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BUDGETING IN HUNGARY DURING THE DEMOCRATIC TRANSITION

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ABSTRACT. The transition to democracy and a free market economy in Hungary and other Central European nations has provided a unique opportunity to study rapid change in budget systems, institutions, and policies. This article examines budgeting in Hungary since 1989, beginning with an analysis of the comparative budgeting literature in an attempt to identify an appropriate theoretical framework for the study. Then it explores budgetary definition and measurement problems, debt and economic conditions, external actors and constraints on the budget, budget institutions and process, and the impact of Parliament on the budget and concludes by assessing the problems and prospects for Hungarian budgeting.

INTRODUCTION

Budget reform has been one of the most difficult challenges for the nations of Central and Eastern Europe (CEE) since the dramatic political changes which took place in 1989. They have had to adapt radical new budget policies while reinventing budgetary institutions to facilitate both economic restructuring and democratization. The challenges are enormous: maintaining fiscal balances while preserving essential services, privatizing state-owned industries, allowing sufficient resources for defense for eventual NATO membership, and protecting domestic constituencies from the ravages of economic upheaval. This

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study is an overview and analysis of budgeting in Hungary since 1990: changes in budget policy, politics, and institutions and the forces that have shaped them.

Budgeting has increasingly been recognized in recent years in the United States and other industrial democracies as one of the most critical, integrative processes in governing. This may be even more true in the case of the nations of the former Eastern bloc in the rapid transition towards representative democracy and market capitalism. As a result, a collaborative research project on the Hungarian budget was organized by the authors in 1995 at the Budapest University of Economic Sciences. This article outlines our framework for analysis, suggesting key variables and relationships, presents an overview of the politics, processes, and policy changes, and makes some preliminary assessment of the problems and prospects for budgeting in Hungary. While this is a study of the developments in Hungary, we believe that the analytical issues involved are relevant to other CEE nations, and intend that this research not only provide the basis for a long-term analysis of the Hungarian budget, but contribute to comparative research on budgeting in other nations in the region.

Hungary was generally considered to be ahead of other CEE nations in terms of economic and political liberalization in 1989 (Swain, 1993), but has followed a more gradualist approach in the ensuing years (Mizsei, 1993). Significant economic reforms began as early as 1968, eliminating quantitative planning targets and making significant reforms in the pricing system. However, these reforms did not make major institutional changes or fundamental shifts in the management of taxing and spending. The budget remained largely an instrument for centralized allocation of resources particularly subsidies to firms and consumers. Revenues were raised mainly from taxation of firms and various turnover taxes, with virtually no taxes on individuals. Economic reforms implemented in the 1980s began to put in place some of the institutions necessary for a market system. After secret negotiations, Hungary joined the World Bank and International Monetary Fund (IMF) in 1982. The government permitted small-scale entrepreneurial activities in agriculture and other areas, creating a growing underground economy. The Companies Act in 1989 permitted the formation of stock companies and private ownership of shares.

Political liberalization increased in the 1980s as well, with the gradual creation of opposition political organizations that would form the basis of political parties which would contest the first free parliamentary elections in 1990. Changes occurred within the Communist Party (the Hungarian Socialist Workers Party - HSWP) as well, with a peaceful easing out of the old guard in 1988. During 1989, the Party negotiated away its monopoly powers with the opposition, accepting multiparty democracy, and declaring in May that the government would no longer be bound by HSWP declarations. In October, 1989, a new Hungarian Socialist Party (HSP) was formed, committed to social democracy, and on October 23, Hungary was declared a republic. No new constitution was adopted, rather, changes were made through amendments to the old constitution, new laws, and informal agreements. Roundtable negotiations created a presidency that would be elected by Parliament, codified a new electoral process, created a Constitutional Court, and established early 1990 as the date for free elections. The former communists were badly beaten in those elections and a new government was formed by a coalition of Christian/Nationalist parties dominated by the Hungarian Democratic Forum (HDF) but including the Smallholders Party and the Christian Democratic Peoples Party.

Hungary emerged from the political transition with a strong parliamentary system. The government was afforded stability by the requirement of a constructive vote of no confidence, along the lines of the German model, with a weak presidency. In 1994, the Socialist party made a remarkable political comeback, winning an absolute majority in parliament, providing an even stronger governing position. To enhance their legitimacy, they formed a coalition with the Free Democrats. Table 1 shows the percentage of seats won by the major parties in the two elections. Despite some initial advantages over regional neighbors, since 1990, both democratically-elected governments have faced daunting challenges in attempting to deal with a multitude of economic and budgetary problems including foreign debt, a proportionately large underground economy, privatization and reduction of subsidies to state-owned industries, high social security expenses, a large entrenched bureaucracy, and a public that is economically battered and disheartened. They faced these problems with an antiquated budgetary infrastructure and had to adopt not only

TABLE 1
Hungarian General Election results, 1990 and 1994
(Percentage of Seats)

Parties	1990	1994
Hungarian Socialist Party	8.9	53.8[a]
Hungarian Democratic Forum	42.0[a]	9.6
Smallholders (Independent Smallholders and Burgeoise Party)	11.0[a]	6.7
Christian Democratic People's Party	5.4[a]	5.7
Alliance of Free Democrats	24.0	18.0[a]
Alliance of Young Democrats	5.7	5.1
Agrarian Alliance	3.0	0[b]

[a] part of governing coalition.
[b] two seats
Source: World Bank (1995).

new policy approaches, but new institutions and processes for making those decisions.

FRAMEWORK FOR ANALYZING HUNGARIAN BUDGETING

Much of the research and scholarly literature on budgeting emanates from the United States, where in the 1960s "incrementalism" became the dominant theory of budgeting. Based on the work of Wildavsky (1964), Fenno (1965) and others, budget processes were seen as stable, predictable, changing little from year to year, based on well defined roles that could be represented by relatively simple decision rules. The growing comparative literature on budgeting was strongly influenced by this theory, with a number of studies finding incremental budgeting in other European democracies, international organizations, and other levels of government (Cowart, Hansen and Brofoss, 1975; Hoole, Job and Tucker, 1976). By the late 1970s and 1980s incrementalism was seriously challenged as a theory of budgeting (LeLoup, 1978) because of the narrowness of its analytical focus and changes in the environment and processes of budgeting. Given the magnitude of the changes in Hungary and other CEE nations since 1989, budgeting there is anything but incremental.

