

# Fiscal problems after democratic changes

## The Hungarian Experience

4th Annual meeting of OECD-MENA Senior Budget Officials  
Beirut, 21-22 September, 2011 | Balázs Romhányi

FISCAL RESPONSIBILITY INSTITUTE BUDAPEST



# Structure of the presentation

- Characterization of the old regime
- Dimensions of changes around 1990
- Immediate problems
  - fiscal
  - institutional
  - political economic
- Long term problems
  - fiscal
  - institutional
  - political economic
- Some lessons



# Characterization of the old regime

- Single party system without free elections
- Plan economy
  - State owned enterprises more than 90%
  - Full employment („in door unemployment”)
  - Central planning, regulated prices, no competition
  - Import control
  - Relatively large welfare state
- External relations biased towards the E-block
- Economic and cultural elite linked to the party



# Dimensions of changes around 1990

- Political system: Multi party system with free elections
- Economic system: Market economy
- External relations: Opening to the world economy
- Social structure : Partly new political, economic and cultural elite



# Immediate fiscal problems

- Rigid companies without sufficient capital and state subsidy go bankrupt
- Quasi fiscal activities (e.g. price subsidies) of many state owned companies fall explicitly on the budget
- Contraction of the economy implies sharp drop in the tax revenues



# Immediate institutional problems

- Lack of reliable information about the status of the economy
  - Deliberate misreporting under the previous regime („skeletons”)
  - Partial collapse of the statistical system
- Lack of experience in the new elite about economic policy in practice
- Almost no political interest in the institutional setting of fiscal policy (a lost opportunity)



# Immediate political economic problems

- Large part of the human capital became suddenly obsolete: large groups became losers of the changes
- Losers had to be (?) pacified so as not to jeopardize the reforms: extra spending



# Long term fiscal problems

- Large informal economy
- Inefficient state owned companies with regular state subsidy survive
- Sheltered from market pressures the inefficient state bureaucracy survives
- A great abnormal pensioner boom (early and disability pensions, sick pay, etc.)





