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The Transformation of the Hungarian Fiscal and Monetary Constitution

ABSTRACT

The new Hungarian constitution, the Fundamental Law of Hungary, passed on 25th April 2011, entered into force on 1st January 2012. The new constitution and the cardinal laws regulate the institutional basis of the fiscal and monetary system of the country and also sets forth the basic rules of the distribution of tax burden. The Fundamental Law caused momentous controversies in the political and in the academic sphere. The author takes a historical perspective with the purpose of showing the conditions under which the post socialist Hungary re-joined the market-oriented world in the era of globalization. The author also describes the core constitutional changes and provides arguments for their appropriate nature.

KEYWORDS: constitutional law, fiscal constitution, monetary law, tax law, fiscal sociology

I. INTRODUCTION

The new Hungarian constitution, the Fundamental Law of Hungary, passed on 25th April 2011 and went into force on 1st January 2012. The Fundamental Law is a so-called core constitution and it directs the National Assembly to pass cardinal laws on subjects specified in it; several aspects of public finances and the central bank are regulated by cardinal laws. The new constitution and the cardinal laws regulate the institutional basis of the fiscal and monetary system of the country and also the basic rules of the distribution of tax burden. The Fundamental Law caused momentous controversies in the political and in the academic sphere. Those scholars who criticised it questioned its necessity, professional correctness and legitimacy. A renowned scholar formed one of the main objections towards its fiscal rules as follows: “The elevation of topical economic or taxation policies of the present government to constitutional status,

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thereby making changes by future governments practically impossible”.¹ Legal scholars of this view expressed basically similar opinions,² and scholars of economics expressed similar views regarding the so called unorthodox fiscal and monetary policy pursued in the frame of the new constitutional system.³

The – previous – Constitution was neutral in terms of economic policy⁴ while the Fundamental Law is not. The changes at both constitutional and policy level were the results of a crisis situation before 2010.⁵

Bearing in mind the critics mentioned above, I describe the core changes and argue for their appropriateness. Almost a decade ago, I made proposals similar to those enacted in the FL.⁶ Although the Hungarian system of finances is far from perfect, the experience of the last decade shows that the changes have resulted in a positive outcome until this time.

¹ L. Sólyom, The Rise and Decline of Constitutional Culture in Hungary, in A. von Bogdandy and P. Sonnevend (eds), *Constitutional Crisis in the European Constitutional Area: Theory, Law and Politics in Hungary and Romania*, (Bloomsbury Publishing, London, 2015, 5–32) 19. <https://doi.org/10.5040/9781474202176.ch-001> <https://doi.org/10.5040/9781474202176>

² E.g. Deák D., *Alkotmány és adójog*, (HVG-Orac, Budapest, 2016); A. Jakab and P. Sonnevend, Continuity with Deficiencies: The New Basic Law of Hungary, (2013) 9 (1) *European Constitutional Law Review*, (102–138) 121., <https://doi.org/10.1017/S1574019612001058>; M. Bánkuti, G. Halmai and K. L. Scheppele, From Separation of Powers to a Government without Checks: Hungary’s New and Old Constitution, in G. A. Tóth (ed.), *Constitution for a Disunited Nation: On Hungary’s 2011 Fundamental Law*, (CEU Press, Budapest and New York, 2012) (237–269) 240. (“the pension system, the family welfare support system, the basic rules of taxation all assigned to cardinal laws”).

³ E.g. Bod P. Á., A magyar pénzpolitika nemzetközi meghatározottságáról, (2011) 10 (1) *Hitelintézeti Szemle*, 1–13.

⁴ G. Brunner and L. Sólyom, *Constitutional Judiciary in a New Democracy – The Hungarian Constitutional Court*, (The University of Michigan Press, Ann Arbor, 2000) 294.; Sólyom L., *Az alkotmánybíráskodás kezdetei Magyarországon*. (Osiris, Budapest, 2001) 627–629. The Constitution included that the Hungarian economy is a market type economy [Preamble; § 9 (1)] and declared that private and public property are equal in terms of rights and protection [§ 9 (1)]; however, otherwise it was silent about economic policy. The Constitutional Court explained in its reasoning that the Constitution was neutral in terms of economic policy. [33/1993. (V. 28.) AB; The formula on economic neutrality was a frequently repeated statement of the Constitutional Court in its decisions.]

⁵ For more details e.g. Kolosi T. and Tóth I. Gy. (szerk.), *Társadalmi riport 2010 (Social Report 2010)*, (TÁRKI, Budapest, 2010).

⁶ Simon I., A közpénzügyek szabályozása az alkotmányban: tervezet, (2011) (16) *Pázmány Law Working Papers*, 1–41., <http://plwp.eu/evfolyamok/2011/122-2011-16> (Last accessed: 31 December 2018); Simon I., A közpénzügyek szabályozása az alkotmányban, in Drinóczi T. and Jakab A. (szerk.), *Alkotmányozás Magyarországon 2010–2011*, II. köt., (Pázmány Press, Budapest and Pécs, 2013) 361–417.

II. POWER BALANCES – PROPERTIES OF DIFFERENT AGES

1. Power balances from historical perspective

1. Human societies have organised themselves in different ways in different periods of time, in different locations and cultures. There have been differences among them in the size of population, geographical location, the economic and technical background and in the legal institutions that have determined how societies operated. These conditions and institutions have substantially influenced the possibilities of different societies.

2. The assumption followed in this study is that the power structure of a given society strongly determines its legal institutions. A century ago, Charles A. Beard concluded that “the social structure by which one type of legislation is secured and another prevented – that is, the constitution – a secondary or a derivative feature arising from the nature of economic groups seeking positive action.”⁷ His view is based on James Madison’s thoughts on conflicting economic interests.⁸ This inquiry does not follow the hypothesis – a kind of economic determinism – quoted just above; however, having analysed economic and financial affairs and their regulation for three decades one can derive the conclusion that economic and financial interest can at least not be neglected. My assumption is that, although economic interest has substantial influence on the legal institutions of a society, including its constitution, it is not the sole determinant factor on constitutional setting; depending on the given situation, among others, the culture, trust in the opposition parties, patriotism and even national sentiment can have a significant effect.

3. The Hungarian changes in 2010 and afterwards were responses to a complexity of challenges that could not have been answered via orthodox responses. That is why the decisions of the Government and Parliament have been perceived as unorthodox; the situation was unorthodox. If we recall some historical events – constitutional moments – we can realise that these situations and the outcomes were unorthodox.

4. The written formats of power balances, the roots of the modern constitutionalism can be found in the Middle Ages; e.g. the English Magna Carta from 1215 and the Hungarian *Aranybullá* (*Golden Bull*) from 1222. In substance, these documents were agreements between the king and the nobility containing the responsibilities and

⁷ E.g. C. A. Beard, *An Economic Interpretation of the Constitution of the United States*, (The Lawbook Exchange, New York, 1921) 13.

⁸ Beard, *An Economic Interpretation of the Constitution of the United States*, 14.; J. Madison, The Federalist No. 10, in A. Hamilton, J. Madison and J. Jay, *The Federalist Papers*, (Penguin Books, New York, 2003) 52.

competencies of the ruler and the rights of the nobility.⁹ Needless to say that, at that time, the Church was part of the power structure in Europe. In our days, the Magna Carta is a historical symbol of the rule of law; however, its significance at that time was much less since the ruler ignored his obligations.¹⁰

5. The next constitutional moment to be referred here is the liberal constitutional state, created mostly in the nineteenth-century, although earlier variants – such as in England – existed. The parliaments – and therefore the whole political system – of new bourgeois nation states were rather oligarchic since voting rights were allocated to a small fraction of society.¹¹ The Third Estate took over the power positions of the absolutistic nation state and its political purposes can be described in two key words: constitutionalism and parliamentarianism. The first excluded arbitrariness and, in substance, created the rule of law, while the second created a regime where the power is derived from and accountable to the electorate.¹²

From the perspective of finances, Professor Tibor Nagy showed that the one-time political class defined four areas of finances in the constitutions and kept them at the competence of the parliaments; taxation, public debt, budget and the oversight of its execution and the currency.¹³ Other constitutional safeguards were not necessary since the parliament was itself the institution that guaranteed the legality and proper operation of finances. From a taxation point of view, it is important that the principles of generality and equality of taxation were also introduced; first and foremost this meant the abolition of the tax privileges of the nobility.

2. Power balances from a historical perspective: the post-war period

1. After the Second World War, western societies created a system that integrated a substantial part of the population, and guaranteed the preconditions of a life that allowed people to live with dignity. That was the welfare state which, beside political rights, ensured social, cultural and economic rights, as was declared in different internationally accepted documents, such as the UN Covenant on Economic,

⁹ R. C. van Caenegem, *An Historical Introduction to Western Constitutional Law*, (Cambridge University Press, Cambridge, 1985) E-book 2012, <https://doi.org/10.1017/CBO9781139170871> (Last accessed: 31 December 2018); Mezey B., *Alkotmány és képviselet a középkori Európában*, in Mezey B. and Szenté Z. (szerk.), *Európai parlamentarizmus és alkotmánytörténet*, (Osiris Kiadó, Budapest, 2003, 19–177) 31.