However, other works by Caiden and Wildavsky (1974), and Wildavsky (1986), developing a comparative theory of budgeting, hold more promise for providing some theoretical basis for examining budgeting in CEE nations. Some of their hypotheses about budgeting in poor countries are adaptable in part to the situation in CEE, even though their research did not deal explicitly with budgeting in communist countries, and nations like Hungary, Poland, and the Czech Republic are not "poor" or developing countries. Specifically, their work pointed to the relationships between wealth and predictability, between uncertainty and repetitive budgeting, and suggested the potential importance of political culture in comparing budget processes. Utilizing those variables to develop hypotheses applicable to this region, we would expect that, first, the rapid transition from command to market economy in itself would reduce predictability in budgeting and that short-term reductions in wealth would tend to increase uncertainty. Second, as uncertainty increases, repetitive budgeting - the need to frequently readdress and revise taxing and spending decisions - would also be likely to increase. Third, a political culture cultivated both among the mass public and elites under 45 years of communism with centralized resource allocation, artificially low prices, and few taxes on individuals, would make it more difficult to adapt new budgeting processes and policies, particularly in the short run. Straussman (1996: 93) also points to the importance of political culture in his review of ideals and reality in budgetary reform in CEE, noting that, “As the case of financing culture indicates, textbook-like prescriptions need to accommodate the realities of history, particularly more than four decades of experience with a command economy.”

A key development in budget theory in recent years has been the differentiation between microbudgeting and macrobudgeting and the inherent tension between them (LeLoup, 1988). Macrobudgetary decisions include choices on broad-based budget totals, the size of the public sector, deficits and debt, that are influenced by aggregate economic trends and external constraints. They represent more centralized, top-down processes and decisions made by high level officials. Microbudgetary decisions include lower level choices on programs, agency and ministry budgets, influenced by specialized interests and constituencies. Decision-making tends to be more fragmented and decentralized, more bottom-up, and focusing on middle- and lower-level officials and legislators. The tension between macrobudgeting and microbudgeting can be characterized as the war between the "whole" and the "parts" of a nation's budget, trying to balance allocative goals with fiscal discipline and responsibility. Allen Schick (1986) has shown the increasing prominence of macrobudgetary adaptation among industrial democracies since the 1980s in response to fiscal stress, high deficits, and other external factors.

The microbudgeting - macrobudgeting dichotomy should be particularly useful for explaining budgeting and Hungary and other CEE nations. The rapid economic and political changes have put tremendous pressures on both outlays and revenues and increased the normal tensions between budget claimants and conservers (Schick, 1988). The economic transition, we hypothesize, has led to an even greater emphasis on macrobudgeting and external constraints than in other nations. Not only do Hungary and her former communist neighbors face enhanced problems of fiscal imbalances and budgetary restructuring, but have an additional set of external constraints imposed by international actors such as IMF and the World Bank, by the goal of membership in the European Union and NATO, and in bilateral relationships with countries like the United States and Germany that establish conditions for receiving economic assistance. The extraordinary need to focus on broad taxing and spending aggregates places additional strains internally in adapting political institutions and processes to make budgetary decisions that can achieve these macro-level objectives while maintaining legitimacy and satisfying domestic constituencies and their needs.

Both budgetary and political institutions should be important in explaining budget outcomes. Outdated budgetary institutions that have not adapted quickly enough, that are fragmented and lack accountability and control mechanisms, and do not provide accurate and definitive budgetary information can serve to obstruct efforts to implement major budgetary changes. Conversely, strong political institutions that enhance policy-making capabilities can work in the opposite direction, assisting a government in making major policy changes. Weaver and Rockman (1993) offer a three-tier model for assessing government capabilities, distinguishing first between presidential and parliamentary systems, second between regime and government types within these systems, and third, a broad array of institutional characteristics and political conditions. Using their model, Hungary would appear to have potential for relatively high government capability given its strong parliamentary system, and single majority party government. In this study, we will consider both the impact of general institutional characteristics of the political system and the more specific nature of existing budgetary institutions.

Some literature is beginning to emerge on budgetary developments and trends in the region. Looking at the Czech and Slovak republics, Caiden (1993) found that budget processes were beginning to take on the rudimentary characteristics of those found in more developed democracies. Straussman (1996) found a number of institutional changes taking place in CEE nations since 1989, such as the strengthening of finance ministries, diversification of revenue sources, and proper classification of outlays. Change is often slow, however, and Straussman (1996: 82) notes that rates of “fiscal learning” vary significantly in the region. Mikesell (1995) found difficulties in Ukraine adopting to Western practices and some resentment of the high expectations of external actors. Experiences in Lithuania during the transition revealed that the previous command system had not only disadvantaged national policymakers, but had provided little budgetary expertise at the local level (Vanagunas, 1995). Straussman and Fabian (1995) also described disparities and problems of local government finance in Hungary. The emerging literature on budgeting in the region during democratic transition reinforces the view that the dramatic changes involve not only major policy shifts, but fundamental institutional and conceptual changes in budgeting as well.

DEFINING AND MEASURING THE HUNGARIAN "BUDGET"

One of the problems of analyzing budgeting in Hungary involves definition and measurement. This is particularly important in making relative comparisons between Hungary and other nations. The difficulties in Hungary are particularly acute because of a fragmented budgetary system, the lack of a standardized accounting and budgetary information system, and the added uncertainty caused by the economic transition itself (Semjen, 1994). Hungary does not have a unified national budget in the American sense; rather, the "budget" is made up of four subsystems:

Central Government Budget. The “state” budget is the largest component, encompassing the activities of the central government. Revenues come primarily from value added taxes, personal income taxes, corporate taxes, excise taxes, and income through privatization of state property. The central government budget finances general administration, defense, policy, education, and some social benefits. In 1995, the central government budget was 1.7 trillion forints ($13 billion USD).

Chapters and Ministries. The separately financed funds for chapters (bureaucratic entities) and ministries also provides financing for some central government functions and include some transfers from the central government budget. Each separate fund is created by an act of Parliament and is under the control of individual cabinet ministers who have discretion over the use of these resources. These budgets include own-source revenues.