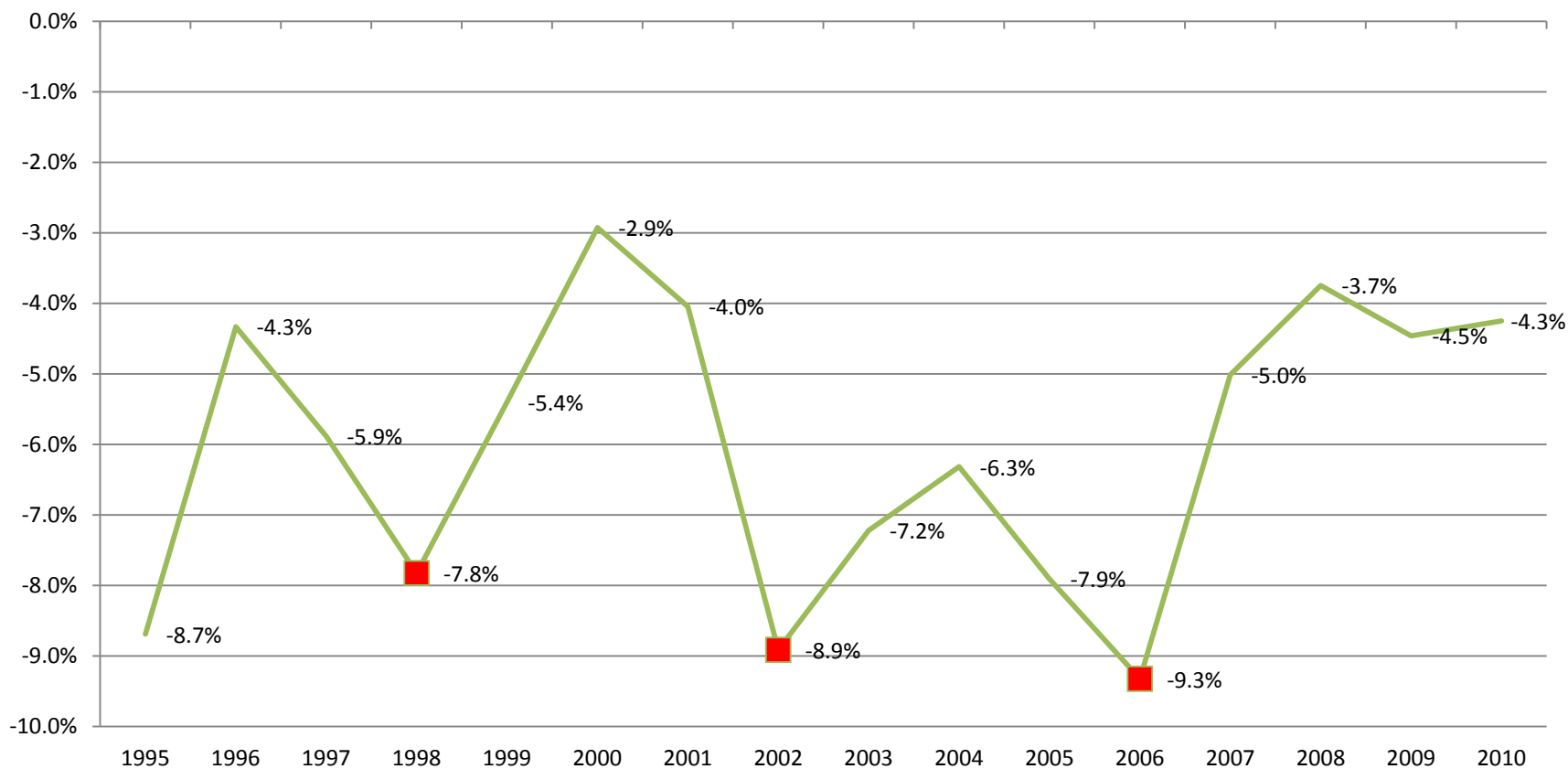
# Long term institutional problems

- Fiscal alcoholism, lack of government self-control
- Strong political budget cycles



# Political budget cycles in Hungary

Deficit / GDP



# Electoral dismissals in CEE

Electoral dismissals						
Country	Elections 1989–2004	'Electoral dismissals'	Year(s) of dismissal(s)			
Czech Republic	5	3	1990	1992	1998	
Estonia	5	4	1990	1995	1999	2003
Hungary	4	4	1990	1994	1998	2002
Latvia	5	4	1990	1995	1998	2002
Lithuania	5	4	1990	1993	1996	2000
Poland	4	4	1991	1993	1997	2001
Slovakia	5	4	1990	1992	1994	1998
Slovenia	5	3	1990	1993	2004	
CEE 8	38	30				



# Long term political economic problems

- Social preferences
  - Tax evasion, but
  - Excessive reliance on the state
  - Low participation in the labour market
- Lack of experience of the electorate
- Lack of budget honesty mutually reinforced by political budget cycles



# Some lessons

- If losers of the changes have to be pacified, it is vital to avoid long term traps
- If the electorate is pro-state, high tax - high spending states is the likely outcome → rules to limit expenditure growth
- Prevention of political budget cycles by fiscal rules and independent fiscal institutions is feasible before the cement dries



# Some references

- **Alberto Alesina and Nicola Fuchs-Schündeln**  
Good-Bye Lenin (or Not?): The Effect of Communism on People's Preferences  
AER, 2007, pp 1507-1528
- **János Kornai**  
The great transformation of Central Eastern Europe  
Economics of Transition, 2006, pp 207-244
- **Pieter Vanhuysse**  
Divide and Pacify: Strategic Social Policies and Political Protests in Post-Communist Democracies  
Central European University Press, 2006



Thank you!