¹⁰ J. Melton and R. Hazell, *Magna Carta.... Holy Grail?*, in R. Hazell and J. Melton (ed.), *Magna Carta and its Modern Legacy*, (Cambridge University Press, Cambridge, 2015, 3–20) 3. <https://doi.org/10.1017/CBO9781316285718.002>

¹¹ Caenegem, *An Historical Introduction to Western Constitutional Law*, 194–195.; Concha Gy., *Újkori alkotmányok*. I. kötet, (Eggenberger, Budapest, 1884).

¹² Caenegem, *An Historical Introduction to Western Constitutional Law*, 194.

¹³ Nagy T., *A pénzügyi jog alkotmányos alapjai*, (1963) 5 (2) *Acta Fac. Pol. Jur. Univ. Sci.*

Social and Cultural Rights.¹⁴ The basis of these constitutional systems was universal, equal and secret suffrage. This concept of voting right may be derived from the experiences of the wartime needs of these societies. As military service and taxation were universal in those societies, there was no reason to reject the right to take part in elections of those who took on the burdens.¹⁵ *The universal right to vote is a key point for understanding the political developments and policy formation in different countries, not only in the post-war period but also during the last decade, from the financial crisis, starting in 2007, onwards.*

2. The spirit of the age resulted in different principles, either directly in the constitutions or in the decisions of the constitutional courts. Examples: the German Basic Law states that Germany is a social state,¹⁶ the Spanish Constitution also declares that Spain is a social state and also that the tax system is based on progressive taxation,¹⁷ the Italian Constitution followed a similar path and includes the principle of progressive income taxation.¹⁸ From a taxation point of view, it was the age of the global income tax base and progressive taxation with a minimum tax-free threshold (subsistence minima). The German Constitutional Court derived the right to tax-exempt subsistence minima from the right to human dignity.¹⁹

Although, it was a golden age in the North Atlantic region and the Anglo-Saxon world, other parts of the world were less fortunate, – such as the (former) colonies or the so-called Soviet bloc. In the latter, the democratic political system was hollowed out, and elections were rendered meaningless due to the one-candidate system.²⁰

¹⁴ United Nations, *Universal Declaration of Human Rights*, (United Nations, UDHR, 1948) https://www.ohchr.org/en/udhr/documents/udhr_translations/eng.pdf (Last accessed: 31 December 2018); United Nations, *International Covenant on Economic, Social and Cultural Rights* (United Nations, New York, 1966) https://treaties.un.org/Pages/ViewDetails.aspx?src=IND&mtdsg_no=IV-3&chapter=4&clang=en (Last accessed: 31 December 2018); United Nations: *International Covenant on Civil and Political Rights* (United Nations, New York, 1966) https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IV-4&chapter=4&clang=en (Last accessed: 31 December 2018).

¹⁵ E. Huber, Evelyn: Introduction, in S. Leibfried et al. (eds), *The Oxford Handbook of Transformations of the State*, (Oxford University Press, Oxford, 2015, 1–41) 3.; C. Tilly, Reflections on the History of European State-Making, in C. Tilly (ed.), *The Formation of National States in Western Europe*, (Princeton University Press, Princeton, 1975, 3–83) 42.

¹⁶ German Basic Law Art 20(1).

¹⁷ Spanish Constitution 1978 Art 1(1) and Art 31(1). Moreover, the Spanish Constitution explicitly prohibits confiscation.

¹⁸ Italian Constitution 1947 Art 53.

¹⁹ E. Reimer, *German Income Tax – Outline and Reforms*, (Manuscript, 2001, 1–44) 7.; H. Kube, Financing the State – the Tax-funded State versus Multiple and Mixed Financing Strategies, in H. Pünder and C. Waldhoff (eds), *Debates in German Public Law*, (Hart Publishing, London, 2014, 131–158) 148.; J. English, The Impact of Human Rights on Domestic Substantive Taxation – the German Experience, in M. P. Maduro, and P. Pistone et al. (eds), *Human Rights and Taxation in Europe and the World*, (IBFD, Amsterdam, 2011, 285–302) 287.

²⁰ Dezső M. et al., *Alkotmánytan I*, (Osiris Kiadó, Budapest, 2007) 141.

3. As it is important for the interpretation of our age, a short reference to the post-war international world order has to be made. In essence it was a bipolar world order that was composed of – theoretically and according to the international legal documents – equal nation states²¹ surrounded by borders, and those borders entailed economic borders as well (e.g. customs, controlled capital movements). There were changes in that period, such as decolonisation and the development of regional integrations; however, these changes did not change the basic structure of the world order of nation states. It seems likely that the wave of decolonisation – the deconstruction of the European world empires – partly happened as an effect of a new international world power – the US – and because of the socialist alliance led by the Soviet Union. The US brought two important changes to the international world order: multilateralism and non-discrimination.²² The purpose of the latter was to dissolve the strength of the previous colonialist connections and decrease the advantages of the colonialist countries in the economic sphere; it was mainly directed against Britain. Multilateralism served the peaceful achievement of the political goals of the dominant powers, especially the United States.²³

4. International fiscal, monetary, financial and trade law served inter-national economic relations. The international monetary and financial relations were served primarily by the Bretton Woods institutions and the legal infrastructure of the trade relations were ensured by the GATT. The OECD gradually gained its position, especially in the fields of international taxation and foreign exchange liberalisation.

Although western societies integrated the substantial part of the population, at least in material terms, it happened partly on the basis of asymmetric economic relations with economically less developed countries; e.g. unbalanced international trade²⁴ and asymmetry in international tax²⁵ relations.

²¹ Charter of the United Nations Art 1(2). It was promulgated in Hungary by the Act I of 1956.

²² Rodrik D., *A globalizáció paradoxona – Demokrácia és a világgazdaság jövője (The Globalisation Paradox)*, (Corvina Kiadó, Budapest, 2014) 104–105. A special version of the non-discrimination principle is the principle of the most favoured nation treatment as it was formulated in international trade (customs) agreements.

²³ R. W. Stone, *Controlling Institutions*, (Cambridge University Press, Cambridge, 2011) 1–7.

²⁴ W. Milberg and D. Winkler, *Outsourcing Economics – Global Value Chains in Capitalist Development*, (Cambridge University Press, Cambridge, 2013), 285. <https://doi.org/10.1017/CBO9781139208772>

²⁵ E.g. J. Braun and M. Zagler, An Economic Perspective on Double Tax Treaties with(in) Developing Countries, (2014) 6 (3) *World Tax Journal*, 242–281. In the new BEPS context see: A. Christians, Taxing According to Value Creation. (2018) 90 (June 18) *Tax Notes International*, 1379–1383.

3. Contemporary power imbalances: the breakdown of the post-war international system and globalisation

a) The road to imbalances: emergence of the global order

1. The origin of the contemporary world order may be located in the crises of the developed countries in the seventies,²⁶ which was followed by a conservative twist in British (1979) and American (1981) politics and economic policy. The speed of changes was slightly accelerated by the collapse of the Soviet bloc. From the eighties, the developed countries and the businesses of these countries made intense efforts to abolish exchange controls and other obstacles to international investment and the provision of services internationally. The neoliberal free market ideology served as the conceptual basis of this move. It was promoted – mainly in the so-called developing world including the East-Central European countries – by the US via ideological channels (e.g. media, education) and via the creditor institutions (e.g. IMF).²⁷

2. The processes that led to the contemporary political and economic structures usually described by the keywords of privatisation, deregulation,²⁸ liberalisation²⁹ and globalisation. There have been two main lines of legal intrusion into the process of creating the global market. One of them is liberalisation – of customs, foreign exchange (mainly capital movements), provision of services – and re-regulation – mainly through professional standards – of the global market. The content of the different legal instruments follows economic interests and the consequences of them are usually clear for only a narrow circle of professionals.³⁰

3. The liberalisation of capital movements and the provision of services cleared the path to market integration globally and at the same time for the emergence of multinational corporations as they exist in our days.³¹ As Jean-Bernard Auby wrote, the most striking aspect of globalisation “is spatial dislocation: the deterritorialisation of

²⁶ E.g. Erdős P. and Molnár F.: *Infláció és válságok a hetvenes évek amerikai gazdaságában*, (Közgazdasági és Jogi Könyvkiadó, Budapest, 1982).

