradition of rule of law, dating back to the old Hungarian state during the Habsburg Empire. The recent EU accession will certainly be an important factor in further improving the quality of Hungarian democracy.

Hungary has a rather ethnically homogenous society. The intensity of ethnic, religious and social conflicts is comparatively low. Their capacity for mass mobilization has not reached the level of political violence. The problems

related to the Roma are socio-cultural rather than political and have not lead to political protest or mobilization. To date, however, politics has not succeeded in changing the attitudes of the majority society vis-à-vis the Roma.

While the new parliamentarianism has certain roots in the older pre-communist tradition, the parties themselves lack roots in the wider population. Social mobilization diminished, but the division of the public turned out to be persistent, as the referendum on Hungarian citizenship for Hungarians abroad—split neatly along left-right cleavages—demonstrated. The “republican unity” propagated by the moderate left is thus being challenged by the right’s increasing nationalism and populism.

### Profile of the Political System

Regime type:	<i>Democracy</i>
System of government:	<i>Parliamentary</i>
1. Head of State:	<i>Ferenc Mádl</i>
Head of Government:	<i>Péter Medgyessy</i>
Type of government:	<i>coalition majority</i>
2. Head of State:	<i>László Sólyom</i>
Head of Government:	<i>Ferenc Gyurcsány</i>
Type of government:	<i>coalition majority</i>
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional votes gained by party <math>i</math>; <math>p_i</math> is the share of parliamentary mandates controlled by party <math>i</math>. Effective number of parties denotes the number of parties represented.</p>	

### 3.2. Steering capability

While both socialist-led governments had clear concepts for reform, they lacked the political will and capacity to realize their political programs. Unlike between 1994 and 1998 when MSzP had an absolute majority, the continued support of the minor coalition partner, the SzDSz, has been necessary to maintain the government’s majority since 2002, giving it the ability to veto decisions in the governing coalition. As such, Hungary’s “third way” socialism is blocked both by SzDSz’s privatization policies as well as by the populist economic policy inherited from Fidesz.

In 2002, the Medgyessy government envisaged the integration the polarized public, giving the transition to market economy a social welfare turn, strengthening democratic institutions and further improving the implementation of the rule of law as well as the equality of opportunities.

The Gyurcsány government intends to privatize the health care system, but the opposition rejects this plan and can count on the support of the majority of the population. The dispute between various actors in the health care system—medical associations, trade unions, pharmaceutical companies, and government—about the system’s future has been going on for a long time, so far without resolution. This was illustrated clearly in 2004 with the Medgyessy government’s clash with the pharmaceutical industry and the result of the referendum against the privatization of the health care system as planned by the Gyurcsány government. There is a popular consensus for upholding the traditional “communist” health care system against the economic rationality of privatization and the interests of the pharmaceutical industry as well as various sorts of health entrepreneurs.

The introduction of a new judiciary organization is making slow progress. This is in part due to the large institutional challenge of EU accession and its administrative lag, but also due to a lack of resources and financial support, as the resignation of the minister of justice in the autumn of 2004 clearly shows. The slow-down of judicial reform is blocking further measures to create a more effective judicial system.

Decentralization and regionalization are not on the agenda of the Gyurcsány government, and the reforms of the former Medgyessy cabinet have not been implemented yet. Europeanization has strengthened central authorities and disillusioned expectations toward further decentralization and regionalization. The main achievement was the resolution on EU accession and harmonization of EU and Hungarian law.

The introduction of progressive multi-level governance will certainly have positive effects on regional and local governance. However, the reform of local and regional self-government and administration is a heavy burden, one that the Gyurcsány government has proven unable to cope with. If the government keeps this course, it will be an example of political learning from the mistakes and failures of the past.

### **3.3. Resource efficiency**

The new economic policies have yet to be improved and the state’s old fiscal deficits and overall indebtedness continue. The populist economic policy of Fidesz has been reformulated many times by changing finance ministers and by the new government’s budget priorities. Invariably, the inability to abandon populism in favor of export-orientated growth has haunted every government. Medgyessy’s retreat from office was spurred by his decision to fire the minister



of economic development appointed by SzDSz. The liberal democrats did not accept this and declared it the end of the coalition. In August 2004, Medgyessy's own party withdrew their support. Other reasons for his resignation included his failure to manage successful campaigns for the EU referendum in 2003 and the EU elections in 2004 as well as the persistent lack of economic growth and competitiveness. The Medgyessy government did not make efficient use of the available economic and human resources.

