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In October 2008 the main Hungarian public finance actors: the government, the National Bank of Hungary (MNB) and experts cited the high public debt and volume of unsecured foreign-currency loans as the main reasons for the economy's vulnerability. On the other hand according to the formal president of the MNB the first and foremost it was the inadequate level of foreign exchange reserves that made Hungary among the first to request outside assistance, in the form of international credit just after the Lehman bankruptcy.

That critical time the MNB was only partially able to fulfil its role as the 'lender of last resort', and the Treasury was not able at all to conduct an anti-cyclical keynesian fiscal policy due to the previous fiscal years when the government lost its international creditworthiness. Hungarian Treasury (NGM) in November 2011 – three years later than the previous package – requested again outside assistance, in the form of international credit or insurance from the Monetary Fund and European authorities. A rethinking of fiscal and monetary policy, and the comprehensive restructuring of the Hungarian economic-policy mix, are essential in the interests of avoiding the following stops and goes periods and of halting the social and economic disintegration of the country. Instead of good governance Hungary needs co-governance between the fiscal and monetary policy. The Fiscal Council might be a very useful institution to help and moderate this process with its new president. A Lucasian regime change is expected in the Hungarian economy.

Keywords: macroeconomic policy, macroeconomic aspects of public finance, fiscal policy, monetary policy

1. Introduction

What are the main criterias of an analyst concerning to the fiscal policy? The elected government has a discretional power to decide its prefences, and dispreferences. Gouverning politicians learn how to manipulate the fiscal policy not only to implement their programmes, but also use its benefits to ensure their re-elction.

This is just one side of the coin. The other side is there so many traps, disadventage to be a ruling authority. The responsibility refers also to make nonpopular decisions also. Successful program in terms of macroeconomic equilibrium very often is very painful socially. Luxembourg's Prime Minister Jean-Claude Juncker put it in a nutshell when he said: "We all know what to do, but we don't know how to get re-elected once we have done it".[1]

"Defining the state's role is a political decision. In practice, decisions are not made on the "aggregate" weight of the state: that tends rather to feature in political slogans only. But specific decisions may be taken on whether to increase or reduce the share of state-guaranteed pensions financed through the public pension scheme within the total income of the population in old age. Another example would be whether to increase or reduce the share of state-financed health care in total spending on health. These decisions have to be brought through a political process, in line with the constitution and legislation of

[1] http://www.europesworld.org/NewEnglish/Home_old/Article/tabid/191/ArticleType/ArticleView/ArticleID/20424/SweetandsourfruitsoftheVelvetRevolution.aspx

the country concerned and bearing in mind the traditions in its political process. Political decisions, if they are principled, rest on value judgments: individual liberty and freedom of choice, solidarity with other members of society, compassion for the disadvantaged in need of assistance, the right to welfare compensation for present efforts, or responsibility and sacrifice for the future. Politicians and citizens participating in the political process must choose a position in the conflict between such ultimate values." (Kornai, 2010, p. 250).

Hungary became a full member accepted the values of the European Union on 1st May 2004. Its membership has had a positive impact on the Hungarian economy and provided several competitive advantages for foreign companies setting up a permanent presence in the country. Despite all the advantages Hungary should adopt the euro as its official currency as soon as the economic crtierias are fulfilled.

The biggest contradictions of the policy framework built for the euro was that the Maastricht Treaty and the Stablity and Growth Pact concentrated mainly on the numerical aspects of fiscal policy. Macroeconomic policies cannot be assessed without taking into consideration the qualitative aspects of fiscal policy. A fiscal position in itself does not necessarily say anything about the sustainability of that policy. What must also be analysed is the nature – that is the quality – of the policy (Surányi, 2005).

The treaty and pact involved enormous political and economic risks which accumuluted simoultanously in the recent Hungarian ecomoic history. In addition to meeting the economic convergence criteria, a euro-area candidate country must make changes to national laws and rules, notably governing its national central bank and other monetary issues, in order to make them compatible with the Treaty. In particular, national central banks must be independent, such that the monetary policy decided by the European Central Bank is also independent.[2] In the European Union, some of the most important institutional checks on power are those exercised by the European Union and the broader international community, rather than within national level. The enforcement of democratic norms and economic inteerst are the most important functions that the European Union and other international institutes represent.