²⁷ J. D. Levy, S. Leibfried and F. Nullmeier, Changing Perspectives on the State, in S. Leibfried et al. (eds), *The Oxford Handbook of Transformations of the State*, (Oxford University Press, Oxford, 2015, 33–58) 40, <https://doi.org/10.1093/oxfordhb/9780199691586.013.2>; Stone, *Controlling Institutions*, 72–73.

²⁸ The deconstruction of market barriers such as price regulation, structural regulations of the market.

²⁹ Meaning the deconstruction of economic state barriers; for example foreign exchange regulations such as the *OECD Code of Liberalisation of Capital Movements* and the *OECD Code of Liberalisation of Current Invisible Operations*. <http://www.oecd.org/daf/inv/investment-policy/codes.htm> (Last accessed: 31 December 2018). The agreements managed in the WTO framework: GATS, TRIPS and also its elderly brother, the GATT. E.g. https://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm (Last accessed: 31 December 2018).

³⁰ E.g. E. B. Kapstein, *Supervising International Banks: Origins and Implications of the Basle Accord*, (Princeton Univ Intl Economics, Princeton, New Jersey, 1991) (Essays in International Finance No. 185).

³¹ E.g. Simon I., A pénzügyi piac strukturális szabályozása. (2005) 1 (1) *JoGoK*, 10–23.

economic and social activities and mechanisms. What is at stake here is a rearrangement of territories, on the basis of a dislocation of certain activities.³² Today, transnational enterprise and the global market, together with the e-sphere, exist as a reality with interests partially different from the interests of the nation states, and of integrations such as the EU. The transnational corporation organises itself as a value chain in the global marketplace and locates its elements (subsidiaries, permanent establishments) according to its best interests, taking the legal (statutory, judicial etc.) environment into account.³³ One aspect of it is tax planning – including its unacceptable level: aggressive tax planning – the purpose of which is to reduce the amount of tax to be paid at group level. The other side of the coin is the tax competition among states offering a favourable fiscal environment in order to attract investment from multinational market players.³⁴ However, in the global market place, other forms of competition among states are present beside tax competition, which can be called regulatory competition with a more general expression. One of the examples is the area of financial regulation and supervision.³⁵ Generally speaking, the sides of the coin are regulatory competition on the states' side and regulatory arbitrage on the side of market participants. As was formulated by many scholars, businesses – or more generally the economy – seek to neutralise its environment and, with this, beside its environment, it also endangers itself.³⁶ The US subprime crisis – which broke out in 2007 – could serve as an example of how it gradually had arisen despite a regulatory and supervisory environment taken as top quality, based on global offshore fundraising and with unbelievable negative global impact.³⁷

b) An asymmetric relationship: Hungary in the global order

4. It is important to note how the countries of East-Central Europe, among them Hungary, integrated into the global economy, including Europe. Andreas Nölke and Aljan Vlieghe proposed to call the economic systems of these countries dependent market economies, pointing out that, according to their substantial features, these economies differ from the two traditional models; i.e. the liberal model represented

³² J.-B. Auby, *Globalisation, Law and the State*, (Bloomsbury Publishing, Oxford, 2017) 6–7.

³³ E.g. L. G. Baxter, Understanding the Global in Global Finance and Regulation, in R. P. Buckley et.al. (eds.), *Reconceptualising Global Finance and its Regulation*, (Cambridge University Press, Cambridge, 2016, 28–48) 44–45. <https://doi.org/10.1017/CBO9781316181553.003>

³⁴ E.g. W. Schön (ed.), *Tax Competition in Europe*, (IBFD Publications, Amsterdam, 2003).

³⁵ E.g. M. P. Malloy, Bumper Cars: Themes of Convergence in International Regulation, (1992) 60 *Fordham Law Review*, 1–22.

³⁶ Polányi K., *A nagy átalakulás – Korunk gazdasági és politikai gyökerei*, (*The Great Transformation*) (Napvilág Kiadó, Budapest, 2004) 311–313. Similarly e.g. Milberg and Winkler, *Outsourcing Economics...*, 284–285.; Rodrik, *A globalizáció paradoxona...* (*The Globalization Paradox*), 73.

³⁷ E.g. R. Murphy, *Tax Havens Creating Turmoil – Evidence submitted to the Treasury Committee of the House of Commons by the Tax Justice Network*, (Tax Justice Network International Secretariat, Chesham, 2008).

by the US and the coordinative model represented by Germany.³⁸ The main feature of dependent market economies is the dominant role of foreign ownership. Taking the example of Hungary, foreign-owned companies provided 50% – in terms of gross income and gross added value – of GDP between 2010 and 2015. In the energy industry their gross income proportion was 71.3% in 2010 and 55% in 2015. As employers, these companies employed 25% of the labour force in Hungary.³⁹ There are some consequences of this situation. For example, investment decisions are not made in Hungary but in the US and Western European headquarters of the corporations and the local firms are hierarchically controlled by and their managers report to their western headquarters. Moreover, the decisions on financing the locally owned businesses are also made abroad due to the high proportion of foreign ownership in the financial industry.⁴⁰

5. Beside the traditional obligations derived from international legal sources, two additional sets of rules of the global sphere have an impact on Hungary. One of them influences Hungary as a sovereign legislator; the other effects Hungary as a debtor market participant, which has to manage its public debt.

The first set of rules are those professional standards that gain dominance over the last thirty years in the regulation of business activities; for example the standards published by the Basel Committee. A substantial part of those rules under which the financial market and its participants operate are composed of “soft” global standards⁴¹ that become hard domestic laws directly or via the EU implementation process, as with the III. Basel Accord that was implemented into European law via the 575/2013/EU regulation and the 2013/36/EU directive. The content of these global standards are profoundly influenced by the dominant states, mainly, because of its weight, the US.⁴² The dominant market players also have substantial influence on decisions of this kind; this influence might have been stronger before the 2007/08 crisis than today.

The other set of rules are in connection with financing public debt; these rules delimit the possibilities of forming sovereign policy – fiscal, economic, social etc. As Stephen B. Kaplan wrote, the transformation of the method of financing public debt from bank loan to bond issues narrowed excessively indebted states’ room to manoeuvre

³⁸ A. Nölke and A. Vliegenthart, Enlarging the Varieties of Capitalism – The Emergence of Dependent Market Economies in East Central Europe, (2009) 61 (4) *World Politics*, 670–702. <https://doi.org/10.1017/S0043887109990098>

³⁹ These data were derived from the publication of the Central Statistical Office of Hungary, <http://www.ksh.hu/docs/hun/xftp/idoszaki/pdf/kulfleany15.pdf> (Last accessed: 31 December 2018).

⁴⁰ Nölke and Vliegenthart, Enlarging the Varieties of Capitalism..., 679–684.

⁴¹ E.g. C. Brummer, *Soft Law and the Global Financial System – Rule Making in the 21st Century*, (CUP, Cambridge, 2015). <https://doi.org/10.1017/CBO9781316423875>

⁴² Kapstein, *Supervising International Banks...* Kapstein described the process how the I. Basle Accord was accepted. It is in accordance Randall W. Stone’s referred statements.

in policy formation.⁴³ The market – creditors and credit rating agencies – influences the debtor states' policy formation via credit decisions and ratings. The next level of policy formation by creditors is the decisions of international financial institutions such as the IMF. States that have no access to market finance are funded by the international financial institutions, primarily by the IMF. The credit conditions applied by the IMF are based on Washington consensus-type policies; it is a neoliberal type policy framework.⁴⁴ The result of this is normally an austerity fiscal policy; and its components are privatisation, liberalisation and deregulation.⁴⁵

6. It is worth adding that, in Hungary, those channels referred above that promoted the neoliberal ideology – the international financial institutions and the media – operated efficiently.⁴⁶ The connotations of the key words – including privatisation, liberalisation and deregulation – are not, or at least not so positive in East-Central Europe as they were in the beginning of the nineties of the last century. One of the reasons is the asymmetric position of Hungary in the global sphere in economic terms. The origin of the so called unorthodox institutional and policy solutions pursued in Hungary can partly be located here.

c) **The renaissance of the nation state**

7. Since the outbreak of the global financial crisis some changes have occurred in the global power structure.

First, in the financial market – and also in the sphere of international taxation – a kind of global regulation via standard and model setting and governance via policy coordination has emerged during the last decades. These devices gained new structures and methods after the crisis, and narrowed the leeway of transnational corporations.

Second – to make concrete the first point above – the shift from G7 to G20 in global informal policy formation shows that some of the one-time developing countries

⁴³ S. B. Kaplan, *Globalization and Austerity Politics in Latin America*, (Cambridge University Press, Cambridge, 2013) 279. <https://doi.org/10.1017/CBO9781139086196>

⁴⁴ E.g. J. E. Stiglitz, Democratizing the International Monetary Fund and the World Bank: Governance and Accountability, (2003) 16 (1) *Governance: An International Journal of Policy, Administration, and Institutions*, (111–139) 122. <https://doi.org/10.1111/1468-0491.00207>

⁴⁵ See generally the analysis of the creditor debtor relationship in this context: Kaplan, *Globalization and Austerity Politics in Latin America*.

