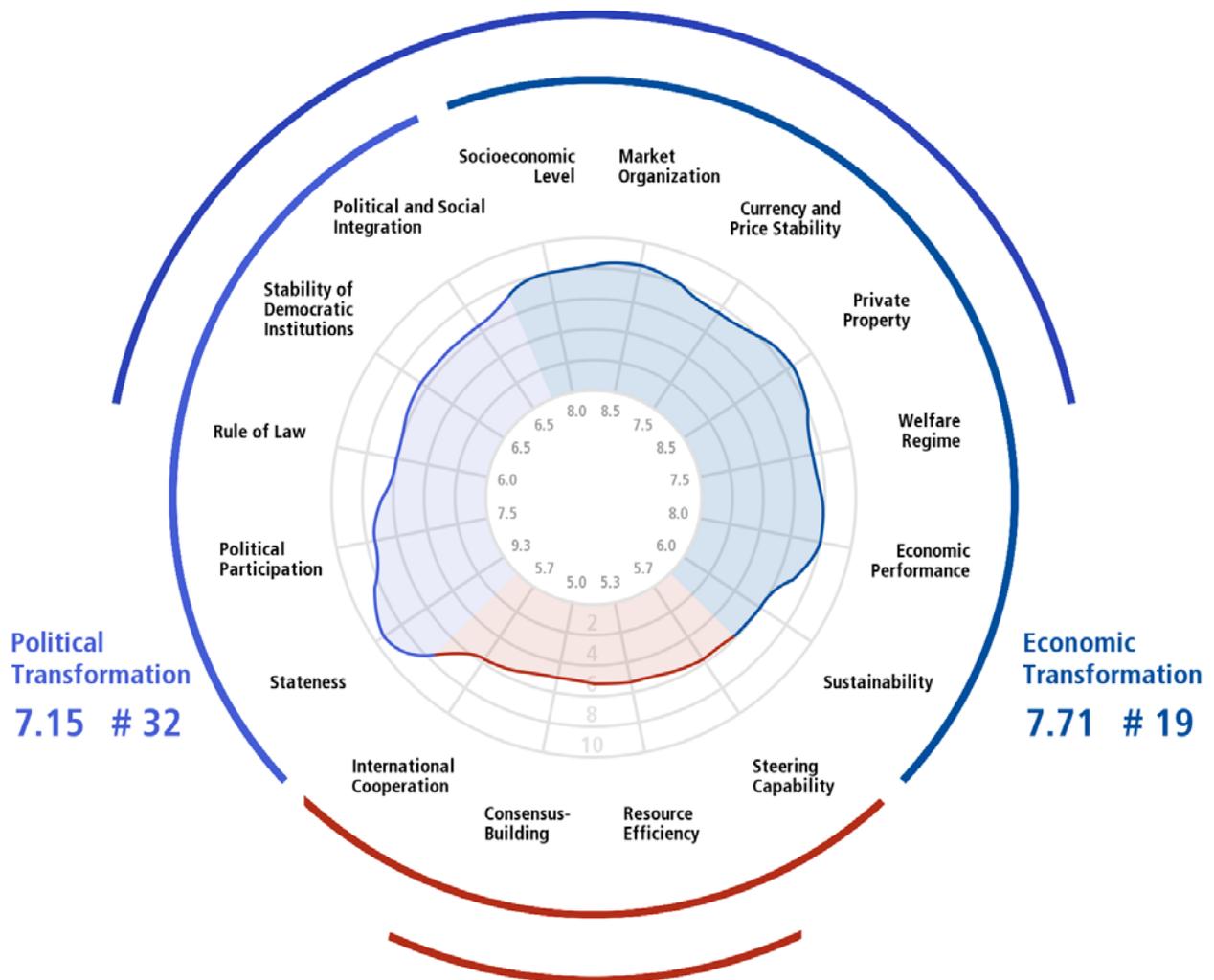


Hungary

Status Index

7.43 # 18

on 1-10 scale out of 129



Political Transformation
7.15 # 32

Economic Transformation
7.71 # 19

Governance Index

4.44 # 79

on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

Please cite as follows: Bertelsmann Stiftung, BTI 2018 Country Report — Hungary. Gütersloh: Bertelsmann Stiftung, 2018.

This work is licensed under a [Creative Commons Attribution 4.0 International License](https://creativecommons.org/licenses/by/4.0/).

Contact

Bertelsmann Stiftung
Carl-Bertelsmann-Strasse 256
33111 Gütersloh
Germany

Sabine Donner

Phone +49 5241 81 81501
sabine.donner@bertelsmann-stiftung.de

Hauke Hartmann

Phone +49 5241 81 81389
hauke.hartmann@bertelsmann-stiftung.de

Robert Schwarz

Phone +49 5241 81 81402
robert.schwarz@bertelsmann-stiftung.de

Sabine Steinkamp

Phone +49 5241 81 81507
sabine.steinkamp@bertelsmann-stiftung.de

Key Indicators

Population	M	9.8	HDI	0.836	GDP p.c., PPP \$	26681
Pop. growth ¹	% p.a.	-0.3	HDI rank of 188	43	Gini Index	30.9
Life expectancy	years	76.0	UN Education Index	0.854	Poverty ³	% 1.0
Urban population	%	71.7	Gender inequality ²	0.252	Aid per capita	\$ -

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

Although leaders of hybrid regimes do not necessarily aim to dismantle the framework of democratic institutions in their country, they do seek to place constraints on liberal democracy. Aiming to depict their state order and its institutions as functioning democracies, in reality, they are merely maintaining the spectacle of pluralist competition. The case of Hungary where, under Viktor Orbán's leadership, checks and balances are under threat as is horizontal accountability, is representative of this phenomenon. Rampant clientelism, growing anti-Western sentiments and the ongoing assault of civil society are also characteristic of the trend toward illiberalism.

The Hungarian government draws upon an ideology of illiberalism that is based on national collectivist thinking and promotes the primacy of the national community over the individual, thereby justifying state intervention in economic, social and cultural matters. This ideological system was formulated in Viktor Orbán's now infamous 2014 "illiberal democracy" speech in Baile Tusnad.

As a result of Prime Minister Orbán's illiberal leadership, Hungary's democratic deficits have become even more entrenched during the period under review. By 2014, the reorganization of the country's constitutional order had been completed, and key positions throughout government institutions had been filled by Orbán loyalists. The government weakened and in some cases destroyed the autonomy of the judiciary, the Constitutional Court, the Office of the Prosecutor General, the National Bank of Hungary and local self-governments. The expansion of government influence over the media shifted into high gear as well. These efforts became obvious to the public through the quarrel between Lajos Simicska and Viktor Orbán that started in February 2015.

Public support for the government was boosted by the refugee crisis after having hit a low point in early 2015. The government's rhetoric, which played on fears of the population, the fence erected on the Serbian border and the 2016 referendum on migrant quotas helped the government strengthen its position. Governmental pressure on the opposition increased when thugs with ties

to Fidesz used physical violence to prevent an opposition deputy from initiating a motion for a referendum. The referendum aimed at lifting the government's unpopular ban on Sunday shopping. The thugs blocked Socialist Party deputy István Nyakó from submitting his application at the National Election Commission. Hungary's highest court, the Curia, finally accepted the deputy's complaint and allowed the Socialists to launch their petition. Ultimately, the referendum was not held because Orbán, in an effort to deflect negative attention, repealed the ban.

Immediately after the 2014 general election, civil society organizations (CSOs) critical of the government were subject to harassment. In autumn 2016, it became public that the prime minister himself ordered this move. To some extent mimicking the pattern observed in Russia, the government's campaign against CSOs continues in alternately small and larger waves. In January 2017, a high-ranking politician even spoke of "sweeping out" the organizations. As the opposition has already been weakened and the media increasingly subject to government control, the government has increasingly focused on CSOs because their criticism now represents the largest threat to the government's hold on power – even though CSOs have relatively little influence on public opinion.

As a result of EU funding and the fact that the government pays attention to the country's macroeconomic indicators, the pace of economic growth has picked up since 2012, though 2016 was a relatively sluggish year (1.9%). A budget surplus led to tax cuts, but not to more resources for the ailing health, education and innovation sectors. At the same time, corruption is now systematic and organized by the state. Laws and public procurement tenders are increasingly and blatantly tailored to favored individuals or companies, state politicians and the Fidesz oligarchs enjoy growing impunity and their ever-increasing fortunes – accompanied by luxurious consumption habits – are more and more noticeable.

History and Characteristics of Transformation

Hungary's transition to democracy took place after 40 years of communist rule. In 1989, roundtable negotiations were held between the communist leadership and the emerging opposition parties that resulted in an agreement to hold free elections in 1990 and to initiate the necessary constitutional amendments. The first democratic elections were won by center-right opposition groups. In the years that followed, Hungary was able to establish a stable democratic political system, characterized by alternating governments of either center-right or socialist-liberal coalitions that were largely sustained over their full terms of office.

The democratically elected governments of the 1990s privatized state-owned companies, liberalized markets, attracted FDI and restructured the economy, which became dominated by private and internationally competitive companies. Hungary reformed its industrial relations and institutionalized a close cooperation between economic interest associations and government. Political and economic reforms spurred economic growth, which lasted from 1994 to 2008. Hungary's governments successfully reduced the tensions with neighboring countries which had

become homelands to sizable ethnic Hungarian minorities after the First World War. Good neighborly relations developed that were not conflict-free, but were embedded in institutions and norms enabling the civilized resolution of disputes. In 1999 and 2004, Hungary joined NATO and the European Union, respectively.

The global financial and economic crisis of 2008 hit Hungary harder than other East-Central European member states because of its successive governments running excessive budget deficits, its high exposure to international financial markets, its dependence on foreign investment and its high levels of foreign currency denominated loans. These economic conditions and effects were compounded, firstly, by an erosion of confidence in the post-1989 political regime that had failed to deliver the mass prosperity that the citizens had been expecting from democracy by the European integration.

Hungary features a strong tradition of political polarization among the country's two major political camps. Amid this very tense atmosphere, Prime Minister Ferenc Gyurcsány delivered in the fall of 2006 a speech at a closed parliamentary faction meeting that was later leaked to the public. In addition to using vulgar language in his speech, he admitted that his party had lied to voters during the election campaign. The leading right-wing opposition party Fidesz then skillfully mobilized widespread popular dissatisfaction not only with the prime minister and the governing socialist-liberal coalition, but with the way in which Hungarian democracy as a whole functions. These developments helped Fidesz and its minor coalition partner (the conservative Christian Democratic People's Party (KDNP)) gain a two-thirds majority in 2010. Fidesz used this victory to implement a regime change that had allegedly failed in 1989. In line with this effort, it abandoned the 20-year-long consensus built on the separation of powers, subsequently establishing an over-centralized institutional system. Fidesz has used this majority to fundamentally transform Hungary's constitutional, economic, political and social system. It approved a new constitution in 2011 that sought to "cement" its policy priorities by making changes to the respective laws contingent upon a two-thirds parliamentary majority. The government has expanded its influence not only over the public, but over an increasing slice of the private media pie as well, and this soft power of media has played an important role in maintaining the rule of Fidesz. With an electoral system thus shaped to favor Fidesz, the party maintained its two-thirds majority in 2014.