Social Security Budget. The social security budget encompasses an obligatory insurance system financed by a tax on employers and employees. The social security system is self-governing and largely independent, but its expenditures, financing of its deficits, and borrowing must be approved by Parliament as part of the general Budget Act each year. Like the other budget subsystems, social security must present a year-end report to Parliament.

Local Government Budget. The fourth part of the budget encompasses local government financing, including both national and own-source revenues, probably the most independent and autonomous of the subsystems. Nonetheless, there are some connections with the rest of the budget. The central government budget gives direct support in some instances and offers financial guarantees in others. Since the early 1990s, local governments have been given increased discretion in raising revenues (Straussman and Fabian, 1995). As a result, there is tremendous variation in levels of taxation and services now provided by local governments, and dramatic variations in their financial condition. The system is extremely fragmented, and is broken down into relatively small geographic areas within cities. In Budapest, for example, there are substantial differences between autonomous regions of the city in terms of matters like property taxes, rent subsidies, etc.

Each of these budgetary institutions is responsible to Parliament, operates on an annual budget, and in theory they are required not to exceed their estimates in terms of specific categories such as wages, social security contributions, earmarked tasks, or capital spending. Nonetheless, many entities run deficits, such as some local governments and the social security budget, while others run surpluses. Under their parliamentary charter, they may not only charge user fees but may engage in for-profit business activities. Many of the more successful ones consistently bank their surpluses and currently have substantial sums on deposit in financial institutions.

Semjen (1994: 19) concludes that the financial flows between the different budgetary funds and entities are "almost innumerable," making accounting accurately for totals extremely difficult. The World Bank concluded in 1992 that Hungarian officials "are unable to make an informed guess about the amount of double-counting of revenues and expenditures." One analyst wryly noted that if expenditures are counted each time they appear as an outlay in official budget documents, the total amount of government spending would exceed Hungary's GDP! That makes it necessary for research purposes to rely largely on General Financial Statistics (GFS) estimated by the World Bank or estimates by the IMF and OECD. By the Hungarian central budget we generally refer to total revenues and outlays of the central government and ministries, including social insurance and separate extra-budgetary funds, and transfers to local government. If local government own-source revenues and expenditures are included, it is referred to as the consolidated budget.

Depending on which figures for central government taxing and spending are used, somewhat different pictures of the overall size of government in Hungary emerges. Using official Hungarian figures for revenues and expenditures compared to GFS figures reveals a difference of greater than 7 percent in terms of measuring the size of the public sector as a share of GDP: expenditures of approximately 64

TABLE 2
Size of the General Government in Selected Middle-Income Economies, 1994
(In Percent of GDP)

Countries	Expenditure	Revenue	Government Employment*
Hungary	59.5	53.1	26.0
Poland	49.6	46.2	21.4
Czech Republic	49.5	46.4	15.5
Slovak Republic	54.6	50.6	20.8
Slovenia	47.3	47.1	18.3
Croatia	43.6	43.3	22.0
OECD Average	41.3	37.5	na
Portugal	52.2	47.5	na
Spain	44.6	40.1	na
Turkey	25.8	21.5	9.2

(a) Employees of the general government as a percent of total employment in 1993.
Source: World Bank (1995: 10).

percent of GDP by the Hungarian numbers, compared to 57 percent of GDP in 1991 using GFS (Kornai, 1992). Even by the lower estimate, however, according to most experts, expenditures remain disproportionately high given Hungary's economic performance. Table 2 compares the relative size of revenues, expenditures, and government employment in Hungary with other CEE nations, OECD average, and selected "middle income economies."

Because of the fragmentation of the system, data and information problems, and the rapid changes of the transition, uncertainty in budgeting is very high in Hungary. Forecasting both revenues and expenditures has been inaccurate, leading to unpredictability at subsequent stages of the budget process, including the government, the ministries, and the Parliament. As expected, this has resulted in frequent revisions of budget proposals -repetitive budgeting- during the fiscal year (which corresponds to the calendar year). For example, arguably the most important budget proposal since the transition was submitted as a supplemental budget revision during March, 1995.

The uncertainty is exacerbated, however, by the fragmentation of the revenue system which creates incentives for individual ministries to underestimate revenues. Under the decentralized budget system, budgetary chapters finance their operations through a combination of central government transfers and own-source revenues. The Ministry of Culture and Education, for example, encompasses over 1400 separate entities ranging from universities to the state opera. They raise funds, as in other countries, through user fees such as admission charges to performances. However, Hungary, until 1996, had no central Treasury system for collecting and managing revenues. Ministries estimate and collect their own revenues, depositing and investing surpluses in independent accounts at financial institutions. This system creates strong incentives for ministries to purposely underestimate own-source revenues, to strengthen their case for central budget transfers, but then to assume control of any surplus collections. This was allowed until when a rule adopted in 1995 required ministries to return to the Finance Ministry half of all revenues collected over the original estimates. This was not only unpopular with the ministries but was opposed by commercial banks that enjoyed substantial deposits and profits from ministry accounts. Ironically, or perhaps perversely, ministries sometimes buy state-issued bonds of one year duration or less which in part finances the deficit they helped increase.

Despite the measurement and definition questions, one can glean an overall view of the structure of outlays and revenues in Hungary at the level of the national government. Table 3, using World Bank figures, looks at the operations of the central government budget as a percentage of GDP between 1988 and 1994. Despite increases in current figures, with inflation running at around 25 percent per year, in real terms, general government expenditure was only at about 80 percent of its 1989 level by 1993. GDP in Hungary decreased in real terms over this period by around 20 percent before beginning to experience real growth in 1994 (World Bank, 1995).