The fight against corruption has not been very successful, and the socialist-led government must now deal with their own corruption cases as well as those of the previous governments, which have yet to be reviewed. In Transparency International's Corruption Perceptions Index (CPI) 2004, Hungary ranked 42nd of 146.

### **3.4. Consensus-building**

In Hungary, all major political actors agree on the establishment of a market economy and parliamentary democracy. In this respect, there are no influential veto actors in the country.

While a consensus on republicanism, social market economy and Europeanism is just emerging among the left-leaning public, there a considerable segment of Hungarian society holds nationalistic views and xenophobic attitudes. Racism is mainly directed against Hungary's Roma population. Anti-Semitism is also a problem, but to a lesser extent. Oppositional networks, parts of the media and a nationalist subculture claim to represent "the" Hungarian identity, stating that they are "the nation" and the government and its supporters are "the traitors." The government has not yet been able to bridge this gap.

The 2002 elections polarized Hungarian society, and the new Fidesz opposition has adopted a steady escalation strategy against the socialist-led government. It even accuses former allies like Dávid Ibolya—the minister of justice in the former Orbán government and a member of the MDF—of being allied with the "Communists." While Fidesz was very critical of the EU referendum and framed EU accession as a danger to the country's national interests, MDF was in favor of the EU accession. Fidesz recently defended citizenship for all ethnic Hungarians living in foreign countries, which was successfully initiated as a

referendum by a politically isolated NGO. After the referendum's failure, they denounced the government parties and the people who voted "no" or abstained as "aliens" to the nation.

While Fidesz is clearly trying to polarize a generally apolitical, passive and welfare-oriented public, the MSzP and SzDSz stress the ideals of a socialist “third way” and are attempting to reunite the public with the ideas of Europe, modernity and democracy based on a “republican,” “civic” identity. Although the opposition role has enhanced Fidesz’s populism, because of the conservative’s predominantly elitist and media-oriented style, popular mobilizations by its political action committees remain an exception. The socialist-led coalition’s replacement of Prime Minister Medgyessy with Gyurcsány can be classified as the selection of an efficient leader for the left as opposed to the right’s charismatic leader, Viktor Orbán. Gyurcsány as well as Medgyessy are among the richest people in Hungary and they both were part of the communist system.

The style of governance has been bottom-up rather than top-down, with civil society supporting and organizing public criticism toward institutions. While the current government’s pro-EU orientation is unequivocal, once in the opposition, Fidesz started to move toward nationalism and Euro-skepticism. Both the 2003 referendum on EU accession and the 2004 referendum on citizenship highlighted not only the differences between the positions taken by the opposition leadership and the government, but also the discord within society. There is a need for reconciliation and a common basic consensus for the immediate future.

The present governing coalition partners agreed on the common basis of Europeanism, rule of law and republicanism as opposed to Fidesz’s nationalism, Euro-skepticism and orientation toward the church, ruralism and traditionalism. The MDF has shown consensual as well as conflictive elements. This ideological frame will characterize the further process of Europeanization and democratic governance. At present, the Gyurcsány government enjoys the full support both of its own party and its coalition partner and it is gaining popular support. This should enable the new government to realize its political program of social welfare and economic modernization. However, there have already been some tensions. For instance, by the end of 2004, the SzDSz minister of education provoked the first real church-based mass mobilization against the government since 1989 on the issue of financial support for the church’s education centers. The prime minister then immediately withdrew the contested decision. As such, the socialists seem to be more conscious about their relations to the church than the liberals are.

