Zoltán Török

UNDERSTANDING LARGE SCALE POLICY CHANGE

NATIONAL POLICY REFORM UNDER EXTERNAL CONSTRAINTS – THE CASE OF HUNGARY

Doctoral Dissertation

Department of Public Policy and Management

Supervisors:

Professor György Hajnal, PhD

Professor Károly Mike, PhD

Corvinus University Budapest

Doctoral School of Political Science

Understanding large scale policy change

National policy reform under external constraints – the Case of Hungary

Doctoral Dissertation

Zoltán Török

Budapest, 2020

Table of Contents

LIST OF TABLES:

LIST OF GRAPHS:

LIST OF ABBREVIATIONS:

CDS	Credit Default Swap
COCOPS	Coordinating for Cohesion in the Public Sector
DGEcFin	Directorate-General of Economic and Financial Affairs
EC	European Commission
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EMU	European Monetary Union
EP	European Parliament
EU	European Union
Fidesz	Fiatal Demokraták Szövetsége (Alliance of Young Democrats)
GDP	Gross Domestic Product
IMF	International Monetary Fund
MIP	Macroeconomic Imbalance Procedure
MSZP	Magyar Szocialista Párt (Hungarian Socialist Party)
NATO	North Atlantic Treaty Organization
NPM	New Public Management
OECD	Organization for Economic Cooperation and Development
RQ	Research Question
SBA	Stand-by Agreement
SSC	Social Security Contribution
SZDSZ	Szabad Demokraták Szövetsége (Alliance of Free Democrats)
VAT	Value Added Tax
UECEP	Understanding East Central European Politics

CHAPTER 1.

INTRODUCTION

1.1. Setting the research problem area

The realm of public policies is in a perpetual flow of change. These changes exert sometimes disruptive, sometimes more incremental impact on the affected citizens' everyday life. A better comprehension of the above changes surrounding us, promises the potential of an improved accommodation capability to the new setup for the citizens, and facilitates a smoother and more efficient change-management for the policy makers. Therefore it is important to gain a thorough understanding of the phenomenon of policy change, i.e. what are the circumstances under which the need for policy change gets articulated; what are the sources of the newly set policy choices; how the policy change process evolves. As such, comprehending the factors facilitating (or, conversely, hindering) change is similarly essential in the quest of studying public policy change. The general research area of the dissertation is public policy change.

While there is abundant literature on the public policy change topic, the theory is fragmented and it consists of a number of streams. These do not constitute yet a coherent and general framework though. Each of these streams of thoughts has the underlying ambition to provide plausible explanations to the questions: What factors drive policy change? How the policy change process unfolds? The theories' answers are aligned to the particularities of their actual choices concerning the approach and the framework. The dissertation argues that ultimately these answers are not so far away from each other. As such, the dissertation argues that it is a viable enterprise to build a comprehensive policy change theory by bringing together existing ones onto a common platform. To start the task of theory-buling, it is advisable though to narrow the policy change types and concentrate on a special type of policy change for the sake of setting a common scope. The dissertation's selected the area for the above purposes is large scale policy change (or policy reform) under external constraints.

As a macroeconomic analyst[1] I have been deeply involved in the research of the economic developments over the past two decades. My research area has been primarily the Hungarian economy, however I studied in depth the regional peers[2], the Euro-Area, and other global developed and emerging markets. I have witnessed ample evidence for that the content and the quality of national level policy making has essential influence on the overall economic performance of the individual countries. The qualitative characteristics of economic policies affecting the macro-level and the change of these policies over time (i.e. fiscal policy in general, and various policy areas, such as tax policy, education policy, health care policy, industrial policy in particular) have been always in the forefront of my professional attention.

Not solely professional economists should be interested in the development of the various macroeconomic indicators of a given country though (such as inflation, unemployment rate, real GDP change, the size of the budget deficit, public debt-to-GDP ratio, the balance of the current account etc.) - the changes in the macroeconomic environment are essentially reflecting the changes in the quality of life of the citizens. The 2008-2009 financial crisis and the subsequent European sovereign-debt crisis (2011-2012) brought about distinctive break vis-à-vis the previously accepted modus operandi in the realm of the economy (see Appendix 2. GDP change over the previous year in EU member-states between 2004-2014) and financial markets. The crises also generated meaningful repercussions in the field of (both national and international) politics and resulted in new mechanisms in the governance within the European Union (Alesina, 2012; Blöchliger at al 2012, De Grauwe, 2013, Sutherland et al 2012; Ongaro 2014). Several countries – including a number of EU member states - got into severe

---

[1] I am the Head of Research at Raiffeisen Bank Hungary since 1997. My main task is to analyse and forecast macroeconomic developments and financial market trends in Hungary and in other relevant countries.