In terms of the composition of spending, a major trend, which began in the mid-1980s before the regime change, has been a reduction in government subsidies to state industries (both consumer and production subsidies) accompanied by rapid growth in social welfare

TABLE 3

Operations of Central Government, 1989-94
(In Percent of GDP)[1]

	1989	1990	1991	1992	1993	1994
Revenues	56.0	54.4	51.9	55.2	54.9	53.1
Expenditures	57.2	54.0	54.0	60.6	61.5	59..5
Subsidies	11.4	9.0	7.4	5.5	4.3	4.5
Transfers	18.2	20.2	20.6	24.0	22.5	23.1
Pensions	8.6	9.2	10.5	10.4	9.7	10.3
Family Allowances[2]	3.7	3.7	4.3	4.4	3.6	4.6
Sick Pay	1.2	1.1	1.2	1.0	1.0	1.0
Unemployment	0	0	0.8	1.6	2.1	1.1
Other Transfers	4.7	6.2	3.8	6.6	6.1	6.2
Interests	2.3	2.8	3.8	5.9	4.7	6.8
Other	25.4	22.0	22.2	25.2	30.0	25.1
Balance	-1.2	0.4	-2.1	-5.4	6.6	6.4
Adjusted Balance[3]	-1.2	0.4	-2.1	-6.1	-6.7	-7.2

(1) GDP before 1990 adjusted for comparability.
(2) Includes child allowances.
(3) Excludes privatization.
Source: World Bank (1995).

expenditures. For example, by 1990, subsidies to state industries had fallen to approximately 10 percent of GDP from 26 percent only four years before (Semjen, 1994). However, social welfare and general government expenditures, on the other hand, increased by nearly 50 percent as a proportion of GDP during the same time period. Hungary was ahead of other CEE nations in restructuring budgetary support for inefficient industries and artificially low prices by the time of the transition. However, it meant that there were fewer additional budget savings to be found there and that expenditure reduction would have to come in the sensitive area of social welfare support.

Cutting social welfare expenditures is problematic in Hungary because programs are not targeted or means-tested in most cases, and cuts affect citizens at all income levels. In late 1995, the tax on employers was raised to 48 percent of all salaries for employers and 10 percent for employees. This is very high for the region and compares to employer costs of 26 percent in the Czech Republic, 32 percent in Poland, and 31 percent for EU nations (World Bank, 1995: 17). The effect of these high rates is to discourage employment and for enterprises to shift operations to the informal sector. With generous family allowances, unemployment benefits, and disability, 10 percent of the working age population relies on social security support at an estimated cost to GDP of 2 percent. With early retirement ages and other problems with the pension system, control of social welfare spending is a major budgetary problem. The system’s financial problems are exacerbated by the fact that state-owned enterprises are in arrears by approximately 12 percent in terms of their contributions. This further contributes to the budget deficit.

While Hungary seemed to be ahead of other CEE nations in terms of having a revenue structure more comparable to western industrial nations at the time of the transition, there are severe problems with the tax system. Financing government activities has become more difficult and revenue forecasting has become increasingly unreliable. Hungary introduced a personal income tax in 1988 and a corporate tax in 1989. As Table 4 shows, corporate income and personal income taxes make up only 5.5 percent and 18.1 percent of total revenues respectively. Value added taxes contribute 20.3 percent of revenues while social security taxes comprise one-third of all tax collections. Hungary today has a heavier tax burden than other nations in the region. The World Bank concludes that this heavy tax burden and the deficits are the main obstacles to economic growth over the next decade (World Bank, 1995). Tax rates must be even higher because of revenue losses from extensive tax relief and "loopholes", with the inability to tax so-called “gray” economic activity (now estimated at nearly 30 percent of GDP), and severe problems with tax compliance from a citizenry used to avoidance of government rules and requirements.

Estimating the revenues from privatization has been particularly inaccurate, with actual revenues ranging from 30 to 300 percent of what was annually forecast in the budgets during the 1990s. Until 1996, progress had been slow in privatization compared to CEE neighbors. At the beginning of 1995, 65 percent of the initial State holdings of enterprise equity remained under State control, resulting in a low return on the nation’s capital. Despite some privatization, state

TABLE 4
Tax Structure in Hungary, 1994

Revenue Sources	% of Total
Corporate Income Taxes	5.5
Personal Income Taxes	18.1
Value Added Tax	20.3
Excise Taxes	10.2
Trade	8.7
Social Security	32.3
Employers	(24.1)
Employees	(8.2)
Total	100.0

Source: World Bank (1995).

enterprises losses remained large - around 7 percent of GDP in 1994 (World Bank, 1995: ix). In early 1995, Socialist Prime Minister Gyula Horn was roundly criticized by the international financial community for personally blocking the privatization of the Hungar Hotel chain to a western consortium, with some questioning his party's commitment to privatization in general. Late 1995 marked a significant turnaround, however, with the passage of a new privatization law and appointment of a Privatization Minister. Originally slated to earn $1.07 billion from privatization in 1995, the State Privatization and Holding Company sold off more than $3 billion worth of companies. While many saw this as a nice problem to have, it reflects the continued inaccuracy and uncertainty that characterizes national budgeting and precipitated a divisive battle within the government between the "deficit hawks", led by then Finance Minister Lajos Bokros, who wanted to apply all the windfall to deficit reduction, and Privatization Minister Tamas Suchman, with some support from Horn, who wanted to use the proceeds to invest in Hungary's crumbling infrastructure.

DEFICITS, DEBT, AND EXTERNAL CONSTRAINTS ON THE BUDGET

High annual budget deficits and external debt have been a serious problem for Hungary in the 1990s and are a critical force in pressuring government to look for dramatic macrobudgetary solutions. After 1990, the annual budget deficits rose to around 7 to 8 percent of GDP (World Bank, 1995), and consistently were larger than initial projections. The budget deficits were relatively greater than other CEE nations such as the Czech Republic where deficits are more in the range of 3 percent of GDP. The costs of servicing the external debt imposes severe constraints on decision makers and reduces funds available for other budgetary needs. By 1994, debt service reached 28.8 percent of total expenditure. The costs of interest payments were approximately $1.5 billion, with the rest of the debt consisting of amortization that was rolled over by issuing new bonds.

Many nations live with comparably high budget deficits, particularly if they are financed from domestic savings. That has not been the case in Hungary, and one of the problems is the fact that the deficits are primarily financed with foreign borrowing and by new money creation which has kept inflation above 20 percent annually. Another serious macroeconomic problem impinging on fiscal balances is the trade deficit, which is largely a competitiveness problem rather than a direct result of the budget deficits. Trade imbalances have developed as imports have outstripped exports. The current account deficit of Hungary in 1994 was the equivalent of 4 billion U.S. dollars. Exports that year represented less than 80 percent of imports. While the debt rescheduling sought by Hungarian government officials would ease short-term budgetary pressures, it would not in itself solve this underlying competitiveness problem.