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

Transformation Status

I. Political Transformation

1 | Stateness

There is no relevant competition with the state's monopoly on the use of force, which covers the entire country. Far-right paramilitary groups consisting of a couple of hundred members pose no threat to the state's monopoly on the use of force.

Question
Score

Monopoly on the
use of force
10



Hungary can be regarded as a homogenous nation-state since the 1920 Treaty of Trianon. The whole population accepts the nation-state as legitimate.

State identity
9

There are 13 officially recognized minority groups in the country (Armenian, Bulgarian, Croatian, German, Greek, Polish, Roma, Romanian, Ruthenian, Serbian, Slovak, Slovene and Ukrainian), but the members of these minorities are all part of the Hungarian nation and have Hungarian citizenship. These minorities are constitutionally entitled to establish self-governing bodies and they all have a “nationality advocate” in the National Assembly.



After 2010, the government passed legislation to facilitate ethnic Hungarians' acquisition of Hungarian citizenship. According to government statements, by the end of 2016 more than 900 thousand people had acquired Hungarian citizenship this way. Persons belonging to the Roma minority are reportedly subject to discrimination and social exclusion, among others, in employment, education and prisons.

The state is secular, but religious dogmas have a moderate influence on the legal order.

No interference of
religious dogmas
8

An amendment to the Fundamental Law in 2013, approved only by the self-defined Christian-Conservative governing parties, gave a restrictive definition of family in

the constitution, which critics consider to be exclusionary: “Hungary shall protect the institution of marriage as the union of a man and a woman established by voluntary decision, and the family as the basis of the survival of the nation. Family ties shall be based on marriage and/or the relationship between parents and children.”

This restrictive definition is mostly for symbolic purposes, however, in some cases, it has practical implications. For example, the Home Purchase Subsidy (CSOK) for families with children can be granted to non-married couples raising children, but if they are only planning to have kids, they cannot take this opportunity (unless they choose to marry each other). Nevertheless, the conservative definition of family has neither led to tougher anti-abortion legislation nor the termination of the institution of registered partnership available to same-sex couples since 2009.

On the other hand, church-owned schools play an increasing role in education. In the 2016/2017 school year, 207,800 children were educated in church schools (13% of all students). Three years earlier this number was only 191,800 (11.5%). Financial reasons are partly behind this, but Minister of the PM Office János Lázár made it clear that “the conviction of today’s Hungarian state is that the most important actors in education are the church-owned schools” and “the government believes the best thing for students is if they are taught to be good Christians and good Hungarians.”

The state maintains a differentiated administrative structure that provides all basic public services throughout the country. Hungary’s central and territorial state administration has been completely restructured and centralized by the Fidesz-led government.

In addition, the government has nationalized public education and hospital care almost completely. Since April 2015, politically appointed government commissioners have become responsible for all areas of local public administration.

2 | Political Participation

After its overwhelming victory in the 2010 elections Fidesz has introduced a new electoral system, since then the elections are free but not fair.

The majority components of the electoral system (the increased share of mandates won in single-member constituencies, the abolition of the second round of voting and the so-called “winner compensation”) are all elements that favored Fidesz at time of their implementation, but they could benefit an opposition force in a later election—if its popularity was significantly higher than that of Fidesz. Therefore, the most criticized majority components of the system could provide an opportunity for the opposition.

However, there are numerous elements of the electoral system that consistently favor right-wing forces (e.g., gerrymandered constituency map) and rules that provide



1

Basic administration

10



1

Free and fair elections

7



1

advantages to the governing party. One example is that the government can run a virtually unrestricted campaign under the guise of public service advertisements, while parties are de facto banned from broadcasting political advertisements on commercial TV and radio channels. Due to the near-unlimited public financial resources available to the government, it can exploit that there are no regulations in place on campaign activities outside of the 50-day-long campaign period. Moreover, pseudo-civil society organizations can also campaign without restrictions, and laws regulating their obligation to account for their expenses are even laxer than they are for political parties. Obviously, this also benefits the governing party. In addition, campaign financing rules were created to encourage the proliferation of sham parties. Thus, it is not the mandate distribution mechanism that erects an obstacle to a change of government, but the lack of fair conditions allowing political parties to reach out to the necessary mass of voters.

The National Election Committee (NVB) consists of mostly pro-government members elected in 2013 for a period of nine years. In general, the NVB conducts its activities fairly, however, in critical moments it does the bidding of the government. On February 29, 2016, they did not validate the referendum initiative of the opposition Hungarian Socialist Party's (MSZP) politician, István Nyakó, who had been prevented from submitting his referendum question by a group of muscular young men (the Curia, which works as a Supreme Court, overruled the NVB's decision). At the same time, the NVB validated the government's referendum initiative against the mandatory refugee quotas. Most independent constitutional lawyers and civil society organizations considered the government's referendum to be unconstitutional for two reasons: the topic of the referendum question did not fall under the competence of the National Assembly and the question was ambiguous. (The referendum was finally held on October 2, 2016, and despite the government's intense campaign, the voter turnout was far from 50%, which is the legal requirement for a referendum to be valid.)

The Hungarian system of political institutions confers largely unconstrained authority to the elected parliamentary majority and the government elected by it. This was already the case before 2010, but since the new constitution and the erosion of the system of checks and balances, its subordination to governmental control boosted the government's power further. Power is concentrated in the hands of the head of government, and important decisions are determined by the prime minister's inner circle.

Freedom of association and assembly are ensured by law in Hungary. The constitution fully guarantees these liberties. The bills and decrees enforce the application and implementation of these rights in every aspect of state operation. However, while there are no general restrictions on assembly and association of any kind (besides those to protect democratic processes), there are two factors that limit

Effective power to govern

10



1

Association / assembly rights

7

these freedoms in practice. First, there is a legal vacuum created by the lack of detailed regulation, which gives the police room for arbitrary decisions on permitting certain gatherings. Second, there were several attempts by the government and state institutions in the time examined to restrict individuals' right to associate and assemble.

The police also used their legal powers to discourage citizens from exercising their right to assemble by initiating legal procedures and issuing high fines for alleged violations. Besides legal obstacles, the government and state institutions also used other means to restrict individuals' rights of association and assembly. In many cases, unknown people with the physical characteristics of security guards, but with no identification or authorization appeared at the venue of demonstrations and tried to deter demonstrators from exercising their rights by physically obstructing or threatening them. In most of these cases, police just stood by and failed to act. The government used a similar strategy to prevent a leading politician of the opposition party Együtt, Péter Juhász, from entering the area of a public festivity on the national holiday on October 23, 2016. The government commissioned a private security firm to secure the event that banned Juhász, who called for a loud demonstration during the prime minister's speech, from entering the area without any justification. Moreover, police failed to ensure Juhász's right to enter the public event. Both the staff of the private security firm and the police failed to defend those who expressed their critical opinion during the prime minister's speech against violent actions committed by pro-government protesters. Outsourcing the provision of security for public events to private security firms (or even to unidentifiable private persons) significantly endangers the right to free assembly.

After 2010, the takeover and harassment of independent media outlets started. The process shifted into higher gear after the governing party's re-election in 2014, and it continues to this day. The Public Broadcaster (MTVA), which was reorganized after 2014, is completely under governmental control. The government allocates HUF 80 billion (€258 million) from the central budget to the maintenance of MTVA, which de facto equals to financing government propaganda. The portfolio includes a significant amount of TV channels and radio stations, all of which air a news program edited by the central state news agency. The impact of these is stronger than that of the news programs broadcast on the main state news channel M1. During the 2016 Football European Championship and the Olympics, every break in the events was filled with government advertisements and short, highly tendentious news blocks.

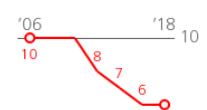
The February 2015 breakup between the previously most influential oligarch Lajos Simicska and Prime Minister Viktor Orbán proved to be a milestone in Hungary's media history. After the breakup, Simicska's outlets became considerably more balanced, often openly anti-government. After Lajos Simicska and the prime minister parted ways, the construction of a new pro-government media empire started. On paper, these media outlets (a national TV, dailies, radios, online portals) are owned



1

Freedom of expression

6



1

by several individuals, but in reality, these are under government control. The key actors are Árpád Habony, an informal advisor to the PM, Antal Rogán, minister for the Cabinet Office of the PM, Andrew G. Vajna, government commissioner for the development of the national film industry, Gábor Liskay and Lőrinc Mészáros. In 2015 and 2016, pro-government media expanded at record pace partly through the establishment of new media outlets (e.g., 888.hu, Lokál, Magyar Idők, Karc FM), partly through the internal reorganizations (e.g., Lőrinc Mészáros bought Echo TV, and the acquisition of independent media (e.g., the weekly Figyelő).

On October 8, 2016, the leftist daily Népszabadság was closed suddenly, allegedly for economic reasons, although this was untrue. The editors of the paper were informed in a letter delivered to them that they needed not to go to work and they had already lost access to their work e-mails and their computers by then. Optimus Press, which has ties to the prime minister's straw man Lőrinc Mészáros, bought the publisher of Népszabadság and other papers Mediaworks on October 25. The government has expanded its influence over regional and local newspapers that have a larger readership than national dailies and even online media.

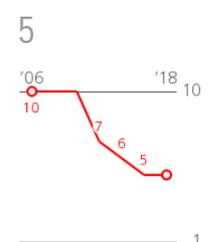
On the other side, there are still some independent media. The largest online portal Index has so far been able to remain independent; however, its current ownership background is unknown. RTL Klub is the last independent commercial TV channel with nationwide coverage, and the relatively popular 24.hu is under the same ownership. Brit Media Ltd. belongs to the Unified Hungarian Jewish Congregation (Chabad), which invested into leftist media outlets (Klubrádió and weekly 168 Óra). ATV still belongs to the interests of Hit Gyülekezete (Faith Church); however, its oppositional tone has softened as well. After removing Népszabadság, Népszava has remained the only independent daily of national coverage.

3 | Rule of Law

The 2010 and 2014 general elections both resulted in a two-thirds majority in parliament for the currently reigning government that allowed them to amend the constitution and cardinal laws. The Orbán government has dismissed the consensus on the separation of powers, claiming that this policy would represent the will of the electorate. The government significantly weakened state institutions that were originally established to restrict and monitor executive power. Thus, the system of checks and balances has been dissolved, with some remnants of this institutional system in the judiciary. The quality of constitutional democracy has been constantly and gradually deteriorating since 2010, and in 2017 it was significantly lower than it had been before 2010, although it was already a cause for concern.

The executive has granted itself the freedom of uncontrolled government, and by abusing this unprecedented ability to maneuver it advances the interests of those in power and their allies. Thus, the government makes decisions aimed at benefiting

Separation of powers



certain individuals or groups instead of the public (even in the full knowledge of breaching EU laws). Consequently, by early 2017 a special situation had developed in which the uniquely powerful executive essentially worked in symbiosis with certain business circles. State power has been captured by the governing elite and a set of business actors belonging to its inner circles.

