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Hungary grapples with cost of 'Orbanomics'

Andrew Byrne in Budapest


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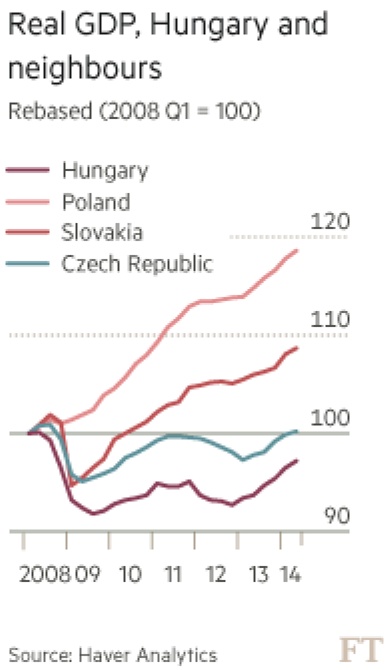
Viktor Orban presided over commemorations of Hungary's 1956 uprising against Communism last week as the country's longest-serving prime minister since the fall of the iron curtain.
Fortified by a trio of electoral victories this year, the prime minister appeared unassailable, inhabiting what his biographer József Debreczeni predicted in 2009 would be an "impenetrable fortress of power".

But cracks have already started appearing in Mr Orban's political edifice, following a bruising diplomatic row with the US and a mass revolt against the government's plan to create the world's first tax on internet usage – a levy critics say will kick Hungary's digital economy back to the 1990s.

The tax is Mr Orban's latest attempt to cut Hungary's fiscal deficit using unorthodox measures – dubbed "Orbanomics" by analysts – which have in effect increased the tax rate and imposed a selective burden on political opponents, say critics.

The internet levy, a charge of Ft150 (62 US cents) for each gigabyte of web data consumed, has galvanised unprecedented resistance to the ruling Fidesz party. But it has also highlighted how few tax options remain open to the government after four years of radical Orbanomics measures, which have failed to reduce the public debt from a level equivalent to 80 per cent of gross domestic product.

“It’s not really a coherent discipline or set of ideas,” says Gyorgy Suranyi, a former central bank governor, who describes Orbanomics as a system of nationalisations, sweeping sectoral taxes and selective awards of government contracts that have increased government control over the economy.



Mr Orban avoided a second International Monetary Fund programme when his Fidesz party swept to power in 2010 by imposing flash penalties on banks and other companies. At the same time he doled out populist cuts in income taxes and utility prices.

But when his tax reforms failed to boost consumption and investment, he was forced into a spiral of increasingly unorthodox measures, says Mr Suranyi.
Within months, the central bank nationalised private pension funds, prompting a one-off inflow of accumulated savings that masked a ballooning deficit. Soon after, Mr Orban slapped taxes on banks and telecoms, energy and media companies.

“If there is one consistency, it is increasing the effective tax rate,” says Mr Suranyi.
Foreign-owned banks, such as Austria’s Raiffeisen and Erste Bank, have felt the cost of Orbanomics most keenly. After he introduced Europe’s highest bank tax in 2010 and a financial transactions tax this year, Mr Orban forced banks to compensate borrowers for “unfair” conditions on euro and Swiss franc loans issued in the mid 2000s, when the Hungarian forint was riding high.

So far $3bn of losses have been imposed but more pain is expected when the government forces all remaining forex loans to be converted to forints in the coming months. Lajos Bokros, a former finance minister, warned this month the sector was being "punished" and Gyorgy Matolcsy, the country's central bank governor, has said that he expects many foreign-owned banks in Hungary to quit the country.

Officials acknowledge the measures have damaged investor confidence but insist remaining conversions will be made at a reasonable rate.

"There may have been a detrimental impact on investment," says Gabor Orban, state secretary for the economy. "But low public and private investment is a central theme in all European countries."

Government ministers also point to strong growth in the first half of 2014 and a declining deficit as evidence that Orbanomics is working.

"This is the first time in Hungary's history when we have been able to meet our deficit targets for three or four consecutive years," says Zoltan Kovács, state secretary for communications.

But the revolt against the internet tax is not Mr Orban's only problem. He has also come under blistering attacks from abroad for the political dimension of Orbanomics, described by former US President Bill Clinton in September as a form of "authoritarian capitalism".

US censure reached new heights this month when Washington banned six Hungarian officials from entering America on grounds of corruption – an unprecedented sanction against a Nato ally and EU member state.

Hungarian government and opposition members alike say the corruption allegations are merely a pretext for the US to punish Mr Orban's inner circle for his "illiberal" reforms and what some analysts describe as a pro-Russian foreign policy. Laszlo Kover, speaker of the parliament, said the west was waging "a verbal cold war" against Hungary.

In the midst of the public frenzy over internet taxes and a mounting diplomatic spat with the US, one Hungarian analyst says he has never seen his country so isolated from western allies, warning that Mr Orban is turning away from the liberal, free-market model of democracy. "He admires [Russian president Vladimir] Putin and what he is doing. He believes the era of the west is over and that is why he is trying to create an alternative model, with the state at its centre."