These economic and budgetary indicators are of great concern to international organizations like the IMF and World Bank that can play a key role in helping Hungary with loans and debt restructuring. Under the circumstances, these external actors have become unusually important in establishing guidelines and macrobudgetary targets and pressuring the government to significantly reduce spending. Despite the targets, these constraints are more general than specific. It is up to the elected government to formulate specific proposals to achieve the goals established by external actors. On one hand, this puts strong pressure on the government to face up to the difficult task of cutting popular domestic spending programs and risk the ire of interest groups and voters. On the other hand, it provides officials with some potential political cover for making tough choices and allows a degree of scapegoating.

The goal of potential membership in the EU and NATO also results in an additional set of external constraints. Hungarian officials involved in the budget process often refer to the Maastricht convergence criteria that would serve as targets for their integration in the EU in the next decade:

- price stability: inflation within 1.5 percent of the lowest three members
- low deficits: no more than 3 percent GDP and debt no more than 60 percent GDP
- limits on exchange rate fluctuations; no devaluations for two years
- interest rates: nominal rates within 2 percent of three most stable members

There will also be requirements for membership in NATO. It is hard to determine what the specific budgetary consequences would be, although it is likely that Hungary would have to increase defense spending above current levels. In general, despite the political problems caused by attempts to meet financial qualifications for EU membership, leaders across the political spectrum generally recognize that in the long run, Hungary will likely be a net beneficiary of membership.

Hungary has recently moved towards achieving these goals. The first freely elected government headed by Prime Minister Antall took a gradualist approach to Hungary's budget problems. No "shock therapy" was proposed. Ironically, the return of the Socialists to power in 1994 and a government headed by Prime Minister Gyula Horn marked the most radical budget reduction package since the transition. Nine months into office, and spearheaded by a new Finance Minister, Lajos Bokros, the government introduced an austerity package in the form of a supplemental budget proposal on March 12, 1995. It devalued the forint, proposed a combination of new revenues, such as duties on imports and tuition for college students, as well as cuts in programs like the family allowance and university budgets. These measures were immensely unpopular at home, precipitating student demonstrations and May Day protests. Reflecting the importance of external international actors to budgeting in Hungary, the Horn government publicly appealed to them for more visible and public displays of support for the 1995 package.

The majority of the proposals were adopted by Parliament in May, but the government warned that even more painful cuts were still coming.

The deficit situation began to improve as a result of these measures, declining in 1995 from an original forecast of 8 percent of GDP to 6.3 percent of GDP. The revenue increases coming from the austerity package reduced the projected deficit from 283 billion HUF to 156 billion HUF during the fiscal year (Report to Parliament, 1995). In 1996, led by newly-appointed Finance Minister, Peter Medgyessy, the government proposed further budget changes, focusing on extending the tax base in order to reduce tax burdens, reform of the pension system by linking contributions to benefits, by introducing performance-based funding rules on education, as well as anti-inflation policies (Prime Minister's Office, 1996). By 1996, the deficit was projected to drop to around 4 percent of GDP, a significant improvement that would affect economic growth, budget flexibility, and future membership in the EU. A supplemental budget containing these measures was proposed in July, six months into the fiscal year.

BUDGET INSTITUTIONS AND PROCESSES

The Hungarian budget process is immensely complex, taking place at a variety of levels and in a series of stages. Nonetheless, it contains actors that behave as resource claimants and resource conservers, and proceeds in both the executive and legislature in a sequence that increasingly resembles processes in other democratic nations. Perhaps the most notable institutional differences is the lack of a central budget office and treasury system, although the Finance Ministry performs some of these functions. The budget process was significantly revised in 1992 with the adoption of the Act on Public Finance, which resulted in the following timetable.

The Budget Timetable

- May 30: the Finance Minister presents the guidelines for the budget that begins January 1 of the following year to the government.
- June 30: The government informs Parliament of the overall guidelines of the budget for the coming year and provides individual ministries and budgetary entities with guidelines for the preparation

of their estimates. Ministers must then begin to prepare detailed budget estimates and requests, negotiating with various actors within their organizations, to meet the deadline of submitting their requests to the Finance Ministry in August.

- August 31: The Finance Minister presents to the government a more detailed bill specifying the budget for the next year. During the next month, intense negotiations take place within the government concerning specific additions or reductions from the original Finance Ministry blueprint.
- September 30: The government is required to submit to the Parliament the budget for the coming fiscal year. In the next month, the Parliamentary Budget Committee holds public hearings on the budget and members propose modifications (amendments) to the budget. At the same time, negotiations take place between the government and members of the majority coalition in Parliament over what modifications might be acceptable to the government. Once it is introduced, the government itself cannot change the proposals.
- November 30: Parliament must approve the overall totals for revenues, expenditures, and deficit. Negotiations continue between the government, primarily the Finance Ministry, and MPs over specific modifications to the budget.
- December 31: Parliament must approve the budget.
- January 1: Start of the fiscal year.

Budget Processes and Politics

The process starts with the preparation of a macroeconomic forecast for the coming year in the form of scenarios based on domestic and international economic conditions. The economists in the Finance Ministry estimate the growth rate, balance of payments, balance of trade, inflation rate, unemployment, much as central budget offices do in other industrial democracies. Of particular importance are the revenue estimates based on current assumptions, often little more than educated guesswork, and a decision in broad terms of what the highest tolerable deficit level would be for external organizations and investors. These so-called "corner numbers" provide the basis for establishing a de facto expenditure ceiling to guide subsequent budget planning. Because significant revenue proposals have been included in the budget proposals every year, the process is iterative as the revenue estimates change. The target for the deficit is also subject to revision during the process of budget formulation, even to the point of last minute decisions that it must be slashed.

These guidelines create the framework for ministries and other budget entities to prepare their estimate of needs (requests) for the Finance Ministry. While the guidelines are loose and changing, since 1994, all budget institutions were strictly instructed to include no real growth in spending in any activity. Nonetheless, as is the practical dynamic in budgeting everywhere, the estimates of needs by claimants end up significantly greater in total than the outline of the Finance Ministry's global budget guidelines allow. Although revenue estimates are faulty at all levels, it is for different reasons. Given the fragmentation and autonomy of various budgetary institutions, and the lack of an institution like the U.S. Office of Management and Budget, there is a high level of information asymmetry between the institutions working in the field and top level budget planners. Although the lower level institutions have a better feel for likely revenues, as has been noted, all the incentives until 1995 encouraged intentional underestimation. Even with the full knowledge of the underestimation, Finance Ministry officials have previously lacked the ability to force greater honesty without a treasury system or different set of rules.