⁴⁶ Szalai E., *Gazdasági elit és társadalom a magyarországi újkapitalizmusban*, (Aula Kiadó, Budapest, 2001). (The author has been engaged in elite research for many decades. According to her in-depth interviews, the commercial TV channels were financed by economic interest groups and they bought the opportunity to be in the programmes in different ways. The interest of the dominant groups – the former socialist technocrats who transformed their political positions to ownership positions and the foreign investors – was to create a monopoly position for the neoliberal ideology – and inside this frame the unconditional promotion of globalisation. The core of these messages was the fetishism of international free market competition and their function was to hide how the real competition exists in the marketplace. Ibid. 223–224.)

have become players in the decision making process.⁴⁷ The weight of the G20 can be measured in the financial field on the basis of decisions, such as the establishment of the Financial Stability Board in 2009⁴⁸ or the launch of the Base Erosion and Profit Shifting project, the mandate for which was received by the OECD.⁴⁹ The BEPS and the Third Basel Accord serve as examples of the new legal devices that might narrow the room for arbitration by multinationals.

Third, the most remarkable change of the last decade is the growing emphasis of national interest in the democratic political systems of Europe and in the Americas. The following examples may show the strengths of the wind of change: the victory of Donald Trump in the US, Brexit, the results of the national elections in Poland, Czech Republic, Italy, Austria, Israel, Brazil, and Greece. The pioneer of this wave was the outcome of the elections in 2010 in Hungary.

In the next couple of years, it will become clear whether the renaissance of the nation states brings a new power balance among the different players in the global arena. Obviously, there are several significant reasons for the changes mentioned but the most decisive factor is democracy itself, the main element of which is the general voting right.⁵⁰ The core causal factor in the changes is that the political power of the western countries left the politically active classes of the societies alone. While western state powers were keen to giving a path for their business enterprises to secure places in the market and investment possibilities globally, and the corporations made substantial capital investments in less industrialized countries – meanwhile strengthening their own global competitors in the Far East (e.g. China) – they forgot their home societies. During the last decades, the inequalities have grown significantly in the OECD countries and the income of the middle class did not grow between 1988 and 2008.⁵¹

8. The question whether the renaissance of the nation state will solve those problems that revitalized some democracies cannot be answered yet. One of the problems that first and foremost should be solved is inequality and the distribution of wealth inside the societies and among societies. That state of inequality existing today even endangers the market itself as it narrows demand.

⁴⁷ G. Smith, *G7 to G8 to G20: Evolution in Global Governance*, (2011) (6) *CIGI G20 Papers*; C. Barry et al., *Making the G20 Summit Process Work: Some Proposals for Improving Effectiveness and Legitimacy*, (2010) (2) *CIGI G20 Papers*. More information at <http://www.g20.utoronto.ca/g20whatisit.html> (Last accessed: 31 December 2018).

⁴⁸ The *Charter of the Financial Stability Board* is available at: <http://www.fsb.org/wp-content/uploads/FSB-Charter-with-revised-Annex-FINAL.pdf> (Last accessed: 31 December 2018).

⁴⁹ *OECD/G20 Base Erosion and Profit Shifting Project: Executive Summaries – 2015 Final Reports*, (OECD, 2015), <http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf> (Last accessed: 31 December 2018) 5.

⁵⁰ Dani Rodrik shows the conflict between the “hyperglobalization” and the democracy under the title of the trilemma of globalisation. See Rodrik, *A globalizáció paradoxona... (The Globalization Paradox)*.

⁵¹ B. Milanovic, *Global Inequality*, (The Belknap Press, Cambridge, MA and London, 2016) 11., 19.

I think Dani Rodrik clearly sees the problem of our age when saying that the proper and sustainable level of globalisation was the one that existed after the second world war as opposed to the one that exists in our age and what he calls hyper-globalisation. The precondition of sustainable global cooperation is the nation state.⁵² It is built on democratic political process and it ensures the legal foundations of the market, including the judicial system. Another institution that carries all of the core functions of the state at least and operates in a transparent and accountable way, as well as granting the basic set of human rights, does not seem emerging on the earth.

9. It must be noted here in this context that Hungary is a member states of the EU, therefore I take the *acquis de l'Union* as the natural framework of the Hungarian constitutional law, as Hungary concluded it in the treaties. One must note that the debate on the constitutional identity of the member states reflects on the questions discussed here in this study.

III. FISCAL AND MONETARY RULES IN THE FUNDAMENTAL LAW OF HUNGARY

1. Finances in the Constitution and in the Fundamental Law – a summary

1. The Constitution that was in effect from 1949 until 31st December 2011 was reticent on financial affairs; its rules covered taxation, the budgetary power of the Parliament and the rules on the central bank and the State Audit Office. It has to be mentioned that the fiscal and monetary rules were enacted as amendments – with the exception of the budgetary competence of the Parliament – in 1989, just before the transition from the so called socialist system to a democratic political system and market economy in 1990. The Constitution was amended with a set of rules that narrowed the fiscal competence of the Constitutional Court with effect as of 20th November 2010. With the effect from 1st January 2011, the Constitution was amended with rules on the Financial Services Authority.⁵³ From this time onwards, the supervisory institution of the financial market gained constitutional status.

2. The Fundamental Law is structured into four parts. The first is a special preamble, a catalogue of values and titled as the “National Avowal”. The second part is titled as “Foundation” (Art A–T) that contains the basic constitutional principles. The third part of the FL which contains the basic rights and freedoms and also the basic

⁵² Rodrik, *A globalizáció paradoxona... (The Globalization Paradox)*, 294–296.

⁵³ The FSA was merged into the central bank in 2013.

obligations, titled “Freedoms and Responsibilities” (Art I–XXXI.). The fourth part regulates the state organization and titled “The State” (Art 1–54).

As mentioned above, the new Hungarian two-tier constitutional system requires qualified majority for the enactment of two types of laws; one of them is the Fundamental Law (passed by the two third majority of the representatives) and the other comprises the cardinal laws (enacted by the two third majority of the representatives present in the National Assembly). These legal sources provide a not negligible proportion of the body of legal norms governing fiscal and monetary law.

3. The Fundamental Law itself regulates a wide range of subjects that belong to the field of fiscal and monetary law.

A short overview of how these rules are structured in the FL is necessary, and some of the rules will be discussed in more detail below in this study. In the second part, the FL sets the basic principles on budgeting (Art N), on the basic relationship of the individual and the community (Art O), on public assets (Art P) and also on money, as Art K) states that the official currency of Hungary is the forint.

In its third part, the FL regulates the basic rules on taxation (Art XXX.), on the pension system (Art XIX.) and on the health care system (Art XXI.).

Part four – that regulates the state – prescribes that the National Assembly decides on the budget and its implementation (Art 1). It includes the competencies of the President of the Republic in connection with public finances (Art 3 and 9), and the status of the local municipalities in the framework of public finances (Art 32 and 34). This part includes a separate chapter titled “Public Finances” (Art 36–44). This chapter on public finances includes the basic rules on the budget, the public debt, the National Bank of Hungary, the State Audit Office, the Budgetary Council, the article in which the FL prescribes that the basic rules – beside the ones that are included in the FL – of taxation and the pension system have to be enacted in a cardinal law,⁵⁴ and also includes the rule according to which payment from public funds to a private party (i.e. mainly businesses) shall be made only if the latter is a transparent entity, meaning that its ownership structure and operation is transparent.

4. The restricted power of the Constitutional Court in the area of fiscal legislation has to be mentioned – which is not the innovation of the FL, as it was referred to above – since it belongs to the new constitutional setting. The essential purpose of these rules is to delimit the potential intervention of the Court into budget framing – an essential part of which is taxation – and the public debt reduction decisions of the Parliament. While the public (“general government”) debt exceeds 50% of the GDP, the Constitutional Court has powers to review laws on the central budget, the implementation of the central budget, central taxes and other fiscal levies, and on the legislation of conditions for local taxes for conformity with the Fundamental

⁵⁴ This cardinal law is Act CXCIV of 2011 on the Economic Stability of Hungary (Stability Act).

Law solely as pertaining to fundamental rights to life, human dignity, protection of personal data, freedom of thought, freedom of conscience and freedom of religion, or rights in connection with Hungarian citizenship, and annuls such laws only in the event of any infringement of these rights. However, the Court has the power to annul the fiscal laws mentioned if they were adopted or published by infringing the procedural rules of legislation laid down by the Fundamental Law [Art 36(4)–(5)].

In the following, some details on some areas of the new constitutional setting and the reasons for their formulation will be given.