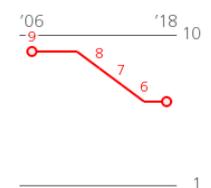
The lack of legal security is also indicated by frequent changes in legislation, regarding which the gravest concern is that the Fundamental Law promulgated in 2012 has been amended six times since then, last in June 2016 (the far-right Jobbik's support was necessary to approve the amendment) when the possibility to introduce a special legal status in the case of a "terror threat" was implemented into the constitution. The amendment was unnecessary, as other special legal statuses in the Fundamental Law had already offered opportunities to handle such a threat. The government wanted to amend the constitution again in November 2016, in connection with immigration and objections to the quota mechanism, but no opposition MP supported the measure; thus, for the first time since 2010 the government failed to gather enough support in the National Assembly for a proposal of this gravity.

The judiciary is largely independent, even though its decisions are occasionally subordinated to political authorities. The judicature is institutionally differentiated and still fulfills its role in society. Courts take decisions against the government even in cases that are important to the executive. For example, lawsuits started to enforce the publication of data for public benefit repeatedly ended in the defeat of the defendant state and government institutions (e.g., the invoices for the foreign visits of the minister for the prime minister's office in September 2015; tenders published by the foundations of the National Bank of Hungary in spring 2016; public disclosure of those civil society organizations affected by the investigation launched by the Government Control Office against the so-called Norwegian Civil Fund in summer 2015). Despite the fact that government-affiliated chairpersons continue to head both the National Judicial Council (OBT) and the National Office of the Judiciary (OBH), regular courts managed to protect their relative independence. The government has rarely influenced their decisions. However, to prevent further negative decisions of regular courts, the government has tried to centralize the judicial review of lawsuits related to the rights of assembly and association.

Even though the majority of the Constitutional Court consists of pro-government judges and the executive curbed its competencies, the court has also made some decisions that go against the intentions of the government. Nevertheless, the Constitutional Court operates more as a body subservient to the government rather than its balance regardless of the fact that it criticized the government in some fundamental rights-related cases. In any case, these decisions did not affect the acquisition and maintenance of central power.

Independent
judiciary

6



Officeholders who break the law and engage in corruption, generally, are prosecuted under established laws, but the government influences whether and which cases of office abuse are investigated. This influence is exerted, among others, through Prosecutor General Péter Polt, an official who is considered to be loyal to the governing political elite. The Office of the Public Prosecutor exercises a wide margin of discretion in deciding whether to initiate investigations. As a consequence of legislative changes in the regulation of the Office, it is no longer possible to contest the Prosecutor General's erroneous, wrong or illegal decisions.

For example, there was no judicial remedy available when the Office of the Prosecutor General refused to launch an investigation in the case of the Saudi billionaire Ghaith Pharaon, who conducted business with Prime Minister Orbán's circles while he was wanted both by FBI and Interpol.

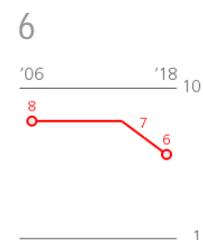
Other cases of non-investigation include Hungarian National Bank officials alleged to have misappropriated public funds in favor of private foundations, a Fidesz MP who the Panama papers revealed to have led an offshore company, and the head of the PM's Cabinet Office who allegedly sold local government-owned properties under their market price.

At the same time, in the period under review, the cases of criminalization of politics have continued against the leading politicians of the previous governments. Although so far none of these accusations have been proven, the prosecutors have harassed them for many years, and they have to face criminal investigations in several rounds until the judiciary has made the final sentence for their favor. The latest case was Dezső Hiszékeny, a Hungarian Socialist Party (HSP) member of parliament who was accused of taking bribes, the prosecutors had even used provocateurs, but finally, it has been proven that there was no criminal case, no corruption.

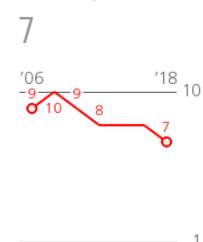
Although civil rights are protected and regulated by law, there are problems with the enforcement of these provisions. Perpetrators of hate crimes committed against vulnerable groups (primarily the Roma, the LGBTQ community, refugees, immigrants and Jews) are often not prosecuted at all, or they are convicted of lesser crimes. In contrast, perpetrators of Roma origin are frequently accused of committing a hate crime against Hungarians. These cases are launched and finished with striking efficiency compared to procedures involving a racist crime committed against the Roma.

According to a UNHCR declaration from June 2016, Hungarian border authorities used excessive force in more than 100 cases of asylum-seekers and migrants trying to cross Hungary's border without authorization. Migrant asylum-seekers were forced back to Serbia or to transit zones where they had to wait, sometimes for weeks, to be allowed to submit an asylum claim. About half of the asylum-seekers in Hungary were detained.

Prosecution of office abuse



Civil rights



The report of the advisory committee of the minority protection framework of the Council of Europe published in September 2016 attested that the situation of national minorities is favorable in Hungary in general; however, the Roma are subjected to systemic discrimination in all areas of life. The document states discrimination against the Roma is prevalent in the areas of housing, jobs, education and health care. The report warned that the segregation of Roma pupils in schools is becoming increasingly commonplace. In addition, the document considered employment data regarding the Roma to be concerning as well, as they constitute 25% to 30% of all persons registered as unemployed.

During the period under review, government officials continued to harass civil society organizations mainly through aggressive rhetoric. On January 10, 2017, the vice president of the governing party and the national security committee of the Hungarian National Assembly Szilárd Németh stated “The pseudo-civilians of the Soros Empire are maintained to force the world of political correctness and global big capital onto nation states. These organizations need to be repressed by any means necessary and I believe they need to be swept out of here. And I believe the international opportunity for this has come.”

Authorities already took action in the period examined, the National Tax and Customs Administration (NAV) showed up at the offices of Energy Club (Energiaklub) in October 2016 to search their premises without any prior notification. It is worrying that the parliament approved a law in 2016 that authorizes Hungarian secret services to monitor practically any digital form of communication. The latest amendment to the constitution and the legal provisions included in it authorize the executive to introduce tough restrictions to the freedom of assembly and free movement and freeze financial assets in the case of a terror threat.

The government further restricted access to information by an amendment to the law on the freedom of information in autumn 2015. As a consequence, the right to request data for public benefit anonymously has been abolished, the work of public employees dealing with the request must be paid for and, moreover, if the owner of the data qualifies it as data used to prepare a decision they need not publish it.

4 | Stability of Democratic Institutions

The Hungarian political system can be categorized as a regime where leaders did not completely dissolve democratic institutions and eroded the rule of law, but strive to restrict their operation and empty them of contents. Democratic institutions exist, but they rarely work. Their role in restraining central power is increasingly lowered, and this tendency was not reversed after the governing party lost its supermajority in parliament in February 2015. Afterwards, the number of governmental proposals requiring a two-thirds majority for approval decreased significantly, but Fidesz still

Performance of
democratic
institutions

6

managed to gather a supermajority in 55 votes in 2015 and 2016 altogether, while they only failed to do so 18 times.

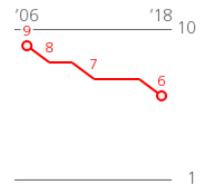
The National Assembly had already functioned as a government-dominated law factory before 2010 with regards to bills only requiring an absolute majority, and this trend has strengthened considerably afterward. The government proposed more than two-thirds of laws approved in 2015 and 2016 and only slightly more than one-fourth of them were private members' bills. The role of private members' bills decreased by half compared to the previous cycle, while the government's weight in the introduction of proposals increased significantly at the same time. The role of parliamentary committees in legislative initiatives is marginal. In this regard, there is no difference between the current and previous parliamentary cycles, only 3 to 5% of approved laws were initiated by the committees.

Most democratic institutions are accepted as legitimate by most relevant actors. However, the Orbán government has advocated an "illiberal" concept of democracy, according to which the incumbent government is entitled to make all decisions on its own since it has been fully legitimized by winning the elections. Due to extreme centralization, any state-dependent institution (ministries, state-funded background institutions, local governments, military, clergy) considers the central power and institutions completely legitimate. The right-wing extremist party Jobbik was supported by 20% of the voters in the 2014 national elections and an average 17% of the respondents in surveys conducted in January 2017. During the period under review, Jobbik representatives have moderated their political positions and statements.

5 | Political and Social Integration

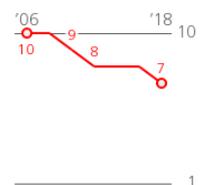
The present Hungarian party system is dominated by the right-wing populist Fidesz party which has governed the country since 2010, together with its minor coalition partner, the conservative Christian Democratic People's Party (132 of 199 seats, 45% of the party list votes in 2014). This system has been called by Prime Minister Orbán as "centralist party system," in which one big party forms the "center," and there are weak parties around without any role in the decision-making process.

The main opposition alliance consisted of five parties (26/19% of the votes/seats): the Hungarian Socialist Party (MSZP); Together 2014 (E2014), headed by former Prime Minister Gordon Bajnai; the Democratic Coalition party (DK) of former Prime Minister Ferenc Gyurcsány; the green liberal Dialog for Hungary party (PM) and the Hungarian Liberal Party (MLP) led by Gábor Fodor. The second biggest opposition party is the right-wing extremist Jobbik (20/12% of the votes/seats). The third legislative opposition party is the green-alternative "Politics Can be Different" (LMP, 5/2.5 % of the votes/seats).



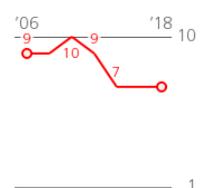
Commitment to democratic institutions

7



Party system

7

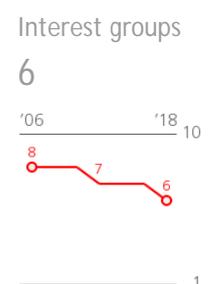


There is strong demand for a new political force; this is indicated by the steep decline of voter turnout at elections. The high share of undecided voters shows that the population turns away from politics. Nevertheless, no new parties gained strength in the period examined. The main reason has been the government's policy since it has managed to discredit all opposition initiatives and civic movements with its ever-growing media empire.

Only Fidesz and Jobbik have nationwide networks. The previously well-organized MSZP weakened organizationally, several of their local branches joined DK. In January 2017, it was questionable if any of the two had nationwide coverage. Other parties certainly do not. Numerous new parties had been organized right before the 2014 general election, a phenomenon the governing party suggested was evidence of a flourishing democracy. In reality, new parties proliferated due to the re-regulated campaign financing system, as campaign finance funds were available from the central budget amounting to hundreds of millions of Hungarian Forints without any serious accounting regulation in place. 14 parties with national lists gathered 4% of the vote altogether, which in itself proves that these parties did not contend for votes, only for money. Since the regulation has not been changed, the proliferation of sham parties will not stop, since it is the interest of Fidesz to fragment the opposition.