The requests for funds are aggregated at the ministry (chapter) level during the summer. This begins a simultaneous bargaining process between the ministries and their component institutions to determine the figure that will be included in the chapter request, and between the ministries and the Finance Ministry to determine what will be in the government's budget. The dynamics of advocates versus guardians appear to be fundamentally the same as in the United States or other OECD countries. Informants indicated that outcomes often depended on the skills, political resources, and power of the various participants in the process, including relying on constituent and interest group support.

By the end of August, the Finance Ministry must finalize budget proposals to present to the government. Cabinet ministers and the leaders of other bureaus attempt to reach an agreement with the Minister of Finance. If they are unable to agree, the full cabinet or the Prime Minister may become involved to resolve specific disputes when they consider the specific proposals in September. Informants suggested that the power of the Finance Minister to enforce his priorities on other cabinet ministers is an important factor and has varied considerably in the years since 1990. One argued that the Finance Minister does not wield enough power in the budget process, and too often is overridden in Cabinet. Labor unions, interest groups, and other interested parties may discuss some of the proposals informally with members of the government, but their influence appears to be less here than at the stage of parliamentary consideration. The government must present its budget to the Parliament by the end of September. Again reflecting the instability in the process, the September 30 deadline has only been met once, in 1993.

That high levels of budget uncertainty lead to repetitive budgeting in Hungary is reflected in the fact that the government also offers important supplemental budget proposals to the parliament throughout the year. Supplemental budgets are far more sweeping than supplemental appropriations requests in the United States, for example. Supplemental budget proposals are generally put together more quickly and with less input from lower levels of decision-makers. Since 1992, there has been at least one supplemental budget proposal of note submitted to Parliament each year. In 1995, the government's package of cuts and revenue increases was proposed only 10 weeks after the start of the fiscal year. This was clearly a case of top-down budget-making and was made only weeks after Bokros was appointed Finance Minister. The plan was largely kept secret from the public and much of the government during the short period in which it was formulated. Its announcement was timed to occur several days before an important visit by IMF officials to Budapest. Several ministers resigned in protest, including the Minister of Social Welfare, when the package was announced.

In general form, the formal budget process in Hungary in most respects looks similar to processes in other nations. The ongoing struggle between claimants responsible for parts of the budget and conservers responsible for budget totals is in evidence. However, high levels of uncertainty, fragmentation, and expansion of the deficit beyond forecast levels has made the process much more repetitive and unstable, characterized by frequent revisions during the fiscal year and outcomes that are significantly at variance from what was planned and approved.

THE IMPACT OF PARLIAMENT ON THE BUDGET

The Hungarian Constitution provides a strong basis for the legislative authority of the Parliament in budgeting: "Parliament endorses the balance of public finances, and approves the state budget and its execution"(Kraxner, 1995: 133). In reality, its influence is much less, but can be significant from time to time. The main source of influence of the Parliament is through negotiations between the government and the MPs in the parliamentary majority. Although Hungary has a strong parliamentary system, the government cannot simply dictate policy. Before the pro forma final vote in the plenary session takes place, there are often a number of significant deals and compromises that have taken place. Among MPs, influence on budget issues varies considerably. Leading members of the majority party have the most potential influence, while members of opposition parties have the least. In this section, we both review the formal legislative budget rules and procedures, the role of committees, and the impact of political parties and party factions on budget outcomes.

Rules and Procedures

In the post-communist period, the laws dealing with the national budget have been amended and revised on a number of occasions. Parliament originally operated on the Act of 1979 on state finances. In 1992, Parliament approved both a new Act on Public Revenues Administration that changed the rules for passing the annual Finances Act and other parts of the budget. In the face of these changes and relatively high levels of uncertainty, the parliamentary process has never developed a stable routine. This is exacerbated by the fragmentation of the budget subsystems themselves, and by the inconsistencies in the timing of budgetary proposals by the government. Parliament acts simultaneously on the various budgets of the subsystems, including a revenues act, and the central government budget with its funds channeled to other budgetary entities including, social security budget, and the national share of local government finance.

In theory, the Hungarian parliament uses a two-step process, in principle not unlike the U.S. congressional budget process, that requires separate action approving macrobudgetary totals followed by legislation detailing subtotals and line-items. In practice, however, both processes overlap, and are extremely fragmented, involving not only the Budget Committee, but all of the standing committees. A debate in the plenary session on overall budget totals begins as soon as proposals are submitted. With all 387 members eligible to speak, the debate can take many weeks and is more for public consumption than policy modification. Time for floor debate is allocated to the parties in rough proportion to their number of seats. The Standing Orders (parliamentary rules) were changed in 1991 in an effort to enforce time limits. In practice, the main restrictions on debate are self-imposed limits agreed on by party factions, somewhat akin to unanimous consent agreements in the U.S. Senate.

The revised rules for parliamentary consideration of the budget lack clarity and precise differentiation of roles. Despite statutory requirement, Parliament has formally approved budget totals only in 1992 (Kraxner, 1995: 139). This means that the debate on totals has virtually no impact on the more specific decisions on taxing and spending. Parliamentary influence is also constrained by a rule that after November 30, all modifications must be “deficit neutral”: spending increases or tax cuts must be compensated elsewhere in the budget. Parliamentary rules also prevent the government from formally revising their budget proposals once they are submitted. In practice, however, the government simply uses parliamentary party members to offer modifications that they support. Delays in submitting the budget, the frequency of supplemental budgets, simultaneous consideration of the parts and totals, and the lack of institutionalized procedures for considering the budget all tend to reduce or preclude parliamentary influence.