2. The budget, the deficit and the public debt

1. Before we have a closer look on the institutional construction of budgetary affairs and disciplined budget management, it is reasonable to recall some interpretations of the public debt and also the figures of both the deficit and the public debt as they existed just before the endeavour to construct a new constitution.

2. As a renowned economist wrote some thirty years ago, public debt in its economic substance is similar to fever; it is a symptom that shows deeper problems of the economic structure of a given country, which structural problems are derivatives of deeper problems, namely the power and vested interest structures of the given society and economy.⁵⁵ The cure may be the modification of these power structures. Minor progress happened during the transition; however, the continuous deficit spending and the high degree of public debt was obvious in 2010.

The measure of the public debt, partly dependent on the informal economy; in this context tax avoidance and tax evasion, have an effect on the revenue side and corruption mainly affects the expenditure side. As an example, James S. Henry showed that the quantity of the capital that was siphoned off to offshore locations from Hungary during the last decades was substantial, even by international comparison.⁵⁶

3. Solving the public debt is also a question of redistributing burdens among recent taxpayers – for example, the free rider problem – and also redistributing burdens among generations.

4. The public debt can also be a question of sovereignty since, above a certain public debt to GDP ratio, financing the debt involves following policy measures, the basic conditions of which are determined by external sources; economically forceful countries seem exempt. In the EU context, these rules are defined as public law rules,

⁵⁵ Antal L., Gazdasági helyzetünk, fejlődési esélyeink és a tőkepiac fejlesztése, (1990) (2) *Bankszemle*, (1–8) 7.

⁵⁶ See J. S. Henry <http://globalhavenindustry.com/> (Last accessed: 31 December 2018) and also the graphics on *The Guardian* website http://image.guardian.co.uk/sys-images/Observer/Pix/pictures/2012/07/21/gu_wealth-offshore-01.jpg (Last accessed: 31 December 2018).

since these are institutionalised in the Maastricht Treaty and the Stability and Growth Pacts and later in the rules of budget planning.

The conflict between Hungary and the international creditor institutions – the so-called troika: the IMF, the ECB and the EU Commission – at the beginning of this decade can serve as an example of the sovereignty problem, which concerns policy formation. Beside the Hungarian example, the Greek financial crisis can also serve as an example of this problem. The two countries – Greece and Hungary – chose two different ways of crisis management, both of which are full of conflicts.

5. The proportion of public debt to GDP grew during the first decade of this century. During the period when – a short political comment is needed – the so called socialist-liberal coalition was in power between 2002 and 2010, the public debt relative to GDP increased by almost 30%. While the *public debt* was 84% in 1995, it was reduced to 51.4% by 2001 – the last whole year of the first Orbán government – and it increased to 77.2% in 2009, the last whole year of the socialist-liberal government. The peaks were in 2010 (79.7%) and 2011 (79.9%). Over a period of almost a decade – since 2010 – the public debt to GDP ratio was reduced by almost 10% to 70.845% at the end of 2018.⁵⁷ The priorities of public debt management, beside debt reduction, have been to increase the share of domestic household bondholders and to reduce the proportion of foreign currency-denominated debt, which was circa 50% in 2010 and 21% in March 2018.⁵⁸

The *deficit* scene is similar. From the accession to the EU in 2004, Hungary was under an excessive deficit procedure until 2013.⁵⁹ In proportion to the GDP, the deficit has been under 3% (one of the Maastricht criteria) since 2012. It was 2.2% in 2018.⁶⁰

6. Although the primary objective of the regulation of the budgetary affairs at constitutional level was the reduction of budget deficit and the public debt, other norms were also enacted in this field. Therefore, it is reasonable to draw up the basic constitutional framework of budgetary affairs in order to have a coherent picture of budgetary rules.

As a starting point the basic principle of budget management has to be quoted: “Hungary is committed to the principle of a balanced, transparent and sustainable management of the budget.”⁶¹ The quoted principle will be recalled below in the debt and deficit management context.

⁵⁷ https://www.ksh.hu/docs/hun/eurostat_tablak/tabl/tsdde410.html (Last accessed: 31 December 2018); <http://www.akk.hu/hu>; <http://www.mnb.hu/letoltes/koltsegvetesi-jelentes-2018-hun.PDF> (Last accessed: 31 December 2018).

⁵⁸ <http://www.akk.hu/hu> (Last accessed: 31 December 2018).

⁵⁹ Council Decision of 21 June 2013 abrogating Decision 2004/918/EC on the existence of an excessive deficit in Hungary. http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/126-12_council/2013-06-21_hu_126-12_council_en.pdf (Last accessed: 31 December 2018).

⁶⁰ https://www.ksh.hu/docs/hun/eurostat_tablak/tabl/teina200.html (last accessed: 31.12.2018).

⁶¹ FL Art N) (1).

The FL keeps the budgetary competences of the National Assembly and orders that it has to pass a budget act and an act on its implementation for each year. The Government presents these bills – the budget and the one on its implementation – to the National Assembly within the time limit prescribed by the respective act. The FL orders that the bill on the central budget and the bill on the implementation of the central budget shall contain all state expenditures and revenues in an identical format and the bills must be transparent and reasonably detailed.⁶²

An automatic regulator is built into the Fundamental Law; if the Budget Act is not passed by the beginning of the fiscal year, the Government is entitled to collect taxes on the basis of the tax laws in effect and to spend, *pro rata temporis*, according to the Budget Act of the previous fiscal year.⁶³ As a potential solution for conflicts manifested in connection with the budget, the Fundamental Law gives the power to the President of the Republic to dissolve National Assembly – announcing the date of the new parliamentary elections at the same time – if the National Assembly does not pass the budget act by 31 March of the given fiscal year.⁶⁴

The Fundamental Law addresses the basic principles of budget execution, stating, that the Government is obliged to implement the central budget in a lawful and expedient manner, with efficient management of public funds and by ensuring transparency.⁶⁵

7. Public debt-brake rules are among the most important norms of public finances in the Fundamental Law. While the public debt is above 50% of the GDP ceiling, the National Assembly has to pass a budget that results in a decrease of the public debt ratio compared to the previous year. If the proportion is under 50%, the National Assembly shall be prohibited from passing a budget that result in the ceiling being breached. There is an escape clause in the Fundamental Law that allows it to ignore the debt-brake rule according to the conditions defined, namely a special legal order or a significant and lasting recession. The clause allows such deviation only as necessary in order to regain a balanced operation. The Stability Act defines the term significant and lasting recession as a decrease in real GDP, using any measure.⁶⁶ The guardian institution of the debt-brake rule is the three-member body, the Budgetary Council, without whose consent the Budget Act cannot be enacted; it has a veto power. One of its members is the Governor of the National Bank, another member is the President of the State Audit Office, and the third member is the Chairman of the Budgetary Council, nominated by the President of the Republic for six years.⁶⁷

⁶² FL Art 1 (2) c) and Art 36(1)–(2).

⁶³ FL Art 36(7).

⁶⁴ FL Art 3(3)–(4).

⁶⁵ FL Art 37(1).

⁶⁶ FL Art 36(6); Stability Act § 7.

⁶⁷ FL Art 44; Stability Act Ch 4 § 15–27 (§ 23–27 qualify as cardinal law).

8. Debt brake rules for the phase of the implementation of the budget are also defined at constitutional level. The FL orders that the government cannot take any considerations that would result in the growth of the public debt/GDP ratio compared to the previous year while it is above 50%. If the ratio is under 50%, this proportion will be an absolute ceiling, meaning that the Government is prohibited to take any consideration that results in exceeding the ceiling.⁶⁸ The Government, on the basis of the semi-annual data, reviews the situation of the economy and the budget and if necessary submits a budget modification bill to the National Assembly in order to ensure the proper operation of the debt-brake rule. The Budgetary Council's veto power applies in this case as well.⁶⁹

9. In order to control the public debt, the municipalities and publicly owned private entities whose debts are calculated in the public debt are only permitted to conclude any kind of business transaction (e.g. loan, lease, issuing securities) that raises public debt – as the main rule – with the prior consent of the Government (in the case of municipalities) or the Finance Minister (publicly owned entities). The Stability Act contains the detailed list of conditions that have to be met for gaining prior consent.

10. As to the deficit, the Stability Act prescribes that the yearly deficit of the public household (“general government” in ESA terms) cannot be higher than 3% of GDP.⁷⁰ Since the public debt – in the usual parliamentary process – is born through the yearly budget deficit, this rule is a very important means of controlling public debt.

11. The budgetary rules of the Fundamental Law explained above have two goals. One of them is to ensure the disciplined operation of public finances. The other is to keep as much fiscal sovereignty of the country as possible in a globalized economic system, as a member state of the European Union. The quite overt reason behind it is that the state has to fulfil its functions in a given society taking into due account its own social, economic and political conditions.

