Robin Hood Smells Blood

As some discerning analysts predicted, the bank tax was not the end-point but the beginning of a process wherein the government turns to certain corporate sectors to cover the budgetary shortfalls. Critically as economists might see it, politically the solution seems astute in light of the real world constraints facing the government.

Considering the political constraints facing the government, it might have chosen one of the least unattractive ways to resolve the deficit quagmire. The presentation of the cornerstones of the new budget revealed that the bank tax was not to be the last windfall tax imposed by the Fidesz-government.

To push the deficit to under 3%, the cabinet has decided to hit three further industries – telecommunications, retail and energy – with new levies totalling 160 billion forints per annum for three years, starting in 2010. Since these industries have reaped superprofits, the government argues, it is time to give something back.

For a while, the situation looked insoluble. Fidesz had to square obligations that were obviously at odds with each other and it looked highly unlikely that any set of measures would successfully meet all these requirements.

First was of course the necessity of adhering to the budgetary numbers laid down in the euro convergence (Maastricht) criteria, and also pledged by the previous government. Orbán and Matolcsy fought hard to have this burden eased, but they emerged bruised from the head-on collision with the EU and the IMF, and the numbers continue to stand. Inevitably, this required additional revenues and/or reduced expenditures.

Second is credibility, which remains the crux of Fidesz' popularity and which it seeks to hold on to even at high costs. A bit of recent history is illuminative in this regard.

During the 2002-2006 MSZP-SZDSZ term, the rationale Fidesz provided for declaring the ruling coalition illegitimate – above and beyond calling it incapable and unsuccessful – kept changing. First it was the false accusation of electoral fraud in 2002, quickly followed by the true allegation that Péter Medgyessy had worked with the state security apparatus under the Communist regime, followed by the also true – but in a parliamentary democracy hardly relevant – charge that Ferenc Gyurcsány lacked a popular mandate.

After the 2006 elections, however, already a couple of months before the Őszöd speech became public, Fidesz' assault on the government's claim to legitimacy focused on the lies the government had used to stay in power. Fidesz itself, in contrast, was cast as the party of truth and integrity. Much like George W. Bush's 2000 promise to "restore honour and integrity" to the White House, Fidesz's attacks against the government's specific policies came second only to the relentlessly reiterated issue of integrity and honesty.

Retaining credibility means that this government cannot do an ostensible about-face in key policy areas without paying a price in terms of upsetting large segments of the electorate. As we noted previously, such a radical policy shift is exactly what many economic experts on both sides of the political spectrum had hoped would happen soon after Fidesz ascended to power. Orbán, the reasoning went, would succeed where Gyurcsány had failed and implement massive reforms in the entire state apparatus and put the budget and public debt issue on a new footing.

Clearly, everybody was aware that this would fly in the face of Fidesz' communication in the past few years, which had – not exactly plausibly – suggested that it was possible to *simultaneously* cut taxes and social security contributions, to preserve and even expand the state's costly commitments and to reduce the national debt and the budget deficit.

For now, the neoclassical economists' expectation of a radical departure from this inconsistent message seems naïve. Gyurcsány had hoped that quick action and the subsequent recovery would salvage him; Bajnai had engaged in a Kamikaze-mission. Orbán is not willing to copy Gyurcsány's gamble, that is he won't say to hell with the campaign rhetoric and pin all his political prospects on a resurging economy.

Orbán appears to believe that credibility is – for now – the most important aspect of his hold on power, so he cherishes it even as it imposes a straitjacket on his policy alternatives. In the current context, the EU budget constraint and the integrity imperative compelled Fidesz to find a solution that would help lower the deficit without effecting a significant change of the course charted over the past years.

Whatever other disadvantages they may entail, the levies thus imposed are an ingenious solution to the dilemma outlined above. They raise a lot of money but seemingly target "deserving" societal actors rather than the people. They are not a hundred percent consistent with Fidesz' rhetoric over the last couple of years – it opposed the previous cabinet's more modest Robin Hood tax – but then no budget consolidation could be. And arguably this is as close as the government could get to eating the cake and keeping it, too.

But what about the economic impact? It is conventional economic wisdom that when it comes to budget consolidation, the most sustainable measure is slashing expenditures and certain state functions along with it. The government has railed vehemently against the previous government's cutting of services, no matter what shape they took (closing schools in small municipalities, hospitals, underused railway lines, etc.) Fidesz argued for preserving the state's strong social role and, apart from rationalising the bureaucracy, it rejected any type of reduction therein.