According to the Hungarian Central Statistical Office (KSH), 62,152 nonprofit organizations operated in Hungary in 2015. The majority of them were associations and foundations, but there were 73 professional associations, 877 trade unions and 2,211 professional, employer organizations among them. As far as the field of activity is concerned, 3,432 organizations (5.5%) were active in professional, economic advocacy, 667 (1.1%) in rights protection, and 2,112 (3.4%) in environment protection (assumed that these fields mostly include interest groups). However, the real activity of, and participation in, the organizations are very low. Both the presence of trade unions at workplaces and the membership in trade unions have been decreasing. According to 2015 KSH data, trade unions exist only at the workplace of 25% of all employees and 9% of all employees are members of a trade union. Sectors that are mainly covered by trade unions are education, health care, public administration, law enforcement, energy and transport.

Two platforms of social consultation exist at the country level, none of which is able to fulfill its function due to the fact the neither of them includes all the relevant actors. The National Economic and Social Council (Nemzeti Gazdasági és Társadalmi Tanács, NGTT), which was established in 2011, consists of representatives of the economy (organizations of employers, national business chambers), employees (trade unions), NGOs, sciences and churches. Since the government does not take part in the NGTT and is legally not obliged to implement its recommendations, this Council has only a consultative function. The composition of the Permanent Consultation Forum of the Private Sector and Government (Versenyszféra és a Kormány Állandó Konzultációs Fóruma, VKF), which was formed in 2012 and consists of the



representatives of the government, employees and employers, also reflects the government's preferences, and lacks the participation of some trade unions and employer organizations. Interest representation and partaking in decision-making has become limited due to the politicization of the public discourse in general. The government condemns opinions and recommendations that criticize it or go against governmental policies, as "political" and "oppositional," and neglects them. The process of giving an opinion on legislative proposals often seems to be nothing more than a formality.

Divisions among trade unions weaken the representation of employees' interest. One of the key problems is the politicization of the sector. Some trade unions are clearly close to the government (e.g., Munkástanácsok, SZEF), and, therefore, disagree with more radical actions against government policies (e.g., one trade union of health sector workers did not join the major demonstration organized by a wide range of health care organizations in May 2015). The government also tries to limit critical voices and control opinions among public sector employees by establishing new forms of platforms that are indirectly overseen by the government (e.g., the formation of the National Teachers' Association in 2014). There is a low number of strikes due to the new strike law approved in 2011, which has made strikes de facto impossible. That is the reason why demonstrations have become the main tool of employees' associations instead of strikes.

According to the Standard Eurobarometer 86, in November 2016 only 42% of the Hungarian adult population was satisfied to some degree (very or fairly) with how democracy works in Hungary, and the relative majority was dissatisfied (56%). The results indicate that Hungarians see the functioning of democracy in a darker light than the average Europeans. The share of dissatisfied respondents is 14% higher than that of satisfied respondents. This is the ninth-highest difference among the 28 member states. However, other surveys conducted during the period from 2015 to 2016 indicate significant variation over time.

Trust in political institutions is low in Hungary. In November 2016, only 17% of the population trusted political parties and 78% distrusted them. In past years, no notable change occurred in this regard, society's approval of political parties can be considered consistently low. Trust in parliament is stronger than it is in political parties; however, distrust is dominant in this area as well, since according to this Eurobarometer report, two-thirds of respondents were rather distrustful and only every three out of ten said they trusted the National Assembly.

At present, Hungary belongs to the group of "low trust societies," meaning that both bonding and bridging social capital has radically suffered in the last years and trust in interpersonal relations and institutions is low in Hungary. TÁRKI Hungary regularly conducts research on the structure of social trust and values, which attest that more than half of Hungarians are distrustful, they completely or generally distrust

Approval of
democracy

7



1

Social capital

6

others. This is related to the fact that two-thirds of Hungarians maintain they are trustworthy, but others are not.

In terms of interpersonal trust, Hungarians are somewhere between western and post-socialist societies, but with regards to institutional trust, Hungary is among the worst not only in Europe but among the states of the former Eastern bloc as well. The state of public distrust is demonstrated by the fact that the trust of the average Hungarian is dramatically low (under 35%) in individuals in occupations toward which trust would be essential, such as MPs, bankers or journalists. Trust in political institutions is heavily dependent on political identity; therefore, institutional trust is relativized based on which political force is in government.

The general distrustful environment and closed mentality in Hungary is not a consequence of economic development, and it is unrelated to the country's social structure, as this characteristic has gone unchanged for a long time. Compared to their average western counterpart Hungarians consider civil and political liberties to be less important, they are not as active in daily politics, not as tolerant of minority opinions and they believe self-realization to be less important. The level of social activity is also low in Hungary. People meet their friends less, do not help each other out as frequently, visit clubs and engage with civil society organizations (CSO) less often than West Europeans.



II. Economic Transformation

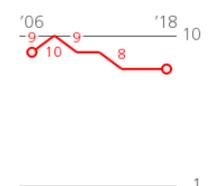
6 | Level of Socioeconomic Development

There is an increasing split in the Hungarian society between the upper third and lower two-thirds of the population, which has been visualized in sociology as the pear model, being narrow in the upper part and large in the lower part. A relatively new phenomenon is the working poor. The employment is increasing, but many people do not have a decent living from their wages, they remain in poverty. Poverty and inequality in Hungary are limited, but they are firmly engrained structurally. In some areas the situation is stagnant, however, in some respects, it got worse in the period under review. In 2016, Hungary's HDI value was 0.828, which was enough for 44th place in world rankings. However, the country's Inequality-adjusted HDI is considerably lower at 0.769. The Gini coefficient in Hungary was 28.2 in 2016, lower than the EU average of 31. Although the coefficient declined by 0.4 between 2014 and 2016, it is still more than four points higher than it was in 2010. The Gender Inequality Index for Hungary was 0.209 in 2016, which was slightly higher than the European average.

Question
Score

Socioeconomic
barriers

8



The rate of people at risk of poverty or social exclusion, meaning that their disposable income is less than 60% of the national median, fell from 31.8% in 2014 to 26.3% in 2016. In this regard, the Great Plain and North region the rate was 32% in 2016. Hungary fares considerably worse in this aspect than its fellow members in the Visegrád States. Mainly the Roma, low-skilled and uneducated individuals, people living in rural areas and those living in the Great Plain and the Northern region are the most susceptible to impoverishment. The rising demand for new employees in the private sector is not going to make their situation more favorable because the majority of them lack the necessary skills to fill the vacant positions. The aforementioned groups are firmly entrenched in the public works scheme (PWS), where the monthly wage is significantly lower than on the primary labor market.

Economic indicators		2013	2014	2015	2016
GDP	\$ M	134680.5	139294.6	121715.2	124342.9
GDP growth	%	2.1	4.0	3.1	2.0
Inflation (CPI)	%	1.7	-0.2	-0.1	0.4
Unemployment	%	10.2	7.7	6.8	5.2
Foreign direct investment	% of GDP	-2.8	9.3	-4.4	-7.3
Export growth	%	4.2	9.8	7.7	5.8
Import growth	%	4.5	10.9	6.1	5.7
Current account balance	\$ M	5094.4	2823.3	3985.8	6054.4
Public debt	% of GDP	76.6	75.7	74.7	74.1
External debt	\$ M	-	-	-	-
Total debt service	\$ M	-	-	-	-
Net lending/borrowing	% of GDP	-5.1	-3.4	-1.7	-
Tax revenue	% of GDP	22.8	23.1	23.6	-
Government consumption	% of GDP	19.7	20.0	20.0	20.2
Public education spending	% of GDP	4.2	4.7	-	-
Public health spending	% of GDP	4.9	4.9	-	-
R&D expenditure	% of GDP	1.4	1.4	1.4	-
Military expenditure	% of GDP	1.0	0.9	0.9	1.0

Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

The size of the informal economy was estimated to be 10% to 17% of the GDP in the early 2000s, which increased in the following years. The government made it obligatory to use online cash machines in certain sectors from 2013 to counter tax evasion and tax fraud and introduced the Electronic Trade and Transport Control System (EKÁER) in 2015. The measures significantly increased tax revenues, which is a good indicator of progress made to whiten the economy. Following the regulation's apparent success, the government extended the obligation to use online cash machines to other sectors, which further helped the constriction of the informal sector.

State administered pricing is being introduced in an increasing number of areas. The gradual reduction of energy prices starting in 2013 – the so-called utility cost cuts – resulted in a considerable increase in the governing party's popularity. The process is currently being extended and preserved. The state must acquire property in the sector concerned and extend its regulative competence to achieve this. The First National Public Utility Service Provider PLC (ENKSZ) offers natural gas, electric and distance heating services. Waste management is overseen by the National Waste Management Coordination and Asset Management PLC since April 2016. Chimney sweeping activities are handled by the Hungarian National Organization for Rescue Services since July 2016.

Hungary is ranked 41st in the World Bank's Doing Business Report 2017 in the ease of doing business ranking. The result is one place lower than it was in 2016; however, it is a considerable improvement upon the 54th position achieved in 2015. Reforms took place in two areas that help enterprises. These are enforcing contracts and paying taxes. In the latter case, the tax rate fell from 48% of the company's profits to 46.5%. The government has introduced special taxes aimed at burdening foreign-owned companies in some sectors. While the special tax on banks is gradually phased out, other special sectoral taxes are retained.

Comprehensive competition laws exist to prevent monopolistic structures and conducts. The Hungarian Competition Authority (GVH), generally, enforces the regulation effectively. In 2016, the National Assembly approved an amendment package to the competition law to lower the administrative burden on GVH and its costs. Consequently, after company mergers are reported to the GVH, the authority can authorize the merger within eight days if the GVH believes it would not significantly restrict competition. Otherwise, the competition authority has 30 days to evaluate the request. The competition authority encourages individuals to provide it with information on cartels. The person reporting the crime is awarded 1% of the fine issued to the companies, but maximum HUF 50 million. Nevertheless, the number of informants remain relatively low. The GVH has claimed there had been

Market-based competition

8



1

Anti-monopoly policy

8



1

several cases where persons who could have provided them enough information to unveil a cartel decided to withdraw their cooperation. Generally, the GVH operates fairly; however, it is liable to government influence when pro-government businesspeople are involved in transactions.

Foreign trade is liberalized both within the European Union and with third countries while existing trade limitations are in line with EU legislation. Hungary is among the top performers in the transposition of EU directives that govern trade within the EU. Government officials regularly emphasize that Hungary has an open economy and support export-oriented companies, which employ a considerable number of employees for relatively high wages. The government does not harass export-oriented industries as they understand that competition is essential for these businesses to perform well. As of November 2016, the Hungarian foreign trade surplus was €1.5 billion higher than in 2015.

The Hungarian banking system is rather solid and oriented toward international standards. Banks and other financial institutions are supervised by the National Bank of Hungary (MNB). According to the MNB's November 2016 Financial Stability Report, the resilience of the Hungarian banking system is reassuring even in the case of various unfavorable shocks affecting the banks' capital adequacy. In the examined period, both the capital and liquidity positions of the banking sector have strengthened. The share of non-performing loans in total loans was 10% in 2016, and the bank capital to assets ratio was 18% in 2016.