2. Political cycles corresponding to the election years

Despite many signs of the nonsustainability of the Hungarian budgetary process, none of the decisionmakers draw the final conclusion, they wanted to avoid facing the challenges. "The dominance of the political cycle over the economic cycle is evident in any time series data on government finances" (Kopits, 2007, p. 17). Following the political transition, Hungary had politically-driven, regular, four-year fiscal cycles until 2006. Election years invariably saw soaring fiscal deficits with a corresponding increase in public debt. The Hungarian macroeconomic data can be found in the Table 1-2.

"In the 2006 annual budget act, the ESA-95 general government deficit target was originally 6.1% of GDP (4.7% with pension funds inside the government sector). The original deficit target did not contain the cost of the Gripen purchase and assumed that the PPP schemes designed for motorway construction from 2006 onwards would comply with Eurostat rules. The upwards revision of the deficit target became inevitable partly due to methodological and accounting changes and partly

[2] http://ec.europa.eu/economy_finance/euro/adoption/who_can_join/index_en.htm

because of the developments in public finances in the first half-year” (Convergence Report, 2006, p. 17).

1. The Eurostat decision concerning the accounting treatment of defence purchases and the incorporation of motorway construction projects into the scope of the budget to improve transparency resulted in an expenditure increase corresponding to approx. 1.5 % of GDP in aggregate.
2. Over and above methodological changes, some non-recurring factors (flood protection expenditures, cancellation of the Iraqi debt, temporary increase of the deficit of municipalities, etc.) as well as some estimated overspending (interest, pension and health care expenditures, household gas price compensation, expenditures of central budgetary organisations, etc.) also pointed to a potential increase in the deficit.

Therefore, in June 2006, short after the general eceltions the government decided to introduce immediate measures to improve the balance.

It is correct to add that, the general government expenditures were increased in 2006 by sizable one-off items (accounting of the Gripen purchase, cancellation of the Iraqi debt, additional flood protection expenditures, one-off costs relating to staff cuts in the public sector, one-off expenditures relating to MÁV. Therefore, the structural deficit was considerably below the cyclically adjusted deficit in those years (Convergence Report, 2007).

By the summer of 2006 it was obvious that without a sharp and deep intervention into public finances the budget deficit could reach 11% by the end of the year. It was a sobering recognition.

“The budgetary policy between 2000 and 2006 attempted to stimulate growth with a high averaging 7-8% of GDP budget deficit, and real-earnings increases that were double the rate of productivity growth. In contrast to this, monetary policy, with forint interest rates that remained unjustifiably high for many years contributed to stimulating domestic demand for foreign currency loans, while at the same time the shoring-up of the exchange rate acted as a brake on growth and deteriorated the external balance” (Surányi, 2010, p. 24)

In the period of rapid adjustment, the expenditure cuts and the increase of revenues had been implemented simultaneously. A lasting budgetary equilibrium could be achieved only by the structural reform of the expenditure side, but rapid stabilisation also required the increase of tax and contribution revenues at 2006. Apart from stronger budget discipline, several measures promoted the reduction in the expenditures to GDP ratio. Possibilities were very limited. Hungary was paying a high price for the erroneous and wholly unsustainable fiscal and monetary policies followed between 2001 and 2008. It is primarily the fiscal and incomes policies that should be blamed for the abortive economic policies of the past period, because they were not able to accumulate reserves to counterbalance any possible external shock – reserves that would have enabled fiscal policy to operate anti-cyclically.

“The fiscal consolidation, although successful in quantitative terms, did not lead to economic growth, higher employment or the conditions for a better standard of living, and hardly improved the low growth potential of the Hungarian economy. With a degree of bluntness, one could say that the emergency operation was a success, but it remains uncertain whether the patient will live to see tomorrow or the day after” (Surányi, 2010, p. 23). As a result of the economic policy pursued by Hungary between 2007-2010 the country has been among the most disciplined countries as regards its budget policy is concerned. Leading economic experts (Alesina and Perotti, 1995) list three conditions to be satisfied on the basis of OECD country experiences for successful consolidation:

1. Instead of increasing taxes the emphasis should be put on the expenditure side.
2. The size of administrative spending and the number of state employees should be cut
3. The social welfare system has to be redesigned.

