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Introduction

The Dear Reader is holding the **issue No. 71 of the Central European Political Science Review** (CEPSR – CEPoliti Review) in their hands. We launched this review in September, 2000. Everyone was surprised by the great interest, thus we continued with four annual issues, and has been continually publishing ever since. Now we are editing the **Vol. 19. No. 71 of CEPSR.**

By today, the **Central European Political Science Review** has not only become the only social scientific review of Central Europe, but because of its integrative power and great professional prestige, we can proudly say it fulfills a bridge role, since it not only informs, but also has orienting and value transmitting roles among the intellectuals of the region.

The **CEPSR** has been informing the curious Readers of the most important scientific results, political events, programs and books of the region for 19 years. Its success is shown in the fact that it is ordered from four continents, partially by libraries, and partially by private subscribers.

In the **No. 71 of the Central European Political Science Review** we publish studies of illustrious social scientists, György Matolcsy, who is the "father of un-orthodox economy". He is not only one of the best "neo-Keynesian" theoretical economist of the 21st century, who founded a school while simultaneously he is a practical expert of the field and proved as a politician as well that his theory works excellently in the practice.

The main topic of this issue is: NATIONAL IDENTITY AND THE EU. The so-called indigenous minority (KIM minority) question is one of the most problematic issues of the European Union, which they haven't paid enough attention so far. This is why we regard as very important the study of Catalan author Mercé Corretja, in which she shares with us the exciting dilemma about where are the boundaries of the sovereignty of the European integration regarding the minorities.

The **Central European Political Science Review** is a refereed academic journal that publishes theoretical, policy, and empirical research articles on Central European countries across the whole spectrum of political science, history, social science, environment protection, and culture, all with emphasis on Central European politics, public policy, political culture and foreign policy in comparative perspectives. However, **CEPoliti Review** (CEPSR) also welcomes manuscripts on different aspects of contemporary social development, when these relate closely to Central European politics, political economy, political culture, reform and opening, development, the military, law and legal system, foreign relations, and other important issues of political significance.

The editors of **Central European Political Science Review** welcome articles, conference reports and book reviews for publication, which focus on Central Europe or has a message for this region. The contact person is the assistant of editor: Dr. Borbála Kossuth: kossuth.borbala@gmail.com

János Simon
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György Matolcsy

Economic Success on a Historic Scale in Hungary Eight Years and Twelve Steps

Introduction

Hungary has accomplished twelve game-changing historical economic leaps since 2010. One could say that twelve steps were required to return from the side of the pitch and get back onto the playing field. The thirteenth step, which was required to permanently maintain economic convergence is under way, namely the field of competitiveness; an area where a lot of work still needs to be done. There are well thought over, profound reforms behind the changes so far. Hungary has utilized and applied both orthodox and unorthodox economic tools. We initiated changes which have slotted into each other like cogwheels do.

If a change occurred at one cogwheel it set other cogwheels into motion as well, resulting in changes elsewhere. Essentially this renewed economic policy is the secret behind Hungary's success.

Stabilization and growth

Nowadays it is evident both in Hungary and in the globalized world that historical leaps in economics cannot be achieved without structural reforms. Since 2010, this logic has been well and truly prevailing in Hungary. Taking a global view of the two electoral cycles starting in 2010 and coming to a close this year, we can already state that the last eight years were successful thanks to these reforms. Our crisis management was successful, and we successfully returned to the pathway of economic convergence.

As a result of failed economic policies during the first decade of the 21st century, by the time of the global financial crisis our country went from a regional leader to the back of the pack; but since 2010 we have fought ourselves back into the middle of the field. In order to achieve this, we needed extraordinary results in certain fields. For example, in employment, in balancing external debts and the government budget, Hungary has displayed improvements that rank it in the top three in Europe.

One of the most important characteristics of these nearly eight years of reforms is that they were not separate measures, but instead were an intensively executed set of moves based upon an extremely conscious economic policy. The most important structural reforms were implemented within the first two-three years of the post-2010 government cycle. It is extremely rare for a reform program to successfully implement economic stabilization and initiate economic growth simultaneously.

Hungarian reforms were capable of achieving this because they followed a logical order. First it was the key move in handling the budget, followed by a sharp turn in monetary policy which was built on this, along with initiating a simultaneous step to raise competitiveness.