The conversion of foreign exchange loans to Hungarian Forint-denominated ones continued with car and personal loans. In November 2015, Swiss Franc-based loans were converted at HUF 287.2 and Euro-based ones at HUF 309.2. The difference between the actual exchange rate and the one set out by the law was paid jointly by the state and Hungarian banks, costing them HUF 15 billion each. Overall, the conversion of FX loans has decreased the vulnerability of the Hungarian banking sector, although banks in Hungary have lost about HUF 1,000 billion as its consequence.

The Hungarian government purchased Hungarian Foreign Trade Bank (MKB) and Budapest Bank (BB) in September 2014 and early 2015, respectively. They agreed with the European Bank for Reconstruction and Development (EBRD) that all the government's direct and indirect equity stakes would be transferred to the private sector within three years of their acquisition. MKB Bank was sold in June 2016 to two private equity funds, Blue Robin Investments and Metis. Moody's stated that the reorganization directed by MNB was successful in laying the foundations of the bank's transfer to the private sector. The new ownership of MKB quickly confirmed they would keep the MNB-appointed management in place. Budapest Bank was bought by the government considerably over its market price, and it is possible that the state would incur significant losses if BB were privatized. Banking sources told

Liberalization of
foreign trade

10



Banking system

8



Reuters that efforts to sell the bank have stalled because the government wants to get what it paid for it.

Lastly, state-owned Eximbank continues to be a problem. It was established to reduce the competitive disadvantage of domestic SMEs and help them export their products. However, the bank's actual operation seems to hinder SMEs, as Eximbank finances the purchases of pro-government businesspeople (e.g., Andrew G. Vajna, and the prime minister's son-in-law István Tiborcz) that are not related to exports.

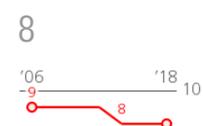
8 | Currency and Price Stability

According to Eurostat, consumer prices increased by 0.4% in 2016, up from a 0.1% increase in 2015. Hungary's National Bank has set an inflation rate target but does not have an exchange rate target. Officially it communicates that it tries to keep the exchange rate of the Forint stable. In 2016 the Forint-Euro exchange rate was less inconsistent than it had been in the four years before. However, the weakening of the Forint continued, albeit slower. While in 2013 the yearly average EUR/HUF exchange rate was 297, in a year it rose to 309. In 2015 the average was 310, while in 2016 a Euro was worth 311 Forints.

The MNB has often been criticized for the foundations it established. The National Bank started six foundations in December 2013, and it allocated HUF 259.6 billion (€0.8 billion) to these new entities together with property worth HUF 6.8 billion (€0.02 billion). Since then, the Public Procurement Authority has fined the foundations on several occasions for failing to launch public procurement tenders. Furthermore, European Central Bank (ECB) President Mario Draghi voiced his criticism in a letter, as speculation arose that the foundations' state-bond purchases might have constituted a breach of the prohibition of monetary financing. The foundations reacted to these concerns in autumn 2016 and started to reduce their state-bond portfolio. In addition, Eurostat indicated at the time of the announcement of data on deficit and debt in October 2016 that the institution is discussing with the Hungarian statistical authorities the possible rerouting of operations carried out by the National Bank of Hungary, deemed to be undertaken on behalf of the government. This is not the only debate Eurostat has with Hungary, the issue of the state-owned Eximbank (Hungarian Export-Import Bank PLC) is also on the agenda. The European authority believes Eximbank needs to be reclassified inside the general government sector that would result in the slight increase of state debt.

The Hungarian debt-to-GDP ratio gradually fell from its 2011 peak of 80.7% to 74.7% at the end of 2015. This slow decline continued in 2016 as well. The National Bank of Hungary (MNB) in its forecast published in December 2016 expected that the rate would be between 73.5 and 74% at the end of 2016. Thus, the government was able to adhere to the debt rule laid down in the Fundamental Law requiring that state debt decreases every year until it reaches 50% of the GDP. Furthermore, it

Anti-inflation /
forex policy



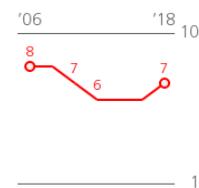
1

Macrostability

7

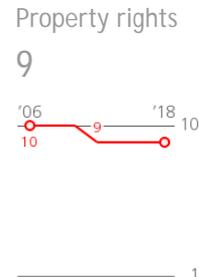
fulfills the requirement of the European Union, which stipulates that a member state must decrease its debt-to-GDP ratio by an average of one-twentieth of the reference value over a three-year period as long as the state's debt is over 60% of its GDP. Besides the fall in the rate of debt, its structure improved as well. The share of Hungary's debt denominated in foreign currencies fell from 40% in 2014 to 25% at the end of 2016. The budget deficit in 2015 was 1.6%, the lowest rate in Hungary in at least 20 years. In 2016, the deficit is estimated to have been between 2.1% to 2.3%.

As a consequence of the favorable macroeconomic processes, all the three credit agencies upgraded Hungary's sovereign debt rating to the lowest of "recommended for investment" category. The first was Fitch in May 2016, followed by Standard & Poor's in September and Moody's in November. Nevertheless, Hungarian grades still fall behind the country's regional competitors. An investor-friendly, predictable economic policy, maintaining fiscal discipline, a more significant decline in state debt and the improvement of the country's potential growth rate are all prerequisites for further upgrades. Actually, the main problem is that the investments are still well below the pre-crisis level of 2008, which prevents the long-term economic growth.



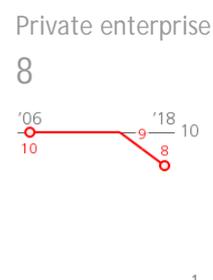
9 | Private Property

Property rights on acquisitions, benefits, use and sale are well-defined and enforced, although the government sometimes regulates the use of private property without offering compensation for the financial losses it causes. In June 2016, Hungary was referred to the EU Court of Justice for a law promulgated in December 2013 that terminated investor's contracts on the use of agricultural land without compensation even though the contracts would only have expired on 1 January 2033. The European Commission maintains that the law did not ensure respect for property rights enshrined in the EU Charter of Fundamental Rights.



In the 2016 Doing Business Report, Hungary was ranked 28th in the ease of registering property, which is a significant improvement from its 52nd rank in 2014. Hungary is ranked 8th regarding ease of enforcing contracts through courts.

Private companies are viewed institutionally as important engines of economic production, and they are given legal safeguards; however, the concentration of market power is tolerated in certain economic segments and in such cases that conservation serves the political aims of the government. The government has continued to increase its influence over the economy through pro-government businessmen. They use EU-funded public procurement tenders to capitalize the business circles close to the government. Consequently, over one-third of public procurement tenders had only a single bid. This practice is widespread in the construction sector.



In 2016, Prime Minister Orbán stated that there are four areas where the share of Hungarian ownership must be over 50%, namely the media, retail, energy and

banking sectors. In 2015 and 2016, the state or entrepreneurs close to Fidesz mainly made acquisitions in the energy sector and the media. An increasing number of economic sectors are being targeted by the state to be nationalized or handed over to pro-government business circles; however, export-oriented sectors remain unaffected. The government has actively tried to gain influence over the retail sector and discriminate against foreign firms. In the period under examination, the government largely completed the integration of credit cooperatives, the Hungarian Post and the Hungarian Development Bank Group.

If business actors happen to come into conflict with the government, they risk losing their assets due to government interventions. For example, Zoltán Spéder, an influential entrepreneur with previously good Fidesz connections, had to sell his stakes in an FHB Land Credit and Mortgage Bank in 2016, after he had fallen from grace with the government.

10 | Welfare Regime

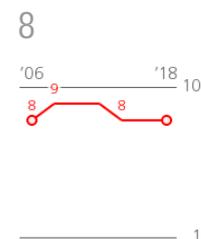
Social safety nets are well developed but do not cover all risks for all strata of the population. The extension of the public works scheme (PWS) played a key role in the post-2010 improvement of employment data. The average number of monthly participants in the PWS was 178,852 in 2014, 208,127 in 2015 and 224,812 in the first ten months of 2016. A long series of studies attest that the forceful enlargement of the PWS is unfit to guide the unemployed back to the primary labor market and government officials admitted this at the end of 2016. In reality, the PWS became the symbol of subservience, as mayors, notaries and minority leaders decide who is and who is not allowed to partake in the scheme.

According to Eurostat, 2 million 735 thousand people (28.2% of the population) were at risk of poverty in 2015, which is the lowest number since the economic crisis. The relatively quick increase in real wages played a role in falling poverty numbers, but the PWS also helped to improve this statistic. The share of people at risk of poverty is still high in comparison with other countries in the region. At the same time, the Eurostat data also reveal that the number of children living in extreme poverty rose by more than 70% between 2010 and 2014 from 71 thousand to 123 thousand, although decreased to 93 thousand in 2015. Nevertheless, the government allocated less money to financial and in-kind benefits supporting the socio-economically most disadvantaged groups in 2017 than a year before.

Hungarian spending on health care as a share of the GDP is gradually falling. From the 5.08% rate in 2010, it fell to 4.72% in 2015.

In the 2017 budget, more than 82% of housing-related expenditure was allocated to programs mainly benefiting the better-off portion of the population who already live in more satisfactory housing conditions. The 27% VAT rate continues to be the

Social safety nets



highest in the EU, although the government started to implement targeted VAT cuts for certain foodstuffs.

Since 2011, when the Orbán government abolished the mandatory private pension pillar, the pension system has been a one-pillar statutory scheme which is a mandatory, uniform, defined benefit pay-as-you-go system with an earnings related public pension combined with a minimum pension. The scheme is recognizably unsustainable.

Legislation to provide equal opportunities for all groups of Hungarian society exists in principle, although there are provisions that allow for discrimination against certain groups. Furthermore, the implementation and enforcement of these laws are insufficient in some areas.

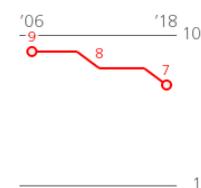
According to a Council of Europe report, Roma children are increasingly segregated in schools, which is the result of the “separate them in order to aid their development” practice widely employed by authorities. The European Union started an infringement procedure against Hungary for the segregation of Roma students.

According to Eurostat, the employment rate of women is considerably lower than that of men. In 2015, 57.8% of the female population held jobs, while the male participation rate in the labor market was 70.3%. One reason for this is that the Hungarian government’s family policy does not encourage women to return to the labor market after giving birth. According to the Central Statistical Office KSH), in 2014 women earned 13.2% less on average than men, which is a higher difference than it had been nine years before. Currently, 9.54% of the National Assembly is made up of female MPs, which is the 120th place in the world rankings.

