This country case study analyses International Monetary Fund (IMF) interventions in Hungary and most notably the Stand-by Arrangement (SBA) signed with the IMF in 2008. Before the 2008 banking crisis, Hungary suffered from several economic problems – in particular, the economy faced heavy indebtedness and a lack of economic growth.

When the indebted banking sector was hit by the 2008 crisis, the government called for an IMF bailout. The IMF programme recapitalised active banks in Hungary and imposed austerity measures and reforms on Hungary. However, this study shows that these measures have not improved the economic weaknesses of the country.

Before 2008, Hungary’s economy was largely fuelled by external funding (loans and investments). However, Hungary achieved the lowest aggregated economic growth among countries in Central and Eastern Europe between 2004 and 2008 (2.9 % compared with 5.3% of GDP for whole region according to the World Bank World Development Indicators). Combined with large balance of payments deficits (€35 billion between 2004 and 2008), the external debt rapidly became unsustainable. Household debt was also problematic and doubled between 2004 and 2008 while, according to the OECD, the overall private sector debt went from 122% to 168% of GDP (overall, private sector debt doubled during the same period).

The high level of indebtedness, particularly from private debt, made Hungary’s economy dependent on external financing sources and highly vulnerable to external shocks. The 2008 banking crisis led to a freeze of the interbank market. To avoid the collapse of its banks (nationals and affiliates of foreign banks), the government requested a loan of €12.5 billion from the IMF, to which the EU added €6.5 billion. The IMF pushed for a larger loan request from Hungary than the needs assessed by experts. The difference is explained by a willingness to bail out largely foreign banks.

The IMF programme had two main objectives: to bring long-term fiscal sustainability and to maintain adequate capitalisation of domestic banks. The fiscal objective was translated into conditionalities

<table>
<thead>
<tr>
<th>Year</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
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</thead>
<tbody>
<tr>
<td>Economic growth (% of GDP)</td>
<td>4.789353</td>
<td>4.295658</td>
<td>3.962944</td>
<td>0.511279</td>
<td>0.878582</td>
</tr>
<tr>
<td>External debt (% of GNI)</td>
<td>86.0519</td>
<td>82.61801</td>
<td>125.1182</td>
<td>137.8686</td>
<td>154.4349</td>
</tr>
</tbody>
</table>

*Source: World Bank World Development Indicators*

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attached to the letter of intent signed with the IMF. These conditionalities were essentially an austerity package that included tax cut cancellations, freezing of salaries and social benefits and pension cuts.

Austerity measures fail to deliver

The economic consequences of the crisis were dramatic. Hungary lost 8 per cent of its Gross Domestic Product (GDP) between 2008 and 2009. Between 2008 and 2012, social spending was cut by 13 per cent. Additional austerity measures were adopted to respect fiscal objectives that were defined in the letter of intent between the IMF and Hungary. These include: cuts in local government budgets, an increase in retirement age, cuts in maternity leave, elimination of energy subsidies for the poorest, and cuts in support for public transport, VAT increases and an increase in personal income tax.

These measures did not bring about the desired results of stopping the debt distress and restoring loan activities. The budget deficit was barely reduced (3.8 per cent in 2010 from 3.7 per cent in 2008), public debt-to-GDP ratios increased because of the EU and IMF loans and GDP fell by 6.3% in 2009 and only stabilised in 2010 (-0.2%). Private sector debt slowly improved but remains problematic as it went from 90 per cent of GDP in 2008 to 80 per cent in 2010.

The second objective of the IMF programme failed as well, since the banking sector remains very fragile and the loans activities have not recovered since 2008.

Finally, the programme failed to respect Hungary’s ownership of reforms. The social partners and even the parliament were barely consulted on the adoption of the IMF programme and the resulting austerity measures. This study shows that the Central Bank and the Finance Ministry were the only real interlocutors with the IMF.

In summary, this study finds that the IMF’s interventions in Hungary forced economic reforms with poor accountability and transparency in their adoption without bringing tangible economic success. Today, the economic problems in Hungary remain the same – in particular, with balance of payments deficits and high levels of public and private debt.

This report has been produced with the financial assistance of the European Union. The contents of this publication are the sole responsibility of the author and can in no way be taken to reflect the views of the European Union.