Fiscal consolidation had two waves, the first came from internal pressure and the second due to international conditions. The two financial adjustment programs together satisfied the three conditions of a theoretically successful fiscal consolidation. In an effort to correct worrisome trends in fiscal policy an increasing number of countries introduced a rules-based fiscal responsibility framework. Hungary was on the verge of financial bankruptcy in 2006 and in 2008.

The unpredictability of fiscal policy, which had previously made it impossible to coordinate fiscal and monetary policy, was eliminated. In the light of the antecedents, this was perhaps the most important change to the substance of government policy. Besides the quantitative fiscal correction, therefore, another commendable change was the strengthening of fiscal discipline, which led to greater predictability and less uncertainty. In contrast to this, the economic mix of the post-2006 correction, the interaction between budgetary and monetary policy, continued to be typified by a lack of mutual trust and coordination. This monetary policy focused on a one-sided and immediate anchoring of inflation and inflationary expectations at around the level of price stability (Chart 1), and, as an incidental objective, on restoring the short-term credibility of the Central Bank. After the agreement was concluded with the IMF, it was no longer so much the technical limitation that prevented the MNB from being active and courageous, innovative and prepared to make wide use of unconventional means and react with the appropriate degree of flexibility, but rather its inability to step out of its own shadow. First and foremost, a fundamental change of principles and approach was needed, similar to the one that has taken place widely around the world as a result of the crisis. Secondly, rather than redefining the opportunities available to it, the central bank highly controversially chose the unilateral tightening of budgetary policy as the way out of what was at the time still primarily a liquidity crisis. In other words, despite an awareness of the substantial expansion in liquidity in the offing from the international financial institutions, there was no fundamental rethinking of the monetary-policy frameworks. Instead, the central bank urged fiscal austerity, leading to a further escalation of the already severe impacts of the crisis (Surányi, 2010).

Table 1: Hungary: Main Economic Indicators

Subject Descriptor	Units	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
General government revenue	National currency billions	5 863,55	6 614,47	7 292,22	7 957,47	8 818,71	9 297,60	10 132,88	11 386,91	12 085,84	12 005,81	12 095,17
General government revenue	Percent of GDP	43,88	43,231	42,339	42,26	42,371	42,318	42,701	44,969	45,174	46,08	44,599
General government total expenditure	National currency billions	6 426,87	7 200,32	8 794,75	9 299,90	10 139,44	11 018,44	12 350,17	12 655,97	13 061,74	13 167,64	13 248,07
General government total expenditure	Percent of GDP	48,095	47,06	51,063	49,39	48,717	50,15	52,044	49,981	48,822	50,539	48,85
General government net lending/borrowing	National currency billions	-563,32	-585,842	-1 502,53	-1 342,44	-1 320,74	-1 720,84	-2 217,30	-1 269,06	-975,904	-1 161,83	-1 152,90
General government net lending/borrowing	Percent of GDP	-4,216	-3,829	-8,724	-7,129	-6,346	-7,832	-9,344	-5,012	-3,648	-4,459	-4,251
General government structural balance	National currency billions	-375,72	-621,452	-1 466,45	-1 333,98	-1 405,79	-1 964,60	-2 388,44	-1 390,91	-1 323,61	-779,531	-1 098,34
General government structural balance	Percent of potential GDP	-2,762	-3,996	-8,431	-7,063	-6,836	-9,116	-10,442	-5,677	-5,125	-2,883	-3,925
General government gross debt	National currency billions	7 290,00	7 942,95	9 539,99	10 963,72	12 283,13	13 582,51	15 592,50	16 732,81	19 346,85	20 422,40	21 749,42
General government gross debt	Percent of GDP	54,555	51,914	55,39	58,226	59,017	61,821	65,708	66,082	72,314	78,384	80,197
GDP corresponding to fiscal year, current prices	National currency billions	13 362,78	15 300,17	17 223,38	18 829,63	20 812,86	21 970,78	23 730,04	25 321,48	26 753,91	26 054,33	27 119,83
Current account balance	U.S. dollars billions	-4,01	-3,204	-4,642	-6,702	-8,589	-8,358	-8,578	-9,546	-11,441	0,463	2,696
Current account balance	Percent of GDP	-8,463	-5,996	-6,947	-7,98	-8,363	-7,593	-7,605	-6,923	-7,36	0,36	2,067