In Hungary, trade unions represent about one-third of all employees. The socialist-led governments have attempted to re-strengthen the trade union’s rights, but their austerity policies have raised hostilities in the trade unions of the endangered branches. There are more than 60,000 NGOs registered in

Hungary. The socialist-led governments have resolutely tried to establish a partnership with civil society by means of generous financial aid and, to a certain extent, inclusion of NGOs into policy implementation, especially in the areas of environmental and social policy, women and migration.

### **3.5. International cooperation**

Since 1989, foreign policy has been solidly Western oriented and supported by both left and right. Milestones of this development were the accession to the WTO in 1995, the OECD in 1996, to NATO in 1999 and to the EU in 2004. EU accession was supported by Western countries and their global organizational frameworks. Hungary has become a reliable partner of the transatlantic community.

In the Kosovo conflict and the second U.S.-led war on Iraq, Hungary endeavored to maintain this Western orientation. Regarding Iraq, there were two contradictory lines within the government. The disagreement between the United States and the European Union on the strategy to follow in Iraq brought some confusion into the Western orientation in Eastern Europe. Hungary decided to support the U.S. intervention but withdrew from military participation in 2004 because the government did not receive the necessary support from the opposition in parliament. However, the government provided technical support to U.S. troops and sent a small technical division to Iraq as a symbol of Hungarian support.

A second pillar of Hungarian foreign policy is the concern for the millions of ethnic Hungarians that remained in the successor states of the Austro-Hungarian Empire after 1918. As the minority issue was taboo before 1989, its boom afterwards is not surprising. As in the case of Western integration, there was a consensus among the main political parties to find a peaceful means of supporting Hungarian minorities abroad. In 2001-2002, Fidesz and its coalition passed the so-called "Status Law" on the provision of cultural, educational and welfare services to all registered ethnic Hungarians abroad. By that time, there was already a strong lobby within the Hungarian political elite for full Hungarian citizenship for all ethnic Hungarians. To avoid problems during the process of EU accession, Fidesz did not fully support this during their time in government. However, when the NGO Magyarok Világszövetsége (World Federation of Hungarians) started a referendum campaign in 2004, Fidesz—by then in the opposition—joined it as a means of de-legitimizing the socialist-led government. Following the referendum, the government promised more aid for the Hungarian minorities abroad but declared the citizenship issue as voted down by the public. It expects that EU membership within an enlarged community will provide enough space for communication with ethnic

Hungarians in other countries. Both governments have tried to maintain a good relationship with Hungary's neighbors to the east, while at the same time providing assistance to the Hungarian minorities abroad and thereby preserving their Hungarian identity.

At no time since Hungary's transition to democracy at the end of the 1980s has a consensus on foreign policy issues been as out of reach as it is today. In 1989, EU membership and solidarity with the Hungarian minorities abroad were unifying goals for the new democratic forces. Today, the political parties and blocs appear divided over these crucial foreign policy issues.

However, the minority policies for Hungarian communities abroad have at times provoked neighboring states. With millions of ethnic Hungarians living as Ukrainian, Slovak, Romanian, Croatian and Serbian citizens, the issue has yet to be resolved. Both socialist-led governments rejected the attempts of the center-right opposition to establish Hungarian citizenship for the ethnic communities in the neighboring countries. The referendum on this matter, held on December 5, 2004, did not reach the constitutionally required quorum.

#### **4. Trend of development**

##### **4.1. Democratic development**

The criteria of stateness, political participation and secularization had already been met before the period under observation. This did not change during the period from 2003 until 2005. The elections were free and fair. The turnover of governments was carried out peacefully, albeit with mass mobilizations by the political action committees of the center-right parties. In August and September 2004, there was a government reshuffle by the coalition parties in a constitutional manner. Freedom of choice and civil rights are guaranteed. Both socialist-led governments have made some efforts to provide equal opportunities and fight racial, sexual and social discrimination, but implementing these programs will require a longer period of efficient resource mobilization by the political elites and civil society. EU membership is a stabilizing factor.

The new elite's anti-corruption campaign has proved ineffective. As recent cases and past experiences with the first socialist-led government in the mid 1990s show, the left-leaning parties that make up the current government are not any less corrupt than the right-wing parties before them are. The problem has deep economic and cultural roots.