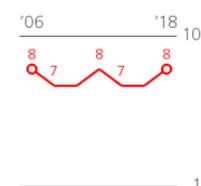
11 | Economic Performance

According to the seasonally and calendar effects adjusted and reconciled data of the Hungarian Central Statistical Office (KSH), GDP expanded by 3.1% in 2015 compared to the year before. Although this is lower than the 4% growth recorded in 2014, it is still the second-highest rate between 2007 and 2015. However, the GDP growth rate was only around 2% in 2016. The main cause of the slowdown in the pace of economic growth is the slower influx of EU funding, which sheds light on the fact that the economy is highly dependent on outside resources. After stagnating in 2014, the inflation rate in Hungary increased to 0.1% in 2015 and 0.5% in 2016. The main cause of price stability was the international environment, especially the low oil prices. The ratio of general government gross debt-to-GDP fell from 81% (2011) to 75% in 2015 (IMF data). The unemployment rate fell from 7.8% to 4.5% between early 2015 and November 2016. The employment rate increased by more than four percentage points to 58.8% in 2016. Even though this is largely due to the widely criticized public works scheme, employment also increased significantly within the private sector.

Equal opportunity



Output strength



12 | Sustainability

While the constitution stresses “sustainability” in many aspects of governance, including environmental sustainability and the National Assembly, ratified the Paris Agreement on Climate Change in May 2016, the government does not consider environmental sustainability as a priority and does not implement it in policies. According to Eurostat, the share of renewable energy in gross final energy consumption was 9.5% in 2014, below the EU average of 16%. Since 2012, Hungary has not come any closer to its EU 2020 target of 13%. The country hardly exploits the possibilities in solar, wind and geothermal energy. Hungary is performing worse than the EU average regarding resource productivity (how efficient the economy uses material resources to produce wealth).

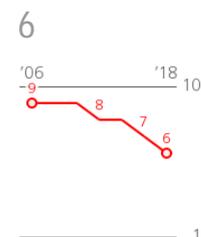
As far as the energy policy is concerned, instead of investing in and advocating renewable energy, the government focuses on nuclear power and the smooth access to oil and gas provided mainly by Russia. The government has been paving the way for the extension of Paks nuclear power plant with the financial aid of Russia, and it has promised continuously decreasing energy prices to the electorate.

While Hungary’s President János Áder is an international advocate for the strategic importance of water, the country does not perform well in using renewable water sources. The mayor of Budapest has been planning a mobile dam system on the Danube River in a popular outing area. This construction would devastate the natural environment and floodplain; therefore, the idea has sparked huge protests since 2015.

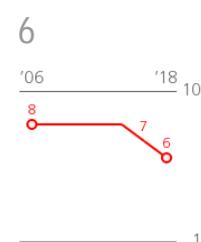
Even though education is not a privileged governmental policy, according to Eurostat data by 2014 government expenditure spent on education had reached 5.2% of the GDP including EU funds. Education policy has been the most debated public issue in the last years, given its steady decline and large public concern. Its decline has been presented recently by the latest PISA Report, in which Hungary has been further downgraded. The Hungarian education system is still struggling with unequal opportunities in schools. Students’ achievements are strongly correlated with their socioeconomic background. No attempts were made to increase the number of underprivileged students in mainstream education in the period under review, in particular, the Roma pupils. In January 2017, the government has overtaken the operation of schools from local self-governments. Previously the operation and financing of educational institutions had been under the local self-governments’ control, while the staff of schools was already the employees of the state.

The OECD-PISA test results of 2015 revealed the significant shortcomings of the Hungarian education system. Hungary is at the bottom of the OECD country rankings for the 2015 PISA results in all examined fields. The results of the mathematics tests matched those in 2012, well under the OECD average. In terms of language comprehension and natural sciences the Hungarian results had never before decreased

Environmental policy



Education policy / R&D



by such an extent. Of Hungarian students, those who achieved the highest percentage only made up 5% of all students. The number of underperforming students (those not being able to name basic scientific definitions and interpret data) made up 26% of all students in Hungary.

In general, Hungarian public education faces several serious problems, and educational institutions are becoming less solid. In 2016 a new movement called *Tanítanék* (I Would Like to Teach) emerged, claiming that the education system has to be radically reformed. According to their analyses, there are six key problems in education: (1) There is no social dialog about educational questions, legislation and policies. (2) Schools, teachers have no institutional autonomy. (3) The financing system of education became strongly centralized and education is in general underfinanced. (4) The lack of equal opportunities is a problem that has existed for decades, segregation is becoming more pronounced and there are no positive developments in this regard. (5) The structure of schooling system is outdated and should be reformed. (6) The overcomplicated evaluation system of institutions and teachers strongly hinders the performance of both teachers and schools.

The number of university students has decreased in the last years, and the amount spent on R&D has been around 1.4% of the GDP, well below the EU average. However, R&D spending has increased over time, mainly due to growing activities of enterprises.

Governance

I. Level of Difficulty

The structural constraints on governance are low, as Hungary has initially been able to rely on a relatively homogeneous society, a relatively developed infrastructure and a territory that has not been contested internally or externally. The increasing wage gap, strengthening segregation, declining quality of health care and education, aging society, emigration of the youth and lack of skilled workers are all structural constraints that ensue from the failures of the consecutive administrations in government.

Hungary has a considerable tradition of civil society, represented in the different opposition milieu that existed under the state socialist system, as well as the role of reform-oriented technocratic elites encouraged by Hungary's liberalized authoritarianism. This particular model of reform socialist governance emerged as a response to the revolution of 1956, which carved out space for societal autonomy. While limited to small segments of the intelligentsia, the opposition milieu was rooted in pre-war and nineteenth-century intellectual cleavages between urban liberals and national conservatives. The reorganization of Hungarian civil society took place in the wake of regime change in 1989 and 1990. Civil society has developed rapidly after the regime change in 1989/1990, but remained dependent on the state and weakly embedded in society. The Fidesz-led government has established a big loyal civil organization, Civil Unity Forum (CÖF), which has decided the allocation of state funds for civil society. The government has also launched several political attacks and smear campaigns against civil society organizations, either funded by the Norway NGO grant or by the Open Society Institute, which contributes to the rapid decrease of trust in the civil sphere.

The majority of the population has negative attitudes toward specific ethnic groups and foreigners. The figures of a study about anti-Semitic prejudice in contemporary Hungary show that the majority (78%) of the people would not give consent for a migrant to live in their neighborhood. Opposition to Arabic (71%) and African (60%) neighbors is also very high. Furthermore, 68% of the society reject the Roma, 57% reject homosexuals and 31% object to Jews living in their neighborhood. In Hungary,

Structural constraints



Civil society traditions



Conflict intensity



anti-Roma sentiments have always been high and stable since the regime change in 1989 as opposed to anti-Semitism, which is less dependent on party preferences.

Migration has been one of the most important political issues since 2015. This period has been strongly thematized by the government-organized propaganda campaign against migrants. The government has framed migration in the context of terrorism, anti-EU sentiment, and economic, religious and social clashes. The EU is portrayed as a failed attempt unable to offer solutions to the migration issue that destroys nations with its policies. Oppositional powers and civil society organizations have not managed to re-frame the issue or come up with alternative narratives. Therefore, public opinion has been dominated by the influenced of government propaganda.

II. Governance Performance

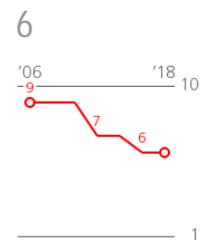
14 | Steering Capability

The government sets many strategic priorities and regularly subordinates them to the demands of office- and vote-seeking. The governing parties' political savvy in maintaining power is in stark contrast to their inability to craft or enact any complex policy strategy for the country. The prime minister relies on a powerful Chancellery to formulate policies, mobilize parliamentary support, coordinate line ministries and monitor policy implementation. However, there are numerous strategy documents that are neither well-integrated nor linked to assessments of financing needs. The government's decisions are often not straightforward even to other cabinet members, and generally, they are not based on professional rationality, but on the logics of power politics and political communication. This is often true for policy measures as well; thus, line ministers and their subordinates rarely dare to make decisions independently due to the all-encompassing nature of power political goals, which results in unpredictable and chaotic operation of the government. Predictability and the few measures aimed at strategic planning are also overwritten by actual political goals and decisions. For example, the National Assembly approved the 2017 budget in spring 2016, just to completely rewrite it at the end of the year and approve it again. This has not forced the government to change course, they are planning on approving the (first) 2018 budget in spring 2017.

The Hungarian government makes its decisions hastily to achieve short-term political goals often without giving any consideration to the potential results of their measures. Therefore, it frequently has to make corrections to policies on the fly or abandon them completely. The government's usual response to problems, be they long existing

Question
Score

Prioritization



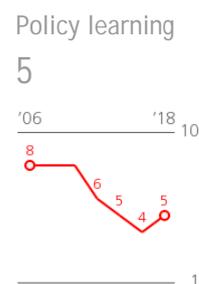
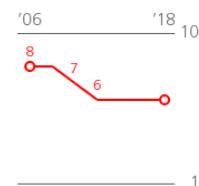
Implementation
6

issues or ones created by the government's own measures, is the centralization of responsibilities or increasing the degree of state intervention in the economy.

For example, the Orbán government reorganized the waste management sector in 2012, resulting in a system that is more expensive to operate and recycles less waste. In addition, non-state-owned public service providers in the sector were banned in 2012 as well. Utility cost cuts and a series of new taxes affecting service providers ensured that the nonprofits then owned by local self-governments started operating at a loss and found themselves in tough financial situations, many even canceling their planned investments. To solve the issue the government created the National Waste Management Coordination and Asset Management PLC (NHKV) to collect the fees for the services and then pay the providers according to their financial needs. The NHKV was supposed to start operating and financial transfers in April 2016, but in June it was still unable to pay service operators due to IT problems, which brought several companies on the brink of bankruptcy. Although local self-governments could have paid them as they had done before, they were not allowed to do so by the regulations. Consequently, the government had to launch tenders for companies in trouble to receive emergency financial assistance. After several months the situation normalized, but the government's centralization efforts created a system that failed to maintain the quality it used to offer before the intervention.

The Hungarian government regularly approves legislation providing a competitive advantage to Hungarian-owned companies. The implementation of these measures, for example, the progressive food chain inspection tax, has been suspended by the European Commission and subsequently the Hungarian government is forced to repeal the law.

The government demonstrates little willingness or ability in policy learning. Policy objectives are regularly subordinated to power political goals. The government has not been interested in independent advice from experts. In public debate, the government denounces constructive criticism as "untrue." There is no forum where the prime minister could be influenced by anybody outside his very close circle. Innovative ideas or constructive criticism are unlikely to be formulated. Regulatory impact assessments have a rather formal character, they are confined mainly to environmental policy-making, and do not rely on regular consultations with stakeholders. EU budget regulations that require Hungary to keep its deficit low have been the main inspiration for the government's constant improvisation, prompting it to change its financial strategy from day to day.