Tax reforms

The twelve major economic changes started when the tax reform was first introduced, with the dual aim of balancing the budget and creating jobs, thus stimulating economic growth. Though according to traditional or orthodox economic theories it is impossible, Hungary succeeded in making it possible, because the tax reform (along with the structural reforms of the Széll Kálmán plans) placed the focus on improving employment. Without the profound changes made in the tax system between 2010 and 2013 none of the other positive economic turns would have eventuated. Hungary executed a row of conscious reforms shifting the system built on income taxes into one focused on consumption and value added taxes, along with maintaining the egalitarian principle and the tool of equal distribution of taxes, incorporating fields with significant income-producing capabilities into helping finance the tax system's reform.

The current tax system of course, cannot be regarded as complete. If budget leeway allows for it, then further stimulation of employment supply needs to be executed, for example with the introduction of a one-digit personal income tax that still has further support of families as its goal. At the same time what has been done so far with the transformation of the Hungarian tax system is already a success in its own right.

Within the tax system the greatest reform was made in the income tax system, which can be regarded as a new phase in itself. I must admit my partiality on this issue, since from the beginning I was in favor of introducing a flat tax income system, especially complemented with key elements supporting Hungarian families, because it encourages people to work harder, perform better and keep on learning. Due to these changes a motivational shift was also successfully initiated and implemented in the Hungarian economy. Once again it is worth working, worth being employed and earning money legally. I myself see this as one of the most important transformations.

Tax reforms supporting employment and labor, played a key role in achieving one of the greatest results – the turn in the job market. It is just amazing what Hungary has accomplished in this field. Since 2010, Hungary has achieved the second largest employment growth within the European Union. While in 2010 Hungary had the lowest employment-rate level among EU member states, by now we have reached the Union's average level while our unemployment-rate is among the five best performing countries.

This phenomenon alone demonstrates – in contrast with the experience of previous periods – that Hungary was capable of achieving economic stabilization and growth without austerity measures. Without exception, all countries that attempted to handle the global financial crisis of 2007-2009 and its aftermaths by applying austerity measures had to face a sharp decline in employment and a rise in unemployment. This is because austerity measures first and foremost take their tolls on the labor market. In contrast with this, since 2010 the number of people in employment has grown by 700.000, consequently Hungary followed its own unique path, which made an unparalleled turn in the field of job creation.

Fourthly by transforming the tax system, introducing structural reforms and a responsible and conscious handling of the budget we completed the transformation in public spending as well. Hungary was the only member country in the European Union which from its entry in 2004 was constantly subject to the so-called excessive deficit procedures (EDP) due to high budget deficits. Resulting from the turn in the budget, the deficit was reduced without employing austerity measures and the state budget became sustainable.

Recognizing this valid change, the European Union abrogated the EDP against Hungary. Since 2013 budget deficit is constantly under 3% of the GDP in Hungary now hovering around a 2% deficit. This also means that within the EU member countries the balance of the budget compared to levels before the global financial crisis improved the most in Hungary.

Decreasing debt ratio

Being the fifth turning point and clearly deriving from stabilizing the budget is that the levels of Hungary's state debt and also the ratio of foreign currencies within that turned on a continuously decreasing course. In 2008 international investors rated Hungary so risky that our country was among the first states coerced to borrow money from the International Monetary Fund and the European Commission. Since 2011, however, debt ratio is constantly decreasing, which is unique and also outstanding within the European Union. Regarding the extent of these improvements Hungary is among the top five member states.

Regaining credibility and trust in the eyes of investors is clearly demonstrated by the fact that since 2010 the Hungarian state is able to completely finance itself from the markets. Also thanks to the Hungarian National Bank's Self-financing Program, the financial basis is more and more reliant on domestic Forint sources. As a result, foreign currency ratio in government debt and debt ratio retained by foreign investors have both significantly decreased, contributing to the fact that regarding net external public debt, Hungary has enjoyed the second greatest decrease in the European Union.

These were the results on which we could built the monetary change starting from March 2013. This enabled the Hungarian National Bank to reduce the base interest rate to its historic low with maintaining primary attention to inflation. The cut in the base rate had a decisive role to play in significantly and constantly decreasing inter-bank rates and government bond yields, which in 2017 resulted in a 600 billion Forint reduction in the burden for the Hungarian government. The cumulated positive effect of the monetary change is about 1600 billion Forints.

In accordance with its mandate, the Hungarian National Bank did not only support price stabilization but also the strengthening of overall financial stability and boosting economic growth. Actions of the central bank – through savings on the lower interest rates and economic stimulus – helped sustain the results of the reforms of the budget too, preserving lowered taxes and making room for certain measures improving competitiveness.