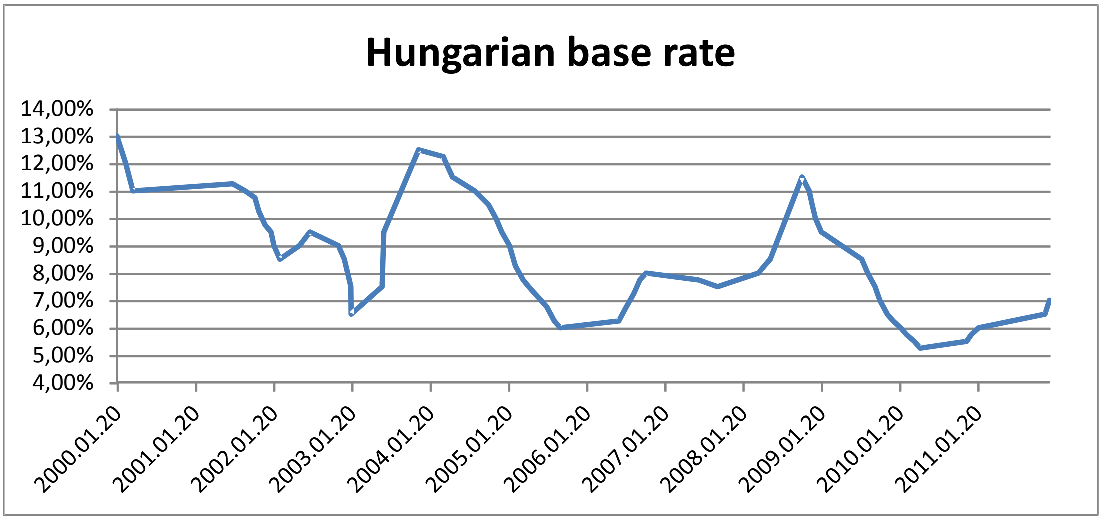
Source: International Monetary Fund, World Economic Outlook Database, September 2011 (www.imf.org)

Table 2: Rating history of the Republic's long-term debt

	Moody's			Standard & Poor's				FITCH Ratings			
	Foreign currency debt	Domestic currency debt	Outlook	Foreign currency debt	Outlook	Domestic currency debt	Outlook	Foreign currency debt	Outlook	Domestic currency debt	Outlook
2008.03.17	A2	A2	stable	BBB+	**negative**	BBB+	**negative**	BBB+	stable	A-	stable
2008.10.17	A2	A2	stable	BBB+	negative	BBB+	negative	BBB+	**negative**	A-	**negative**
2008.11.07	**A3**	**A3**	**negative**	BBB+	negative	BBB+	negative	BBB+	negative	A-	negative
2008.11.10	A3	A3	negative	BBB+	negative	BBB+	negative	**BBB**	**stable**	**BBB+**	**stable**
2008.11.17	A3	A3	negative	**BBB**	**negative**	**BBB**	**negative**	BBB	stable	BBB+	stable
2009.03.02	A3	A3	negative	BBB	negative	BBB	negative	BBB	**negative**	BBB+	**negative**
2009.03.30	A3	A3	negative	**BBB-**	negative	**BBB-**	negative	BBB	negative	BBB+	negative
2009.03.31	**Baa1**	**Baa1**	negative	BBB-	negative	BBB-	negative	BBB	negative	BBB+	negative
2009.10.02	Baa1	Baa1	negative	BBB-	**stable**	BBB-	**stable**	BBB	negative	BBB+	negative
2010.07.23	Baa1	Baa1	negative	BBB-	**negative**	BBB-	**negative**	BBB	negative	BBB+	negative
2010.12.06	**Baa3**	**Baa3**	negative	BBB-	negative	BBB-	negative	BBB	negative	BBB+	negative
2010.12.23	Baa3	Baa3	negative	BBB-	negative	BBB-	negative	**BBB-**	negative	**BBB**	negative
2011.06.06	Baa3	Baa3	negative	BBB-	negative	BBB-	negative	BBB-	**stable**	BBB	**stable**
2011.11.11	Baa3	Baa3	negative	BBB-	negative	BBB-	negative	BBB-	**negative**	BBB	**negative**
2011.11.24	**Ba1**	**Ba1**	negative	BBB-	negative	BBB-	negative	BBB-	negative	BBB	negative
2011.12.21	Ba1	Ba1	negative	**BB+**	negative	**BB+**	negative	BBB-	negative	BBB	negative
2012.01.06	Ba1	Ba1	negative	BB+	negative	BB+	negative	**BB+**	negative	**BBB-**	negative