3. The national asset

1. By definition the property of the state and the municipal governments are considered national assets.⁷¹ Until 1989 there was not even an attempt to account for all assets of the state, and there are only estimates of their value at the time of transformation (1990); however these estimates, both in terms of methods and data, are rather imprecise. According to these estimates, the value of transferable property of the public

⁶⁸ FL Art 37(2)–(3).

⁶⁹ Stability Act § 5.

⁷⁰ Stability Act § 3/A(3).

⁷¹ FL Art 38(1).

household (general government) was 10-11 thousand billion Hungarian forints.⁷² The state-owned enterprises that were transferred to the State Property Agency – a public body responsible for privatisation – were valued at 1700 thousand billion Hungarian forints, and 2600 thousand billion forints together with the value of those land that were given to the ownership of municipalities. The tangible assets of state-owned enterprises were valued in 1968,⁷³ these valuations served as the basis when the state-owned enterprises were transformed into different company forms and also when the companies were sold. Privatisation started in a spontaneous way in 1989; the leadership of one-time state-owned enterprises managed to gain ownership control over the most valuable parts of the companies that were established via the transformation of state owned enterprises.⁷⁴ Privatisation as a regulated process started in 1990 and almost 90% of the one-time state owned enterprises were transferred to private ownership by 1996. The main form of creating private ownership was not privatisation; rather, it was the loss of assets, meaning that the assets simply disappeared. Fifty percent of the assets' value vanished in this way.⁷⁵ In 1995–1996, strategic industries – natural monopolies – were sold off, such as the oil and gas, telecommunications and electricity and the result was that, instead of Hungarian state monopolies, private monopolies or foreign state monopolies were created.⁷⁶ The banking sector was privatised between 1994 and 1997; the result was that two thirds – in terms of assets – of the sector was in foreign ownership in 2000.⁷⁷ It was 85% in 2008 and cc 45% in 2017.⁷⁸

2. Beside privatisation, the question of farmland attracts special interest in Hungary and also in the neighbouring countries. According to prevailing contemporary neoliberal economic thinking – backed by dominant interests in it – land is a form of

⁷² The official HUF/USD exchange rate published by the National Bank of Hungary was HUF 65.41 = USD 1 on 8th April 1990; the day of the second round of the first free parliamentary elections in Hungary. <https://www.mnb.hu/arfolyam-tablázat?deviza=rbCurrencyActual&devizaSelected=USD&datefrom=1990.04.08.&datetill=1990.04.15.&order=1> (Last accessed: 31 December 2018).

⁷³ Matolcsy Gy., *Lábadozásunk éve*, (Tulajdon Alapítvány Privatizációs Kutatóintézete, Budapest, 1991) 141.

⁷⁴ Báger G. and Kovács Á., *Privatizáció Magyarországon I*, (Állami Számvevőszék, Budapest, 2001) 101–103.; Matolcsy Gy., A privatizáció Magyarországon, in Báger G. and Kovács Á. (szerk.), *Privatizáció Magyarországon II. Háttér tanulmányok*, (Állami Számvevőszék, Budapest, 2004, 13–30) 14.

⁷⁵ Matolcsy Gy., A privatizáció Magyarországon, 24–25.; Tamás Erdei the former CEO of MKB Bank and the chairman of the Hungarian Bankers Association also estimated the loss at around 40–50%; see Báger and Kovács, *Privatizáció Magyarországon I*, 132. fn. 238.

⁷⁶ Matolcsy Gy., A privatizáció Magyarországon, 28.; Gidai E., Giday A. and László T., Néhány fontosabb ágazat (vállalat) privatizációja, in Báger G. and Kovács Á. (szerk.), *Privatizáció Magyarországon II. Háttér tanulmányok*, (Állami Számvevőszék, Budapest, 2004) 201–268.

⁷⁷ Várhegyi É., Külföldi tulajdon a magyar bankrendszerben, (2001) 48 (július–augusztus) *Közgazdasági Szemle*, (581–598) 583–584.

⁷⁸ *Raiffeisen CEE Banking Sector Report 2018*.

capital, as can be seen in EU law⁷⁹ and the OECD Code⁸⁰ referred to above. One of the purposes of these rules was to neutralise land as a political phenomenon. However, a substantial part of society in East-Central Europe think that the land of a country – beside its economic value – is not only a political phenomenon but it is also a part of the national identity. The recent majority of parliamentary representatives in Hungary are also of this view, as can be derived from the texts and spirit of the legislative acts of the last decade.⁸¹ This question is a major conflict factor in the relationships between the EU and several member states.⁸² The reasons are rational and simple: these member states are reluctant to sell off one of the bases of their existence; this is particularly true for the East-Central European countries. There are significant differences between member states in terms of the quantity of the domestic capital to be invested, in land prices and the ownership structures.

3. On the basis of previous experiences – briefly mentioned above – the FL includes the basic rules of national assets.

The concept and the functions of national asset are defined in the Fundamental Law and cardinal laws. At the level of the basic constitutional principles, Art P) constitutes that natural resources, particularly arable land, forests and water resources, as well as biological diversity, in particular native plant and animal species and cultural assets shall comprise the nation's common heritage; responsibility for protecting and preserving them for future generations lies with the State and every individual. Moreover, the FL states that the basic rules relating to them have to be regulated in cardinal laws.⁸³ Art 38 of the FL defines national assets as the property of the state and the municipalities and their function is to serve the public interest and satisfy public needs. In addition, it stipulates the basic rules of asset management.⁸⁴

⁷⁹ Council Directive of 24 June 1988 for the implementation of Article 67 of the Treaty (88/361/EEC).

⁸⁰ OECD Code of Liberalisation of Capital Movements 2018. Hungary has made reservation in respect of real estate operations. Annex B Reservations Hungary List B, B1, 66. <http://www.oecd.org/daf/inv/investment-policy/Code-capital-movements-EN.pdf> (Last accessed: 31 December 2018).

⁸¹ E.g. Act CXXII of 2013 on Transactions in Agricultural and Forestry Land and its official explanatory memorandum.

⁸² Financial services: Commission requests Bulgaria, Hungary, Latvia, Lithuania and Slovakia to comply with EU rules on the acquisition of agricultural land, Brussels, 26 May 2016. See also: Commission Interpretative Communication on the Acquisition of Farmland and European Union Law (2017/C 350/05).

⁸³ FL Art P) (1)–(2). Act CXCVI of 2011 on the National Asset define the national asset and regulates its management.

⁸⁴ FL Art 38.

4. Taxation

1. As mentioned at the beginning of this study, one of the core points of the critics against the new constitutional system was that certain tax policy elements were included in the Fundamental Law and in the Stability Act. These are the new rules of personal income taxation. My view is that these are one of the most important – adequate and appropriate – elements of the two-tier constitutional law and the tax system has made a small step toward tax justice, although it remained rather regressive due to the significant proportion of turnover taxes – e.g. VAT – in net wages.

Hungarian real wages did not improve between 1980 and 2009.⁸⁵ The yearly national average net wage was 6702 euro in Hungary, while the EU (28) average was 24,162 euro in 2015, the same data was 8630 euro, and 24700 euro in 2018.⁸⁶ The difference in the costs of living is far less significant than the wage gap when comparing EU countries. The data of the Central Statistical Office shows that the major part of the Hungarian population lives in households that have no savings of at least 70 thousand forints.⁸⁷ This proportion was 74% in 2010, 75% in 2011, 74.9% in 2012, 70.7% in 2014, 50.7% in 2015, 31.4% in 2016, and 33.2% in 2017.⁸⁸

A closer look at the wage structure at national level may add also important information. The national average net wage (5th decile in the gross wage statistics) was one and a half times more than the subsistence minima (HUF 75,024 in 2009 and 78,736 in 2010) in 2010; this figure was two and a half times more in the 7th decile, in the 8th decile the net wage was three times more than subsistence and in the 9th decile four times more than the subsistence. There was a very narrow scope for progressive taxation of labour income; and it is true for the present situation as well, in spite of the fact that the last couple of years brought an increase in wage levels.⁸⁹ The highest 10th decile was composed of cc 46,000 taxpayers and their monthly gross income was 1,5 million Hungarian forints, which was 780 thousand in net, after (progressive) tax

⁸⁵ Kovács I., A jövedelemeloszlás és jövedelemegyenlőtlenség a személyi jövedelemadó-bevallási adatok tükrében, (2011) 89 (3) *Statistikai Szemle*, (294–312) 306–307.

⁸⁶ See for comparison: http://ec.europa.eu/eurostat/statistics-explained/index.php/Wages_and_labour_costs/hu; <http://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do> (Last accessed: 31 December 2018).

⁸⁷ Cc 233 euro depending on the exchange rate. This figure was calculated at the 1/300 euro/forint rate.