Avoiding the dry-up of credit

Among the twelve historical economic changes the eighth, achieving the turn in financing was one of the hardest to achieve. In 2013 when I first met the president of the European Central Bank as president of the Hungarian National Bank, he greeted me by saying: "We know that crediting has effectively stopped in Hungary." Of course we were well aware of that, the thing we did not know was how close Frankfurt was watching us.

In our profession the so-called drying up of credit is among the most insidious phenomena. In such circumstances even companies with favorable prospects and great potential do not receive credit, excepting maybe a few huge enterprises. In Hungary the result was: several hundred thousands of small and medium sized enterprises were left without financial resources/capital, while outstanding company credit sunk by 5% annually. Had we not changed this situation, we would not have been able to sustain the changes made in the other segments of our economic policy.

In order to avoid the drying up of credit we introduced a growth credit program in 2013 which gave some 40.000 micro, small and medium-sized enterprises (SME) a total of 2800 billion Forints in discounted credit. The growth credit program came up to its calling and ignited lending, so now we can calculate with an annual 5-10% rise in the credits – borrowed from the market – held by SMEs. This is one of the most important prerequisites to the convergence of the Hungarian economy, since without investment and credit there is no economic development, and that is why this element is so important.

The ninth turning point came about when – with the help of the Hungarian National Bank –foreign currency-based loans (held by a vast number of Hungarian individuals) were successfully exchanged for Forint loans; foreign currency mortgages represented one of the biggest threats to our economy and society. This iceberg was successfully melted by a row of measures running parallel with reckoning with unilateral interest-rate increases, which resulted in a 1000 billion decrease in the debt held by households, translating to a 25% decrease in their monthly payments. The government, the Hungarian Banking Association and the Hungarian National Bank concurred in swapping these mortgages into Forint loans as soon as possible. This was a rather valuable decision, justified only two months later – following the unexpected decision of the Swiss National Bank – by the rapid strengthening of the Swiss franc.

It is important to note that the Hungarian National Bank carried out its monetary political change while it had narrowed its own balance sheet. In the last couple of years, the most important central banks of the world were usually capable of stopping the financial crisis only by inflating their own balance sheets. In Hungary the opposite had taken place, and so this was the tenth profound change.

All reforms mentioned above played a role in one of the most important and extremely valuable success, the ignition of economic growth, which was the eleventh turning point. After the new government took office in 2010, it quickly became obvious that we were capable of managing the crisis. This was also true for other countries as well (albeit maybe from a better starting position), but it was only achieved by sacrificing their growth to a great extent.

We did not have this luxury. Besides economic stabilization, we also had to boost economic growth. Though the growth in 2011 was followed by a temporary decline in 2012 due to several factors, from 2013 onwards Hungary's economy has been growing dynamically. On average a growth of 3 percent between 2013 and 2016, while our estimate suggests that from 2017 to 2020 it will exceed that.

Maintaining economic growth is crucial to convergence, which is the twelfth change. Since 2013 the growth rate of the Hungarian economy has been exceeding the European Union's average, but this scale is not enough for us to reach the average development levels of the European Union in the foreseeable future. The key to maintaining the changes made and results achieved – the twelve turning points – so far is succeeding with the thirteenth turn, completing a reform in competitiveness.

Final remarks - Hungary's place is among the leaders

We are only at the beginning of this process, but we have already achieved several results. This is why we shouldn't listen to those siren voices who are telling us that our competitiveness has decreased. Those who are stating this frequently rely on surveys, which heavily fluctuate every year, and are often subjective.

Based on competitiveness rankings that predominantly use objective indicators Hungary typically performs better – yet we cannot be satisfied with this. We also have to be among the very best in increasing competitiveness in order to realize our plan of successful convergence.

The Hungarian National Bank has recently published its own Competitiveness Report for the first time. Not every country publishes one like this: less than half of the EU members release a similar document. More than 90% of the analyses of the Hungarian National Bank is based upon facts. It includes all the data – meaning facts of the Hungarian economy – which in our view is a part of measuring competitiveness. It integrates into the overall work aimed to increase our competitiveness, on which the Hungarian National Bank has been working intensively in recent years at the request of the Hungarian Prime Minister Viktor Orbán.

The fruit of this work includes the volume containing the Hungarian National Bank's competitiveness proposals, entitled "Competitiveness and Growth".

If Hungary will be able to complete the necessary competitiveness reforms – continuously, step by step – along with the twelve fundamental changes, we will get into a leading position in more and more areas.

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