Source: Government Debt Management Agency Private Company Limited by Shares (ÁKK Zrt.)

Chart 1: Hungarian base rate in %



Source: MNB

3. The rise and fall of the Hungarian Fiscal Council, and Fiscal Council 2.0

Hungary was hit harder by the liquidity crisis, and had to make use of outside assistance because of the very high (1) public debt, and (2) volume of unsecured foreign-currency loans. A successful economic-policy response to the crisis would demand the effective management of its underlying causes. And if this crisis management is successful, the primary factors precipitating the crisis should improve substantively: the public debt and the volume of foreign-currency loans should decrease (Surányi 2010).

The time to maturity of the loans from the International Monetary Fund is 5 years. Hungary will start paying back its loans drawn from the IMF after a 3-year grace period. Therefore, the first tranche of the IMF loans, which was drawn down in November 2008, has to be paid back from Q1 2012 in 8 quarterly installments. The tranches of the loan from the European Commission have one single repayment date each. The redemption profile of the IMF and the European Commission loans is in the Table 3.

Table 3: Rating history of the Republic's long-term deb million currency

	IMF			European Comission		Total
Date	**XDR**	**EUR eqv.**	**HUF**	**EUR**	**HUF**	**EUR**
Q4 2011				2	537,4	2
Q1 2012	527	614	151,556			614
Q2 2012	790	906	227,333			906
Q3 2012	790	906	227,333			906
Q4 2012	797	913	229,131			913
Q1 2013	797	913	229,131			913
Q2 2013	797	913	229,131			913
Q3 2013	797	913	229,131			913
Q4 2013	797	913	229,131			913
Q1 2014	270	299	77,576			299
Q2 2014	6	7	1,798			7
Q3 2014	6	7	1,798			7
Q4 2014				2	537,4	2
Q2 2016				1,5	403,05	1,5
Total:	**6,373**	**7,302**	**1,833,050**	**5,5**	**1,477,850**	**12,802**

Source: Government Debt Management Agency Private Company Limited by Shares (ÁKK Zrt.)

The deep global recession has focused attention on the need for counter-cyclical fiscal policy. The fiscal stimulus requires a careful evaluation of fiscal space and available financing (Kandil et al., 2010, p. 3). The half of the large increase in budget deficits in major economies around the world is due to collapsing tax revenues and to low (often negative) growth. Less than ten percent is due to increased discretionary public expenditure, as in stimulus packages (Galbraith, 2010, p. 2).

Due to the financial crisis, when the Hungarian authorities faced with a critical situation and "To put fiscal sustainability on a permanent footing, we have already submitted to parliament a draft fiscal responsibility law, which establishes fiscal rules on public debt and primary deficit, strengthens the medium-term expenditure framework (rolling three-year expenditure ceilings) and creates a fiscal council to provide independent and expert scrutiny" (IMF, 2008, p. 5).

The Hungarian government got rid of the Fiscal Council. Jozsef Varga member of Parliament proposed in an amendment to the 2011 budget draft to cut the Fiscal Council's budget to 10 million forints, more than 80 times, from the formal 835.5 million forints. Mr. Varga, who is the chairman of the Public Foundation for the Roma living in Hungary, proposed to channel the difference to the Roma foundation he leads. "It's necessary and timely to rethink the role of the Fiscal Council".[3]

The new Constitution includes the fundamental provisions with regard to the Magyar Nemzeti Bank, the State Audit Office and uniquely to the Fiscal Council.