⁸⁸ *Háztartások életszínvonala 2014*, (*Standard of living of households 2014*), (KSH, Budapest, 2015) 26., <https://www.ksh.hu/docs/hun/xftp/idoszaki/hazteletszin/hazteletszin14.pdf> (Last accessed: 31 December 2018); *Háztartások életszínvonala 2016*, (KSH, Budapest, 2017) 25., <https://www.ksh.hu/docs/hun/xftp/idoszaki/hazteletszin/hazteletszin16.pdf> (Last accessed: 31 December 2018); *Háztartások életszínvonala 2017*, (KSH, Budapest, 2017) 13., <https://www.ksh.hu/docs/hun/xftp/idoszaki/hazteletszin/hazteletszin17.pdf> (Last accessed: 31 December 2018).

⁸⁹ STATADAT: 2.1.35. *Az alkalmazásban állók havi bruttó átlagkeresete a nemzetgazdaságban (Employees' monthly gross wage) (2000–)*, http://www.ksh.hu/docs/hun/xstadat/xstadat_eves/i_qli012b.html (Last accessed: 31 December 2018).

and social security contributions. The effective personal income tax rate was 16,34% on the global tax base (basically wages) in 2010.⁹⁰

2. The Fundamental Law and the Stability Act give the constitutional basis of taxation. Art XXX of the FL reads as follows: “(1) Everyone shall contribute, according to their capabilities and participation in the economy, to financing the needs of the community. (2) For those raising children, the extent of their contribution to covering common needs shall be determined while taking the costs of child rearing into consideration.” The word “capabilities” above refers to the principle of ability to pay while the other principle – participation in the economy – is not yet clarified. The latter can serve as the constitutional basis for fiscal levies that are not closely connected to the ability to pay; such as environmental taxes. In addition to these rules, the Fundamental Law orders that the basic rules concerning the bearing of public burdens have to be laid down in a cardinal act – i.e. in the Stability Act – in order to make one’s contributions to common needs calculable.⁹¹

3. As to the distribution of tax burdens, the general rule for taxation in the Fundamental Law contains three principles. These three principles – as they were quoted above, the ability to pay, involvement in the economy and family (child) allowance – give the basic framework of tax burden distribution. The ability to pay principle is further delineated, relating to the labour income of natural persons and also for business income, in the Stability Act. As regards labour income, these rules are the mandatory flat tax, the 50% cap on the tax wedge – meaning, that the total amount of fiscal burdens on the employer and the employee on the gross salary must not exceed the net salary of the employee – and the family allowance. In respect of the latter, the Act says that an increasing amount per child has to be provided, depending on the number of children, in such a way that, from the number of three children, the amount of allowance per child has to be higher than for one child and for two children. There is also a guarantee rule: the amount of the allowance cannot be less than in the previous fiscal year.

As regards the taxation of business income, the Stability Act contains a flat tax rule for business income with suspensive effect until 1 January 2020.⁹²

Together with the changes in constitutional basis of the tax burden distribution, there was also a tax reform in Hungary; the tax policy was modified from 2010 onwards. The key concept was to decrease fiscal levies on labour and on business, as it has been thought that this increases the level of employment and supports economic growth and to keep the high level of consumption taxes and to temporarily (2010–2012) or for a longer run reallocate that tax burden from labour to certain industries (retail

⁹⁰ National Tax and Customs Authority, *Personal income tax statistics 2004–2010*, <https://nav.gov.hu/nav/archiv/szolgaltatasok/adostatisztika> (Last accessed: 31 December 2018).

⁹¹ FL Art 40.

⁹² The referred rules of the Stability Act on tax burden distribution are § 36–38.

trade, banking, telecommunication, energy) the revenue of which arises from domestic consumption and the extra profit realized in the previous decade stemmed more from location-specific than firm-specific rents.⁹³ The real result of the policy change has been a partial shift of the tax burden of the working middle class – whose wage income was depressed near to the subsistence minima as explained above – to other tax subjects. The lowest income earners did not gain on the abolition of the second tax bracket, the progressive rate of income tax. The abolition of the tax exempt threshold caused temporary difficulties; however, it was a stated policy goal that no one could be worse off as a result of the modification of income taxation. In the public sphere, a compensatory mechanism – i.e. a wage increase – was introduced and the government made real policy and legal efforts to motivate employers in the private sector to compensate the potential net income loss of wage earners by increasing wages.

Art O) of the FL has to be referred here: “Everyone shall bear responsibility for his or her own self, and shall contribute to the performance of state and community tasks according to his or her ability and faculty.” The quoted principle shows the basic concept on which the relationship between the individual and the public (the political community) is built. In the Hungarian tax system there is no tax exempt threshold. Needs that arise have to be financed via direct subsidies. The Constitutional Court decided in the same way two decades ago, explaining that the Constitution does not contain a prohibition of the taxation of minimum income.⁹⁴ The Government response to the critics was twofold: first, the rate of tax evasion is substantial around the minimum wage (which was around subsistence level); a high proportion of the labour force is employed on minimum wage and this amount is usually supplemented with non-taxed amounts. Moreover, it is a social habit that entrepreneurs include their income in their personal income tax return at minimum wage level. The second was that the necessary increase in wage levels would provide a more advantageous position for everyone and the reduction of the level of unemployment – that went from 11.7% in 2010 to 3.8% in 2018⁹⁵ – would have the same effect.

4. Beside the rules that establish certain limits on the distribution of the tax burden, the Fundamental Law includes other rules of taxation. The first to be mentioned is on the statutory basis of taxation; it is not new, but the way of regulation is new, at the second tier, i.e. the cardinal law level. Taxes – and other fiscal levies – must be based on a statute, which is, as a general rule, an act of the National Assembly; thus,

⁹³ See e.g. <https://www.internationaltaxreview.com/article/b1f9k22yr9xl5q/location-specific-advantages-india-and-china?supplementListId=90794> (Last accessed: 31 December 2018).

⁹⁴ Constitutional Court Decision 85/B/1996. See: I. Simon, Restricting the Legislative Power to Tax – National Report: Hungary, in Restricting the Legislative Power to Tax, IACL 17th Congress (General reporter: Henry Orderer), (2007) 15 (2) *Michigan State Journal of International Law*, (341–369) 347–348.

⁹⁵ https://www.ksh.hu/thm/2/indi2_3_2.html (Last accessed: 31 December 2018).

the taxing power is in essence one tier. It follows from the text of two articles of the Fundamental Law: Art XXX establishes taxation as a fundamental obligation and Art I (3) orders that, beside fundamental rights, fundamental obligations also must exclusively be regulated by Acts of National Assembly. There are minor exceptions – in terms of the volume of public revenues – such as local taxes. The Fundamental Law itself empowers the municipalities to decide on local taxes in the frame of an act of the National Assembly; it is Act C of 1990 on Local Taxes.

In addition to these rules, the Fundamental Law orders that the basic rules concerning the bearing of public burdens have to be laid down in a cardinal law – i.e. in the Stability Act – in order to make one's contributions to common needs calculable.⁹⁶

The Stability Act gives an open list of fiscal levies, – e.g. tax, duty on the acquisition of property, contribution – and classifies them into two groups on the basis of one criteria, whether they are paid in return for the services of the state or local municipalities provided in their capacity as public authorities – e.g. duty for court procedure, licence fee – or they are paid without any *quid pro quo*. This classification also carries an incomplete statutory definition of the concept of tax. The Stability Act specifies a narrow scope of delegated taxing power, mainly in the area of fees; for example, the Governor of the Central Bank is entitled to levy fees on the basis of an act of the National Assembly.

2. Beside the questions of taxing power, the rules on tax legislation (tax law making) are also defined at constitutional level. As to the (formal) limits of tax law-making power, the Stability Act contains the mandatory 30 day period between the promulgation day and the day any kind of tax statute – and its modifications or amendments – enter into force and on the prohibition of retroactive legislation, apart from those rules that are favourable to all taxpayers without discrimination.

5. The currency and the central bank

a) The currency

1. The Fundamental Law declares in its Article K) that the official currency of Hungary is the forint. The Act on the Hungarian National Bank authorises the Bank to issue banknotes and coins in the official currency of Hungary, and states that banknotes and coins issued by the Bank qualify as legal tender in Hungary.⁹⁷

Beside its symbolic meaning and practical importance – i.e. the forint fulfils the functions of money in Hungary – there is another important feature of the constitutional regulation of the currency: the replacement of currency with another

⁹⁶ FL Art 40.

⁹⁷ Act CXXXIX of 2013 on the National Bank of Hungary (MNB Act) § 4(2).

one requires the modification of the Fundamental Law. The practical importance of Art. K) will arise when the country joins the euro zone, and replaces forint with euro. It requires the modification of the Fundamental Law, therefore requires at least a two-third majority vote. As the exchange rate of replacement restructures the economic positions and redistributes wealth, the two third majority vote is an important safeguard in the decision making process. One can assume with good reason that the privatisation process verified the public choice theory; therefore control points like this are justified.