Local government reform and regionalization have been blocked; they did not

benefit from EU accession in the short run. The efficacy of local government depends much on the region's resources and socioeconomic development. The formidable incongruities between various regions and between urban and rural settings should therefore be met by adequate development policies.

As before, the basic constitutional organs ensured stability during the last two years. There is still some tension between institutions like the Constitutional Court or the central bank and progressive governments, as the latter tend to perceive institutional checks and balances as hindrances to their radical reformism. However, the Constitutional Court preserved its importance during the two socialist-led governments and blocked some expansions of governmental power. The effects of the referendum held on December 5, 2004, were polarizing. There is a growing alienation between Hungary and the Hungarian minority communities abroad, with the latter feeling rejected, betrayed, and left alone by their mother country. While the government parties are trying to restore the unity of the Hungarian political community on a European and republican basis, Fidesz and MDF stress national identity instead.

#### **4.2. Market economy development**

As macroeconomic indicators attest, Hungary ranks highly among the new EU member states. Due to progressive taxation on middle and high incomes, and tax reduction on incomes by the social democrats' "third way" tax policy, income differences may not increase rapidly. The government has developed this redistributive tax policy even further within the 2005 budget.

Hungary has made considerable progress in making its economy EU compatible. There is a growing transparency of and reliability in the financial and capital market. Stability once brought a considerable influx of foreign direct investment to Hungary. As transparency is now being demanded from all the new Eastern European member-states, Hungary has lost its previous competitive advantages, and foreign direct investment is being more equally distributed in the region. All currency constraints have been removed. Foreign trade has been liberalized according to EU standards, while the economic, banking, and fiscal regulations are approaching EU standards.

However, in 2004 the Gyurcsány government worked out an agreement with the banking sector to introduce progressive taxation on banking from 2005 onwards. The government intends to reallocate the peak profit for welfare and public benefits, according to its "third way" vision.

EU accession will enable Hungary to keep up with its Rhineland model of

social market economy and neo-corporatism in the end. Inflation is under control. It was not possible to reduce corporate and income taxes as drastically as the SzDSz intended, as it was necessary to reassign the tax burden to the well-off and redistribute income for the benefit of the poor. There have been severe cutbacks in public expenditures, but these were coupled with new welfare measures raising expenditures and taxes as well as demanding more control and bureaucracy. Both socialist-led governments have fought against the high budget deficit, albeit with only modest success.

#### **D. Strategic perspective**

**Starting conditions:** The starting conditions for further consolidation of Hungarian democracy were quite favorable. There were no problems concerning stateness and well-performing economic structures had been established. Certain traditions of civic society and the rule of law in Hungarian political culture and history proved conducive to a stable constitutionalism and the acceptance of minority rights. On the other hand, the Medgyessy and Gyurcsány governments inherited Fidesz's populist economic and fiscal policies and a highly polarized public. The former conservative government had threatened the functioning of parliamentarianism, the electoral system and the all-party media consensus and pursued a nationalist foreign policy.

**Status and development:** Some of these counter-productive elements could be turned around. The re-orientation observed in foreign policy, media policy and parliamentary action clearly illustrate a return to the pursuit of improving a consolidated democracy. Hungary's quality of democracy is not far from that of "old" EU member states.

**Management:** Despite some accomplishments in foreign policy (EU accession) and in domestic policy (reinforcing and further consolidating democracy, support for civil society), some problems persist. These include the failure to transform populist economic, social and fiscal policies into policies of growth and competitiveness; deceleration in implementing regionalization and decentralization; the polarization within Hungarian society; and tensions with neighboring countries over the citizenship status of ethnic Hungarians. Some problems in interference with the freedom of the press under Fidesz were resolved; others remain, such as the right-wing tendency of Hungarian broadcasting. Judiciary reform continues albeit slowly.

However, EU accession provided very favorable conditions for stability that may facilitate a "new wave" of economic and political consolidation. Both

socialist-led governments have tried to build up a broad political consensus based on Europeanism and republicanism, but Fidesz has responded with Euro-skepticism and nationalism from the opposition. However, the current government's concept of a market friendly and socially responsible "third way" could strengthen modernization in Hungary.