15 | Resource Efficiency

In 2014, Hungary spent 10.2% of the GDP on general public services, which was the second-highest share in the EU. The Orbán government has announced measures to cut bureaucratic red tape. In February 2016, the minister heading the prime minister's office, János Lázár, stated that the government would dissolve 29% of 91 central state agencies and cut around 20% of their workforce. Nevertheless, by the end of 2016, there were 3.4% more employees working in public administration than at the time of Lázár's announcement. The main problem of public administration in Hungary is the overregulation; every step in handling a case is regulated in detail and there is no option to deviate from the rules even if they introduce unnecessary and costly steps, which raise administration fees and postal costs. For example, sometimes employees are obliged to ask other institutions for certain information even if they could find it themselves. Moreover, public employees have complained that high-level management often lacks the necessary knowledge of bureaucratic processes and work experience. Political appointments to leadership positions in public administration are common. In addition, public employees' salaries are low, prompting many to find employment in the private sector or abroad.

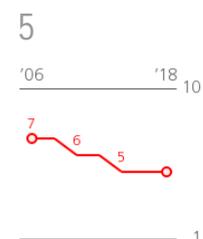
The Orbán government has avoided excessive state budget deficits above three percent of GDP since 2012 and has gradually reduced the gross public debt (as a share of GDP) since then. While the state budgets have been approved well in advance to make Hungarian fiscal policy more "predictable," the governing majority has often thwarted this objective by amending approved budget laws.

Prime Minister Orbán has abandoned the practice of dividing government into distinct policy areas. Instead, he has created a government consisting of deputy prime ministers and ministries overseeing several policy areas. Politically delicate and conflicting sectors, such as health care and education, have become non-transparent under this system. The degree of independence and responsibilities of ministers overseeing large portfolios are often unclear. The authority of ministries is shared on some issues, and the prime minister's affection with encouraging competition among the members of his cabinet also creates confusion from time to time.

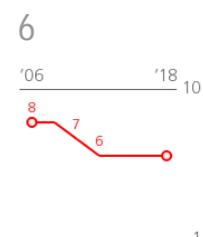
The government tries to handle internal confusion. The prime minister decided in August 2016 that the government would be split up into two cabinets, an economic and a strategic, which are political institutions tasked with preparing and making decisions. The minister of the prime minister's office heads the Strategic Cabinet, and the minister of national economy directs the work of the Economic Cabinet.

Nevertheless, power is concentrated in the hands of the prime minister, who makes the most relevant political decisions relying on a small, informal group within the government independent of cabinets and ministries. The members of this informal circle are Prime Minister Viktor Orbán, the Minister of the Prime Minister's Office

Efficient use of assets



Policy coordination

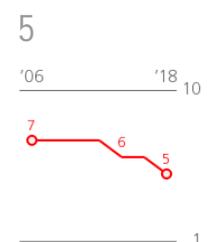


János Lázár, the Minister of the Cabinet Office Antal Rogán, the Minister of Foreign Affairs and Trade Péter Szijjártó and Árpád Habony, the informal chief advisor of the prime minister, informal head of the de facto governmental background organization Századvég and one of the owners of the new pro-government media empire established in 2015 and 2016. The over-centralized one-man leadership built on an informal inner circle is lacking any efficient feedback, and it increases the chance of policy mistakes.

Corruption had caused serious harm to Hungary even before 2010, but in that period, it was a byproduct of a then-democratic system. Since then, one can talk about systemic corruption in Hungary's emerging nativist state capitalism. At this point it is not about some public officials, or politicians abusing their office in return for cash handouts, but that nowadays the legislation is tailored to individuals and companies. A tight political interest group has captured the state. Consequently, the government's anti-corruption policy exists only on the rhetorical level, in reality it goes to great length to transfer the largest possible chunk of public money to its economic hinterland. Those favored by the central power, the so-called "national bourgeoisie" collect their wealth through public procurement contracts offered to them biasedly. As one advisor to the prime minister, the rector of Corvinus University András Láncki put it in an interview in December 2015, "What they call corruption is essentially the main policy of Fidesz."

One good example of systemic corruption is the Residency Bond Program. Offshore companies with unknown ownership structures earned over HUF 100 billion on selling residency bonds to non-EU citizens. Only one of such enterprises was not registered in an offshore paradise. Another example is the "Tao" sport funding system that entitles the donors to deductions from their corporate taxes, which by 2016 had led to HUF 300 billion transferred to clubs competing in five team-based spectator sports without any transparency. Football teams with ties to leading politicians receive a disproportional amount from Tao contributions. Viktor Orbán's team in Felcsút was given HUF 10 billion (€32 million) over five years, but the clubs of Minister of National Development Miklós Seszták and Secretary of State for Taxes András Tállai also profited billions from this scheme. As these clubs are considered weak even in Hungary, the lavishness of companies is obviously not based on business or sports-related reasons, but on political considerations. Transparency International Hungary has sued the National Tax and Customs Administration (NAV) and several ministries to unveil which companies contribute to the clubs and the extent of their financial contributions. As a reaction, the National Assembly has approved a law changing the definition of tax secrets in a fast-track procedure. The effect of the amendment is that today the names of the companies that transferred Tao contributions are legally secret. Although domestic public procurement laws are largely in line with EU directives, the National Assembly approved several amendments in 2016 that further increased the risk of corruption in public procurement procedures.

Anti-corruption
policy



The lower limits for public procurements doubled in 2017. Since then, goods and services can be purchased without starting a public procurement tender under HUF 15 million instead of the previous HUF 8 million, while in the area of constructions the limit was raised from HUF 15 million to HUF 25 million. Thus, it has become even easier to circumnavigate the obligation to launch public procurement procedures. Corruption obstructs economic growth in Hungary just like it does everywhere else. Business actors also evaluate the Hungarian government's anti-corruption measures as unsatisfactory. The World Economic Forum's (WEF) Global Competitiveness Report ranked Hungary 69th in its competitiveness ranking, down from 28th place in 2001. The evaluation of state institutions is especially poor; the country slipped from its 26th place in 2001 to 114th in 2016. Business people pointed to the unpredictability of regulation and corruption as the two main obstacles to running a successful business.

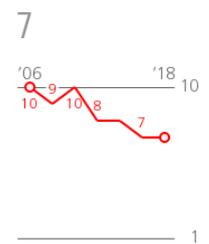
16 | Consensus-Building

Fidesz interpreted its victory in 2010 as an opportunity to rectify what it perceived as a derailed democratic transition. Fidesz identifies itself and its supporters with the nation; thus, whatever it does it originates from the collective will of the nation. However, there is absolutely no consensus. Opposition forces, opinion leaders and stakeholders positioned to the left of Fidesz on the political scale interpret the changes implemented after 2010 as the erosion of the democratic institutional system and a free-market economy. They agree to a great extent that there is a need for a *tabula rasa* after a future defeat of Fidesz. Hungarian democracy and its free-market economy must be placed on entirely new foundations once more, but there is debate among them on the methods of implementing this. They reject Fidesz's single-party constitution, electoral system, media law and institutions controlled by Fidesz's cadres, just as they object to the government's foreign policy orientation and economic policy.

The right-wing extremist Jobbik party views the government as part of the old elite and tries to differentiate itself from the government in every possible aspect, trying to position itself as the only meaningful 21st-century political party. This is made more difficult to achieve by the fact that the party agrees with the government on numerous questions: refugee policy, citizenship and suffrage of Hungarians living abroad, Eastern orientation in foreign policy, Euroscepticism, law and order policies, segregated education, etc. What is more, Fidesz implemented a wide range of proposals suggested in Jobbik's 2010 general election program.

While major political actors generally agree on market economy as the desired economic system for Hungary, there is significant controversy over the scope of the state and political intervention in the economy, the desirable model of economic development and the norms that should guide the behavior of economic actors.

Consensus on goals



Political reformers committed to a liberal, Western-style democracy are in opposition and have very limited influence on the government. The Fidesz-led government is not committed to liberal democracy. On the contrary, the prime minister declared that they are building an „illiberal democracy.” The checks and balances have been weakened, but some of them remain in place. It is obvious, however, that there is a tendency to make efforts to silence voices critical of the government, the main victims of which are representatives of the media and civil society, in addition to opposition parties. As a consequence, the reformers are hardly able to overcome anti-democratic veto actors.

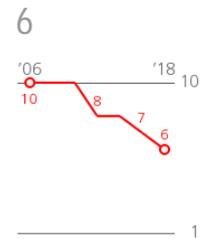
The extreme right party, Jobbik, has moved in rhetoric closer to the center, but its main goals and values have basically remained the same. Jobbik promotes a vision of an ethnic Hungarian nation-state that transcends Hungary’s current borders by encouraging the self-determination of ethnic Hungarian minorities in neighboring countries. The party has revived historical symbols once used by Hungarian fascist groups and has repeatedly instigated anti-Roma and anti-Semitic conflict.

Due to the traumatizing events of Hungary’s 20th century (defeat in the world wars, Trianon, Holocaust, fascist and communist dictatorships, and the Soviet invasion in 1956), there are sharp dividing lines in Hungarian society. Hungarian national identity is damaged, and commonly shared political values are nonexistent. The Orbán-led governing party’s political strategy is to polarize society along political dividing lines. The main principle of this strategy is that the governing Fidesz splits the political field into “national” and “anti-national” sides and then tries to discuss every political topic based on this division. If someone contests Fidesz’s viewpoint, they are almost automatically put into the “anti-national” group regardless of their arguments, because in the view of Fidesz the Orbán government is the only voice of Hungarian national interests. The government has implemented this strategy effectively even with regards to the European migration crisis since 2015. In a series of campaigns, they have sent a message to citizens suggesting that leftist parties, civil society and human rights groups “sided with the aliens.”

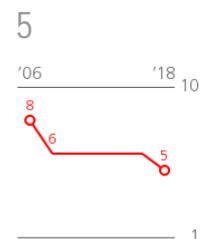
Ideologically, this strategy is not simply built on xenophobia and nationalism; it is founded in a more complicated worldview that can be called Orbánism. Resembling Putinism, Orbánism is based on a closed, traditionalist, Eastern mentality and a sort of urban-rural division. It contrasts its values, principles and relations with the liberal views originating from the age of enlightenment. It can be considered an anti-Western ideology, which prefers national collectivism over individualism and human rights, one that favors authoritarian state organization over liberal democracy and order over freedom.

In conclusion, the politics of Orbán is built on the logics of generating conflicts rather than creating some kind of national consensus. This is obvious both in his domestic and EU-level strategy, as he does not wish to solve conflicts, he wants to generate

Anti-democratic actors



Cleavage / conflict management



new ones to set the political agenda, and this way encourage impressionable voters to side with him.

While the legal environment and institutionalized forms of advocacy, interest representation and social consultation exist in Hungary, the government has been restricting the possibilities of social participation in decision-making since 2010 and stresses the priority of the executive and legislative branches in forming policies and public opinion.

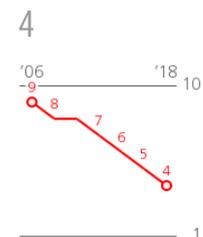
Civil society actors are hindered by many factors when trying to take part in policy formulation. First, in the aftermath of the political smear campaign against the operators and grantees of the NGO Program of the EEA/Norway Grants that the government has systematically distinguished between loyal civil society actors and those organizations perceived as critics. Loyal organizations and quasi non-governmental organizations (QUANGOs) can access state funding, whereas critical groups are excluded.