2. The forint is a freely convertible currency. Inside the EEA sphere, there are no limitations; however, in a wider context there are some barriers to capital movements. Hungary has made some reservations to the OECD Code of Liberalization of Capital Movements, for example for real estate operations.

The forint fulfils the three practical functions of a currency. First, it is mandatorily accepted for settling debts in market relations in Hungary, provided the parties did not stipulate other currency. However, there is one important limitation: salaries (wages) have to be paid in forint. Second, taxes and other fiscal levies have to be paid in forint; it is regulated by the Stability Act.⁹⁸ Third, as a main rule, financial reporting obligations have to be discharged in forint under the Accounting Act, although it is possible to opt out under the conditions specified in the Act. It must be added here that tax returns (personal and company) also have to be prepared in forint.

b) The central bank

3. The Fundamental Law⁹⁹ and the cardinal act on the Magyar Nemzeti Bank (National Bank of Hungary)¹⁰⁰ regulate the Bank. These rules meet the criteria of so called legal convergence, as the legislation is compatible with the Maastricht Treaty¹⁰¹ and Protocol No 4 on the Statute of the ESCB and the European Central Bank.

The Governor of the Bank has the right to issue decrees in the scope of the responsibilities of the Bank – defined in the cardinal MNB Act – which cannot be *contra legem*, meaning that, in the hierarchy of norms, they are at the same level as Government decrees.¹⁰²

4. The primary objective of the Bank is to achieve and maintain price stability.¹⁰³ The consumer price index has risen by under 3% since 2013; in 2018 it was 2.8%¹⁰⁴ and the medium-term target is 3%. The basic rate has been 0.9% since May 2016.

⁹⁸ Stability Act § 28(2).

⁹⁹ FL Art 41(1)–(5).

¹⁰⁰ According to § 184 of the MNB Act, those rules of the Act that regulate the status of the Bank, its primary objective and basic tasks qualify as cardinal law.

¹⁰¹ TFEU Art 131 (TEC Art 109).

¹⁰² FL Art 41(5).

¹⁰³ MNB Act § 3(1).

¹⁰⁴ https://www.ksh.hu/docs/hun/xstadat/xstadat_eves/i_qsf001.html (Last accessed: 31. December 2018).

Beside the inflation target, other objectives are defined thus: “Without prejudice to its primary objective, the MNB shall uphold to maintain the stability of the financial intermediary system, to increase its resilience and to ensure its sustainable contribution to economic growth, and shall support the economic policy of the Government using the means at its disposal.”¹⁰⁵ It is compatible with TFEU Art 127(1). The Bank has a complex target system; to ensure price stability (in itself a complex task); however, it has to be achieved while fulfilling its other mandates, which are to ensure the safe operation of the financial market in a way that serves the sustainable financing needs of the growing economy and to support the economic policy of the Government. In 2013, the mandate of the Bank was in substance doubled: it became the sole – macro and micro – supervisor of the financial markets.¹⁰⁶ Not just the text of the MNB Act was changed that year; but also the interpretation of the text or, in other words, the perception of what was then its new leadership of the monetary system and the economy was different – unorthodox, as it was labelled – compared to the previous one, and also the monetary policy options were evaluated differently. This means that, as long as price stability as the primary objective is not jeopardised, the Bank applies measures that support economic growth. Two measures that have been applied can be mentioned. One of them is the significant cut of the basic rate; the other is the so called Growth Credit Program. The latter provided a measurable quantity of cheap credit from its own resources to the SME sector, extended through the banking system.

5. The basic tasks of the Bank as defined in the MNB Act, are, among others, managing monetary policy, issuing money, managing foreign exchange and gold reserves, preserving the external stability of the country, implementing the exchange rate policy, overseeing the payment, the clearing, and the securities settlement systems, and macro prudential supervision. The exchange rate regime is decided by the Government with the consent of the Bank; the exchange rate policy is managed by the Government and the Bank as a matter of common interest among EU member states. The exchange rate regime and policy cannot compromise the primary objective of the Bank.

6. In the scope of its autonomy, the legislation defined the legal status of the Bank and the conditions of its personal, organisational, institutional (decision making) and financial autonomy. The Bank is a member of the European System of Central Banks (ESCB) and the European System of Financial Supervisors. The Bank and any of its decision-making officials or bodies are prohibited from seeking or taking any kind of instructions from the Government, EU institutions – excluding the ECB – and other organisational units, the governments of the member states or any other organisation

¹⁰⁵ MNB Act § 3(2).

¹⁰⁶ FL Art 41(2) [Fifth Amendment of the FL Art 5(1) with the effect of 1 October 2013].

or political party.¹⁰⁷ The Governor and the – at least two and at most three – Deputy Governors of the Bank are appointed by the President of the Republic on the proposal of the Prime Minister for six years.¹⁰⁸ The Governor can serve a maximum of two six-year terms. The Governor and the Deputy Governors are members of the – at least five, at most nine-member – Monetary Council, which is the supreme decision-making body of the Bank in the scope of its basic tasks. Other members of the Council are elected by the National Assembly for six years, and they are employed by the Bank during their term of office.¹⁰⁹ The financial autonomy of the Bank is ensured by way of loss compensation from the central budget.

The Governor of the Bank has to prepare a yearly written report to the National Assembly and has to be present for a parliamentary hearing.¹¹⁰ The report to Parliament is public, available on the homepage of the Bank. The MNB Act obliges the Bank to prepare and publish a quarterly report on monetary trends – titled an inflation report – and other important developments. The Bank publishes the shortened minutes of the meetings of the Monetary Council that decide on the basic rate.

IV. SUMMARY AND CONCLUSIONS

1. After the free election in 1990, Hungarian society rejoined the historical path from which it was deviated. In sum it is a democratic political system, governed by the rules of the law enacted by the National Assembly and other bodies competent to issue legal norms and the economic base of the system is a market type economy.

2. The new two-tier constitutional system is not neutral in terms of fiscal and monetary policy. On the monetary side, there has not been any change since the Hungarian law embodied the currency school concept – the primary target of the (autonomous) central bank is price stability – as defined in the cardinal MNB Act in accordance with the EU law. The rule on the currency also has to be referred to in this context since it is a real novation at constitutional level.

On the fiscal side, significant changes took place. The most important among them are the rules on the deficit ceiling, the public debt-break rules, the rules on the national assets and the rules on tax burden distribution. The first two serve disciplined budget management and also the maintenance of sovereignty in terms of policy decisions. The rules on tax burden distribution – flat tax on wages, tax wedge rule, family allowance – has served to liberate the wage-earning middle class, especially those with three or more children. From the date of the first tax reform, in 1988 onwards, a

¹⁰⁷ MNB Act § 1(2).

¹⁰⁸ FL Art 41(3); MNB Act § 10–11.

¹⁰⁹ MNB Act § 9(4).

¹¹⁰ FL Art 41(4).

significant proportion of the tax burden was allocated to wage earners, i.e. progressive personal income tax, social security contributions, consumption taxes (e.g. VAT, excise duty); the new rules simply limit the taxing power's access to taxing wages above a certain level.

3. The new constitutional setting has restructured competencies among the different public actors. The modification of those rules that are included in the FL and in the cardinal laws require qualified majority voting. The FL requires a 2/3 majority vote of the total number of representatives, while the enactment and modification of cardinal laws require a 2/3 majority vote of the representatives present. It means a shift in competences of the simple majority of the National Assembly to the qualified majority. This constitutional construction means that the state – i.e. the National Assembly, by simple majority voting – has limited decision making competence on issues that are vital for the existence of the political community; i.e. the nation.

Another part of restructuring competences is the veto power of the Budgetary Council, that delimits the decision making power of the National Assembly. As referred to, the limitation of Constitutional Court competencies in fiscal matters theoretically widens the National Assembly's room to manoeuvre.

4. Hungary is a member state of the EU and part of the globalised world; however, its accession resulted in an asymmetric position, partly because of the economic backwardness¹¹¹ of the country, and the economy of Hungary can hence be named a dependent market economy. The domestic constitutional and policy changes in Hungary after 2010 caused direct extraterritorial effects since, due to the special dependent structure of the economy; state intervention inevitably wounds foreign interests.¹¹²

¹¹¹ E.g. A. Gerschenkron, *Gazdasági elmaradottság történelmi távlatból*, (Gondolat, Budapest, 1984).

¹¹² Auby, *Globalisation, Law and the State*, 17.; S. Battini, *The Globalization of Public Law*, (2006) 18 (1) *European Review of Public Law*, (131), 7., <https://ssrn.com/abstract=895263> (Last accessed: 31 December 2018).