Committees

In creating a committee system in 1990, the Hungarian Parliament established ten standing committees and four special committees that largely parallel the organization of government ministries. The most important committee in the parliamentary budget process is the Budget Committee where all modifications must be channeled. The Constitutional Committee also must review all amendments for constitutionality. Neither of these panels have much staff support or funds to assist in their task. In contrast to the practice in most legislative systems, the Budget Committee is chaired by a member of the opposition party. In theory, this is intended to provide an alternative, bipartisan parliamentary perspective on government proposals. While this would appear on the surface to simply reduce the relevancy of the committee, it mainly has the effect of changing the nature of negotiations between the government and the committee. Instead of working closely with the chairman, the government relies on certain key members of the majority party or governing coalition on the committee.

The Budget Committee holds hearings on all aspects of the government’s proposals. Various ministers and their representatives appear before the committee to discuss their budget allocations. Although the Finance Minister occasionally appears, it may be an indication of the limited importance of these hearings that, most often, lower level officials represent the Ministry. There is no “unity” of the government’s budget in a conventional sense. While representatives of the Finance Ministry present and defend their estimates to the Budget Committee, other ministries attempt to pursue their specialized interests with the standing committees, urging budget increases not necessarily consistent with the official government proposals (Kraxner, 1995: 140). While this adds confusion to the process, the standing committees lack any real power since modifications must be channeled through the Budget Committee where the Finance Ministry focuses their attention. MPs tend to act primarily as program and constituent advocates in the process, proposing spending increases. Virtually all proposals for cuts originate from the government, external actors, or executive elites, particularly from the Finance Ministry.

Any member of Parliament may propose a modification of the budget. It is not uncommon to have nearly one thousand amendments ranging from minor, technical changes in language to major policy changes. The sheer number of amendments became a crushing burden on the process given the short time available for parliamentary consideration since even the most minor change in past years could be brought to a vote in the plenary session, whether it had won approval in the Budget committee or not. In 1994, the power of the Budget Committee was enhanced when the rules were changed requiring that a proposed amendment receive the support of at least one-third of the members of the Budget Committee in order to reach the floor for a vote. However, party factions or any 20 MPs who request so in writing, can circumvent the committee and demand a vote on a modification.

On the surface, the committees are the focal point of parliamentary activity on budget proposals. Committee meetings provide an opportunity to challenge government assumptions and goals, to question ministers, and to propose substantive changes. Committee impact is limited, however, by rules that prevent amendments that increase the deficit, by the fact that it is easy to circumvent the committees, and by the fact that committee action bears little relationship to what will be adopted by the full Parliament. Committees lack independent financial resources or staff. Instead of thorough systematic review by standing committees, the most important parliamentary influence on the budget is through private negotiations between leaders of party factions and the government.

Parties and Parliamentary Party Factions

Political party organizations, inside and outside of parliament, are crucial to understanding the impact of Parliament on the Hungarian budget. The most crucial parliamentary influence on the budget takes place in negotiations over certain key modifications that enjoy support among the members of the governing coalition or constituent groups that they represent. Since 1994, the most important budget battles have been among factions within the Socialist party. For example, members of the governing coalition with close ties to agriculture pressure the government for fewer cuts in agricultural subsidies, or members close to environmental groups push for tax preferences for environmentally-friendly technologies. Some of these disputes between members and the government are debated openly in committee, but most are resolved in closed-door negotiations within the cabinet, between the Finance Ministry and parliamentary party dissidents, or other ad hoc groups within the government coalition. The austerity measures and the more conservative budget policies begun in 1995 have been highly divisive with the HSP with the left wing opposing cuts in social benefits, tuition for university students, and limits on pay increases for government workers.

If a modification has the support of a majority of the members of the governing coalition in Parliament, the government must negotiate in earnest. The position of the Socialists' governing partners, the Free Democrats, is somewhat less critical although the Socialists are careful not to take an action that might lead to their leaving the government. Their practice has been to make necessary concessions to members of their own party rather than reach out to opposition members to defeat an unwanted change. A number of important modifications have been accepted by the government over recent years. In the fall of 1994, the Socialist and Free Democrat legislators were able to eliminate the government's unpopular proposal to raise the sales tax on wine. They were also successful in getting the government to change its position on the rules for firms paying social insurance taxes. In 1995, the government modified its proposal to begin charging tuition for university students by delaying its effective date.

The opposition parties have very little influence on the budget. Their main opportunities are to make a public record through floor speeches and submitting amendments to try to delay and obstruct the process. Occasionally, a technical amendment by an opposition member may be adopted in a gesture of good will, but we could find no instances of significant substantive changes brought about by opposition members. The recent rule limiting floor votes to modifications that received the support of one-third of the committee has reduced the opportunity to obstruct as well.

The external party organization can also play a role in resolving intraparty policy disputes, although it is a far cry from the power of the HSWP before they relinquished their monopoly in 1989. The parties still have tools related to the electoral system to maintain party discipline. In 1996, the Socialist Party Congress in March was effectively used by Prime Minister Horn to build parliamentary party support for the continued economic and budget reform program directed by Finance Minister Medgyessy. At the same time, the frustrations of minority status in Parliament were showing among the conservative opposition. At their March, 1996 Congress, disgruntled moderates in the Hungarian Democratic Forum left to form their own party, the Hungarian Democratic People's Party (Doncsev, 1996: 1)

The influence of constituencies and interest groups on budget policy is most frequently mediated through party factions or directly by the cabinet rather than through committees or the plenary session. Hungary has a tripartite electoral system where members are elected through a combination of single-member districts, party lists, and tabulation of votes in the districts to reflect proportional representation. Intraparty divisions over budget issues often reflect constituency opposition and the positions of interest groups such as labor unions. Even with single-member districts, however, constituency interests rarely if ever result in a break of party discipline. Left-wing and labor union opposition to budget austerity measures have been resolved within the party. Some informants have indicated that interest groups may have as much or more influence in modifying budget proposals than members of the Budget Committee or backbenchers.

In the end, after all the negotiations, speeches, and votes on modifications, the government can count on strong party discipline and be assured of final passage of the budget. As a result, the deadline of December 31 has been met each year since 1990, although on occasion it has taken a frantic last 24 hours to complete action on time. Whatever the fragmentation, duplication, lack of routinization, and other perceived flaws in the process, Hungary's strong parliamentary system precludes a paralyzing deadlock, as often happens in the United States, and eliminates the need for emergency continuing spending resolutions to keep the government functioning. This is one bright spot in a parliamentary budget process that has limited impact on both the overall shape of the budget and content of specific policy decisions.