The standard economic account also suggests that raising additional revenue is generally less desirable, but even this direction offers a wide variety of possibilities, some of which are very adverse to long-term growth, and some that are less so or even neutral.

The specific risk of the adopted tax collection measures is that they turn off investors – domestic and foreign alike – who are desperately needed if the government seeks to expand employment, not to mention add the one million jobs it promised by 2020. Whatever profitability calculations an investor makes now, these must be weighed against the risk of unpredictable one-off taxes that might rob them of the fruits of their investment. Signalling such investors that they are safe from future encroachments will be a formidable challenge.

But even as economists – and some segments of the opposition on their coattails – propose that this heralds a doomsday scenario, it is important to keep the following in mind. First, the short-term political constraints obviously weigh heavier on the government. Second, every budget consolidation yields its own particular tradeoffs, economic and political alike. While they might have planted the seeds of future economic recovery, the Gyurcsány and Bajnai consolidations also contributed to a significant dip in GDP growth with immense political damage to the ruling party as a result.

Furthermore, while supply-side economics has fared less successfully in the empirical realm than in think tanks, there is nevertheless the hope that drastically lower income and corporate taxes – which are on the other side of the ledger – might unleash dormant creative and productive forces that could propel Hungary forward. Even reluctant investors might see opportunities – not only will they have to pay less taxes on their profits, but they can also offer lower gross salaries to provide new employees with the same net income.

Finally, Hungary being extremely dependent on foreign trends, there is also the hope that whatever adverse consequences the crisis tax might have will be offset by an improved international environment that will drive the Hungarian economy forward through hospitable export markets. Though the previous government fared disastrously with this particular gamble, if normal business cycles resume Fidesz' might benefit.

Yet the tax policy may backfire in another way, too. Being by their very nature temporary taxes, the crisis levies cannot sustain a more balanced budget over the long run. This is the case of a problem deferred; as the taxes fade out, Fidesz will once again be faced with the question of finding money for a state that appears overextended. Moreover, the strategy chosen also entails additional risks for Fidesz in that this reckoning, if it will indeed happen, will be a lot closer to the next elections than painful cutbacks would have been now.

To be sure, a lot of circumstances might change until then. The economy could recover impressively, thus offering improved tax revenue even with the lower tax rates. The government itself might finally tackle some reforms of the vast public service sphere, most probably enacting less ambitious rationalisations than those envisioned by its predecessor, but also less controversial ones on account of their more modest scope. Maintaining a leaner public service sector might then be sustainable even without all these extraordinary taxes.

But these are big ifs, and no matter how clever a solution the crisis tax was to this year's crunch, it also opens up a number of potential risks, some of which the government has little or no control over.

Finally, let us turn to a corollary issue, an aspect of Fidesz' relations with the corporate sphere, which many think will turn sour as a consequence of the government's drastic money grab. We are not convinced that these relations will necessarily suffer, and most certainly not across the board, as the government is likely to construct the taxes in a way that affects government friendly market players less, and thus ultimately even improves their position vis-à-vis competitors. Still, it is possible that some or maybe even many corporate actors will come to distrust the government for fear that they might be constantly held up to cover budget shortfalls.

In a democracy in which corporate donations play a significant role in funding parties and campaigns, the repeated use of one-off taxes on profitable enterprises might backfire in terms of drying up corporate funding for the party. That's not typically European, though, and most certainly not Hungarian.

In fact, corporations do play a major role in funding, but very differently from, say, the American model, where corporate giving may not be disinterested but is nevertheless not nearly the same as the illicit kickbacks from public contracts that form the backbone of corporate political "support" in Hungary. Those are unlikely to seize. Moreover, while Fidesz has relentlessly attacked the oligarchy attached to the Socialists, it boasts a very significant supportive business class with numerous forint billionaires who are certainly willing to kick in.

On account of the above, Fidesz can gladly forgo even significant portions of state funding – much more so than the other parties – and by reducing public subsidies by 15% for all parties in July, it garnered additional approval from the public for its modesty and simultaneously weakened the opposition. Like the crisis tax, this was nothing if not ingenious.