Second, the superficial and tokenistic nature of consultations has led many civil society actors to withdraw. The government has replaced them by newly established QUANGOs has strictly regulated and centralized interest groups to ensure their compliance with government policies. This is demonstrated well by the case of the National Association of Teachers (Nemzeti Pedagógus Kar, NPK). It was established to extend the government's control over the organization and control of teachers' representation. In 2016 a new, alternative teachers' movement emerged, which is independent of the state controlled NPK and strongly critical of, but neglected by, the government.

Third, the government frequently relies on private members' bills to avoid the mandatory "social discussion" of government-sponsored bills. Fourth, the government systematically refuses any criticism regarding its work coming from national and international civil society or intergovernmental organizations. For instance, in December 2016 the Hungarian government announced its withdrawal from the Open Government Partnership (OGP). The government's performance was reviewed by OGP after serious concerns were raised by Hungarian civil society organizations regarding their space to operate in Hungary. The withdrawal letter argued that the government's considerations were not reflected in the OGP reports and therefore the report is "unsubstantiated and intrusive."

Creating enemies has become one of the main principles of the government's politics; therefore, it rather intensifies the historic traumas of the 20th century instead of promoting the reconciliation process. The single-party Fundamental Law states that "We date the restoration of our country's self-determination, lost on the nineteenth day of March 1944, from the second day of May 1990, when the first freely elected organ of popular representation was formed." Therefore, it makes Nazi Germany 100% responsible for the crimes committed during World War II (the day mentioned

Civil society participation



Reconciliation

3

is the date of Hungary's occupation by Nazi Germany) and denies any Hungarian responsibility. This interpretation is reinforced by the government's politics of memory, the most notable example of which is the new statue erected on Szabadság square in Budapest with the "German eagle" attacking Hungary.

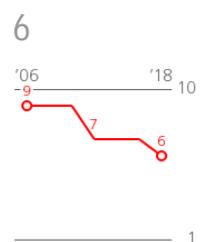
Hungary lags behind in reconciling the experiences of the communist past. Even though one of the most important aspects of the Orbán government's political self-definition is its unwavering anti-communism, many individuals in the government and among its high-ranking officials had held important positions before 1990 (and a lot of them were members of the Hungarian Socialist Workers' Party, MSZMP). The list of secret agents serving in the communist era is not public in Hungary, which constitutes one of the main barriers to reconciliation. However, parties in power (or in opposition) leaked information on the former agent or counter-espionage career of political actors for contemporary political purposes on several occasions. It is especially hard to maintain Fidesz's anti-communist image given the government's increasingly friendly stance toward Russia. While some renowned researchers of different periods of the 20th century are not included in the formation of the government's politics of memory, it has established new institutes led by historians with close ties to Fidesz instead. Therefore, there is no intention to heal the wounds of history; what's more, the government manipulates memories of historical injustices as a weapon against political opponents.



17 | International Cooperation

The political leadership tries to use international assistance for its own development agenda but has a clear deficit in devising consistent, long-term strategies to integrate this support effectively. The government decided to change the Hungarian EU funding system after the European Commission in October 2016 had indicated its intention to freeze the disbursement of EU funds to Hungary due to violations of EU rules.

Effective use of support



Brussels was worried about whether Hungarian authorities responsible for the disbursement of EU funds make their decision independently and without political interference. According to information gathered by the online financial journal Portfolio, the government decided to amend its legislation, relieving the bodies managing EU funds from the need to consult with the minister heading the prime minister's office. By the end of 2016, the Hungarian government had disbursed EU funds amounting to HUF 2,100 billion, but Secretary of State for Public Finances Péter Banai confirmed that only HUF 640 billion had been received from the EU; thus, the majority of expenses were pre-financed by the Hungarian state.

Between 2007 and 2015, Hungary performed well in comparison with other countries in the region. The share of contracted funding was the second-highest in Hungary

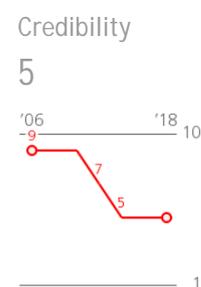
(117%) after Slovakia and Hungary finished first in terms of the share of disbursed funding with 111%.

In 2016, the volume of infringement procedures against Hungary grew noticeably. By spring 2016 the number of ongoing infringement cases against Hungary had increased to 52 from the 42 in 2015, which places Hungary in the middle of the pack. The cases mainly concern the single market, environment protection and financial services. Hungary performed worse in 2016 compared to 2015 in the transposition of EU directives on the single market, the number of these increased to 26 from 18. On the other hand, the number of Hungarian cases the European Court of Justice is dealing with decreased from two to one.

Even though the global political environment allows the Hungarian government more space for maneuver due to the gains of Eurosceptic populist forces and the election victory of Donald Trump, these developments do not significantly improve its international credibility. While the Hungarian government tries to showcase itself in the EU as the protector of Europe and Christian civilization with its unprecedentedly intense anti-migration campaign and by accusing Western leaders of decadence and nihilism for advocating a community-based solution to the refugee crisis, it does not consider any solution founded on the distribution of refugees across member states to be acceptable. Furthermore, the goal of the anti-quota referendum on 2 October 2016 was clearly to create a precedent in the union.

Although the Hungarian administration was widely criticized by both Brussels and Berlin, the European Commission is more cautious with exerting pressure on misbehaving member states partly because of the Brexit referendum. This change in behavior could also have played a role in the termination of the infringement procedure against Hungary that the Commission started regarding the Paks-2 project. Germany does not support punishing the Hungarian government for objecting to the distribution of asylum-seekers by decreasing the structural and development funds allocated to Hungary. The UN Refugee Agency questioned the credibility of Hungary's viewpoint, in several cases, it criticized the conditions in the transit zones on the Hungarian border. The Hungarian government's refugee policy is in contrast with the strategy of the increasingly tough European mainstream because it criminalizes asylum-seekers. Viktor Orbán believes that all terrorists are migrants, the only question is when they arrived in Europe. In addition, it also hurt the international credibility of the Hungarian government that Orbán as an anti-Brexit campaigner blamed the EU's failed refugee policies for the victory of the Leave EU campaign in the British referendum. Moreover, he tried to exploit the public's anti-Brussels mood in his own referendum campaign.

After the US presidential election, the Hungarian government's destructive behavior shifted into higher gear. The administration started an attack on Hungarian civil society organizations (CSOs) receiving funding from George Soros, accusing these "pseudo-CSOs," as they are called by Fidesz, of "trying to force the world of political



correctness and global big capital onto the governments of nation states.” Orbán’s hope that the new Republican administration would be more lenient on East-Central European regimes trying to restrict democracy is not groundless.

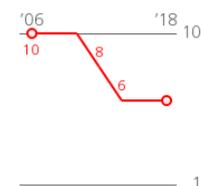
The cooperation of Visegrád states (Hungary, Slovakia, the Czech Republic, Poland – V4) has become essential for Hungary. The Hungarian government considers it to be an alternative center of power balancing Germany. In the political conflict with the European Commission, cooperation is the strongest with the conservative-populist Polish PiS government. Orbán and Jaroslaw Kaczynski announced their “cultural counterrevolution” jointly, the relationship between the two leaders is not even affected by the uniquely strong Hungarian-Russian bilateral relation. Slovakia and the Czech Republic have so far been reluctant to join Polish-Hungarian efforts to curb the competences of the European Commission. At the start of the refugee crisis, the V4 were indeed unified against the mandatory distribution of refugees, but Hungary did not want to approve the “flexible solidarity” concept introduced by the Slovakian EU presidency.

The Hungarian government supports Ukrainian EU membership, and Viktor Orbán made a promise to Kiev that the V4 will represent the country in the EU to help grant Ukrainians a visa waiver and sign the Ukraine-EU free trade agreement. Similarly, it supports the Euro-Atlantic integration of Serbia and the Former Yugoslav Republic of Macedonia.

The Hungarian government continues to be the main opponent of EU sanctions against Russia, but so far it approved the six-month long extension of them in every vote, e.g., on December 15, 2016. Viktor Orbán meets Vladimir Putin the most frequently among European leaders. The meeting was scheduled for February 2, 2017, marking the second time in three years the sides met, where they were expected to discuss the details of the Russian loan-financed Paks-2 project. The details of this project are still a secret. The Hungarian government raised the possibility of re-evaluating the EUR 10 billion Russian loan, but at the time of writing there had been no concrete signs they were looking to exchange it for an alternative loan from the free-market. Even though the murder of a policeman on October 26, 2016, revealed that the extreme right Hungarian National Front (MNA) was in contact with Russian military intelligence, the Hungarian government did not expel anyone.

Regional
cooperation

6



Strategic Outlook

At the time of this writing (early 2017), Fidesz's chances of winning the April 2018 parliamentary elections seem to be rather good. None of the dominant opposition parties are likely to attract a majority of the votes – neither Jobbik, even if it shifts from the extreme right to the center, nor the Hungarian Socialist Party, nor the newly established Momentum movement. The fragmented democratic opposition is once again discussing the “unity” of opposition. In order for the democratic opposition parties to have any chance of winning in 2018, they will need to agree on one common candidate by organizing a “pre-election” in each individual district (106 out of 199 total seats). Thus, far there have been too many political debates, diverging policy approaches and personal rivalries within the democratic opposition to engender anything approaching unity.

In recent years, deep crises in public services, health and education have prompted several protests and activities promoted by civil society, which represents the major opposition to the government. However, Hungarian civil society has achieved little, and the momentum of mass movements against the Orbán regime has died. Nonetheless, these movements have exposed the autocratic nature of the government's decisions in making budgetary cuts that affect civil society and its efforts to centralize control over civil society groups.

Challenges to the Orbán government are likely to emerge from rifts among the ruling elite with regard to the deepening conflict between Orbán and EU leaders. Corruption has become an endemic, systemic feature of the Orbán government. Independent media outlets have reported on the appetite for luxury among some Fidesz politicians and oligarchs (the demise of the opposition daily *Népszabadság* can likely be attributed to such reports). Another challenge that mostly overlaps with the first, but impacts Hungary's economy more directly, is the mass emigration of young Hungarians in particular. Once insignificant, the number of Hungarians leaving the country has increased considerably with nearly 400,000 persons estimated to have emigrated to other EU member states in 2016.

Hungary has become less competitive in comparison with other economies. While Hungary's fiscal situation and employment rate have improved, the education system is confronted with numerous unsolved problems that are likely to constrain the country's medium-term competitiveness.

The Orbán government's confrontational approach to mainstream EU developments and its close relationship with Russia have created tension in the transatlantic community. Prime Minister Orbán's statements about the “decline of the West” have only helped strain relations further. Although Hungary's position in the refugee crisis has to some extent intensified cooperation among the Visegrád States (V4) (primarily with Poland), Hungary's international position is very fragile.