[3] http://blogs.wsj.com/emergingeurope/2010/11/22/hungary-to-disband-fiscal-council/

According to the new Constitution, the members of the Fiscal Council are the President of Magyar Nemzeti Bank and the President of the State Audit Office and its president appointed by the President of the Republic. In light of the new regulation, the Fiscal Council supports the legislative work of the Parliament and inspects the well founded nature of the budget, furthermore delivers its opinion on any proposal with financial impact or affecting the financial system. In addition, the new Constitution gives a special right to the Fiscal Council. The adoption of the budget is subject to the preliminary admission of the Fiscal Council, without which the Parliament cannot adopt the act. Detailed rules on tasks and operation of the Fiscal Council are included in the bill no. T/5130 on the financial stability of Hungary.

According to the Bill (T/5130) on the financial stability of Hungary, the detailed rules on the Fiscal Council will ensure the high quality of economic governance. The Fiscal Council will examine the fulfilment of the debt reduction rule on a quarterly basis and will be empowered with a right to veto with respect to any legislative proposal affecting the budget law.

„The new Constitution contains several very strict regulations to ensure responsible financial management. For example, the NationalAssembly must not adopt a budget that would result in government debt above one half of the gross domestic product. Moreover, while government debt exceeds this value, the National Assembly may only adopt budgets that provide for the reduction of government debt. Deviation from these rules is allowed only in very exceptional cases, which clearly shows that debt reduction has become the highest priority of economic policy in Hungary" (Domokos, 2011, p. 5).

„The questionable relevance of institutions is brought home by the controversy over Hungary's new constitution, which went into effect on 1 January 2012 and inserting a series of provisions to weaken legislative control over the budget" (Fukuyama, 2012).

On 10 January 2012,the President of Hungary, appointed Dr. Árpád Kovács as Head of the Fiscal Council after Dr. Zsigmond Járai had resigned from this post. Dr. Árpád Kovács is former President of the State Audit Office of Hungary and current President of the Hungarian Economic Association. He is also a professor of finance.

4. Conclusion

A strict observance of the convergence programs submitted to the European Commission. Although the Stability and Growth Pact applies to Hungary, financial sanctions are in principle levied for noncompliance only in the euro area. Hungary imposed additional policy rules from 2006 at the as part of convergence programs. How to adopt a fiscal and monetary good governance? A rethinking of fiscal and monetary policy, and the comprehensive restructuring of the Hungarian economic-policy mix, are essential. "Carefully planned communication, transparency and the clear direction towards sustainability may have a favourable impact on the mood and decisions of international investors" (Török, 2010, p. 750).

The current Hungarian crisis is not just a debt and financial crisis, but a governance crisis as well. The response of Hungarian policymakers has been inadequate and badly communicated and they might have lost trust in their own ability to resolve the crisis. While the institutional background is solid of Hungarian economic policy it has deep-rooted problems. The pre-crisis efforts were insufficient to solve the non-sustainable imbalances in the economy. The crisis highlighted the fundamental mistakes, but the worries are still at large about Hungary. Instead of a downward spiral or a vicious circle I think there are parallel processes. I want to put an emphasis on that the fiscal adjustment doesn't lead to a weak economy and lower public revenues which end additional needs in the term of fiscal adjustments. The root of the problems is that the Hungarian decision makers don't prefer to seek of the synergy. This is not just Hungary's fatal problem. There is a strong interdependence between countries, the fall of Hungary can create contagion in the euro-area which might lead to a financial global meltdown.

That is the main reason why Hungarian fiscal performance and achievement of transparency have recently been in the focus of increased international attention by the EU authorities, the international markets and credit rating agencies.

“If the political will exists to do something even in a system with a lot of veto players, it will happen; conversely, bad actors can undo even the best-designed institutions. Maybe institutions don’t matter, after all” (Fukuyama, 2012). The problem is more severe if the euro framework is not well designed.

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