CONCLUSIONS: PROBLEMS AND PROSPECTS FOR BUDGETING IN HUNGARY

Our analysis of budgeting in Hungary during the democratic transition allows us to draw a number of tentative conclusions concerning the conceptual approaches and general hypotheses that were examined. The results seem to confirm the usefulness of the macrobudgeting versus microbudgeting dichotomy for conceptualizing the process and defining key relationships between claimants and conservers. We also found that the process, particularly for supplemental budgets, is more top-down than bottom-up although micro-level actors remain important because of the fragmentation and the lack of a Treasury system.

At the macro-level, because of the system transition and reorientation of national objectives from east to west, external actors have played a critical role in defining parameters and budgetary goals in Hungary. However, the orientation to external actors is fraught with domestic political dangers. One of the weaknesses of the Horn government's 1995 austerity plan was the failure to prepare adequately the public and even members of the governing party for the measures, or to make a compelling case for the long-term benefits of current sacrifices for the future of Hungary's next generation.

In terms of the Wildavsky/Caiden hypotheses, it is clear that rapid system change can cause uncertainty and repetitive budgeting. As we have seen, this is reflected in Hungary in the inaccuracy of forecasting, the lack of routinization of the process, the need for supplemental budgets, and a budget process that has been iterative and adaptive. The structure and stability of both political and budgetary institutions has affected policy outcomes. The fragmentation and autonomy of ministries, their ability to raise own-source revenues and circumvent Finance Ministry oversight, and the lack of a Treasury system for revenues and debt management, has contributed to the budget deficit and reduced the effectiveness of deficit reduction efforts. However, recent reforms in terms of taxing excess ministry revenues and implementation of a partial Treasury system reflect that the government is acting to change institutions in a meaningful way. This is also reflected in fledgling efforts to develop better budgetary information systems and clarify multiple budgetary transfers in an attempt to provide more accurate, standardized information for decision-makers. Looking at the general trends since 1990, it appears that as economic conditions stabilize and budgetary participants gain more experience, the process is gradually becoming more institutionalized.

The nature of political institutions in Hungary has to some degree mitigated the negative consequences of budget institutions and practices. In terms of the Weaver/Rockman three tier model of government capabilities, Hungary has a strong parliamentary system with, at least in the short run, majority single party government, with a minimum of veto points and powerful interest group access. This is reflected best in the adoption of the unpopular austerity packages in 1995 and 1996 which made significant changes in programs and progress in reducing the deficit. This governing capacity still could be imperiled during the current four year government by the split within the Socialist party between left wing gradualists and more liberal economic reformers attuned to external constituencies. Progress may be slowed as the 1998 elections approach.

Impressionistic evidence generally confirms the suggestions of Straussman (1996) and Mikesell (1995) that political culture in the former eastern bloc nations presents an obstacle to budgetary and economic reform. Continued public cynicism toward government in general and suspicion of authority help foster the extensive tax avoidance and continued expansion of the informal economy. Political culture is reinforced by the tax structure itself and high tax burdens that clearly encourage tax avoidance. In addition, past government policy, the fact that reform communist governments allowed the gray economy to develop in agriculture and other areas, have contributed to the resistance.

Although Parliament plays some role in the budget process, it is not a major source of policy change. At first glance, a number of factors exist that might suggest the potential for greater parliamentary influence: a fragmented and permeable executive budget process, uncertainty and repetitive budgeting, permanent standing committees that parallel ministries, rules that allow MPs to vote on budget totals and specific budget measures, and constituency opposition to austere budget policies (Olson and Mezey, 1991: 1-12). However, this potential influence has not been realized because of a number of mitigating factors: the importance of goals established by external actors, the emphasis on top-down macrobudgeting, the blurring of distinctions between parliamentary action on budget totals and parts, structural characteristics such as the minority party chair of the Budget committee, the ability of the government to negotiate budget issues outside of formal parliamentary processes, and the strength of party discipline in voting. Parliament does engage in some ministerial oversight and loudly voices constituency concerns, but its main policy influence is through informal negotiations between party factions and the government.

Although the purpose of the study was not prescriptive, the results of our analysis suggests some conclusions about directions for change. Hungary needs to continue to develop greater certainty and stability in budgetary institutions, more along the lines of western nations. The nation would be better served with a more unified and comprehensive budget system, where revenues and expenditures are accounted for in more standardized, accurate ways. Multiple accounting of outlays are a source of confusion and less effective policymaking. Accounting and financial management changes that narrow the gap between GFS figures and Hungarian figures would add clarity and consistency to the system. The fact that Hungary joined OECD in 1996 should help in this regard. Although the adoption of a limited Treasury system for the central government budget is an important start, a more comprehensive Treasury system is needed to encompass all revenues and debt management. Improved budgetary information systems are needed to improve forecasting of both revenues and expenditures. The recent change to tax ministries surplus own-source revenues by 50 percent is also a significant improvement, but incentives for ministries to estimate revenues more accurately should continue to be developed.

The World Bank and other international organizations have developed extensive specific recommendations for economic and budgetary goals for Hungary that will not be detailed here. But several policy directions seem essential for the nation to achieve its goals of economic integration with Europe. Social security and welfare expenses, carried over from the old system, are not targeted or means-tested, and remain disproportionately high among CEE nations and Europe. The most pressing areas for reform are the pension system and its early retirement ages, family allowances that do not target Hungary's poorest citizens, and health sector reforms maintaining universal access but reducing costs. These reforms, however, hold the greatest domestic political dangers and may be difficult to achieve. Continuing progress in privatization of state-owned industries and reform of the banking system, which is still dominated by state-owned banks, is needed. Finally, the radical disparities in local government finance need to be addressed.

Hungary has the opportunity to achieve strong economic growth in the next decade. The World Bank has developed models of the Hungarian economy showing that with the adoption of budgetary, fiscal, and banking reforms, Hungary could average real growth at least twice as high as average EU growth (World Bank, 1995). Without reforms beyond the 1995 and 1996 actions, however, the large income gap with the EU would not be closed over the next ten years. Which path is realized will depend on continued development of budgetary institutions, government policy choices which will be shaped by the results of the election in 1998.

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