[2] The regional peers are: Slovakia, Czech Republic, Poland, Romania, Croatia and to some extent Austria and Slovenia.

financial distress as a consequence of the financial and economic crisis due to their previously accumulated imbalances provoked by policy malfunctioning (see Appendix 5. IMF program countries in 2009 by program types). The 2008-2009 financial crisis was followed by the sovereign debt crisis in the European Union that had the potential to threaten the proper functioning of same basic pillars of the European integration in 2011-2012[3]. The previously designed governance structures proved to be inefficient to prevent and manage the crisis. The sovereign debt crisis was manifest in a steep increase of public budget deficit and public debt in several member states (see Appendix 3. Public budget balance in EU member-states between 2004-2014 in GDP percentage and Appendix 4. General Government Debt in EU member-states, 2004-2014 in GDP percentage). This provoked the need to cut budget deficit and reduce public debt.

Hungary was clearly one of the most severely affected country of the financial crisis and its aftermaths in the European Union. Because of my job as a macroeconomic analyst, I thoroughly studied the run-up period ahead of the financial crisis and the sudden hit of the crisis starting first with difficulties of the public debt-refinancing[4] (also see Appendix 6. The benchmark yield of Hungarian Government 3-month Treasury-Bill). Later on I analysed the direct and indirect impacts of the crisis on the Hungarian economy and the crisis management from the side of both public and private sector actors. Having professional contact to some of the most relevant figures in public policy making[5], I had the opportunity to gain an insight.

---

[3] The viability of the common currency, the euro-system was questioned by both financial markets and political actors, and even the unity of the EU got endangered by various centripetal forces pointing to potential exits.

[4] In October 2008 the Hungarian Debt Management Agency had a series of unsuccessful government bond auctions – meaning that market demand completely dried up for Hungarian government debt securities, while on the OTC market (i.e. the secondary market of government bonds) the yield of the 3-month treasury bill jumped from 8.91% (23 September) to 13.29% (28 October) – a 50% increase within one month.

[5] Commercial bank economists used to have active personal relationship with the Finance Ministry, the Central Bank, the Fiscal Council, the Prime Minister Office – including the highest echelons of public administration and political decision-makers and also with the representatives of the EU and IMF missions in Hungary.

Notwithstanding, my curiosity was not fully satisfied. There were several areas of interest, where a more in-depth analysis were needed in order to get a better understanding, such as: What is the interplay between national policy making and the general global trends in the realm of public policy design? How do external constraints shape policy outcomes under circumstances of conditionality? How did the country-level decisions over policy questions get influenced by the fiscal consolidation and what was the influence of the EU (and IMF) on the domestic fiscal consolidation? How did the fiscal measures affect public sector reforms and administrative reforms?

In September 2015, an international research project[6] was launched to investigate the politics of fiscal consolidation – the domestic government's political decision-making about consolidation, and the influence of the EU (and the IMF) on that. The research project was interested in how the fiscal consolidation measures affected public sector reforms – in social security, health, education, etc. – and reforms within public administration itself. The ultimate ambition of the research project was to analyse how the EU (together with IMF) affected public sector reforms in countries under the conditions of fiscal crisis and consolidation. The project was led by Edoardo

[6] Scholars from Estonia, Latvia, the Netherlands, Hungary, Greece, Spain, Portugal, Italy and Ireland participated in the project. There were two workshops convened by Walter Kickert and Edoardo Ongaro, the first in the autumn 2016 in Milan, and the second in spring 2017 in the Hague. The list of participants is the following: Joaquim Filipe Araujo (Portugal, Professor, University of Minho), Diego Badell (Spain, Assistant Professor, ESADE, Barcelona), Aleksandrs Cepilovs (Latvia, Latvian civil service and PhD, Tallinn University of Technology, Estonia), Niamh Hardiman (Ireland, Professor, University College Dublin), Muiris MacCarthaigh (Ireland, Lecturer, Queen's University Belfast, Northern Ireland, UK), Tiina Randma-Liiv (Estonia, Professor, Tallinn University of Technology) , Calliope Spanou (Greece, Professor, University of Athens), Francesco Stolfi (Italy, Lecturer, University of Nottingham, UK), Zoltán Török (Hungary, Head of Research, Raiffeisen Bank and PhD student, Corvinus University Budapest), Tamyko Ysa (Spain, Professor, ESADE, Barcelona).

Ongaro[7] and Walter Kickert[8]. As my research interest was largely similar, I felt honoured to have the opportunity to participate in the research team's work.

The research project was a follow-up of earlier research (COCOPS WP7)[9]. COCOPS WP7 research project focused on national governments' political decision-making on fiscal consolidation and reform, (Kickert and Randma-Liiv 2015). The Kickert and Ongaro led new research project explicitly investigated the influence of the EU (and the IMF) on the domestic decision-making (Kickert and Ongaro, 2019). The research work developed in two streams. One with a relative focus on the effects of EU (and IMF) on public sector and administrative reforms and another with a relative focus on the influence of EU (and IMF) on consolidation.

My contribution to the first stream was a publication titled: '*Unintended outcomes effects of the European Union and the International Monetary Fund on*

[7] Professor Edoardo Eriprando Ongaro is a Professor of Public Management at The Open University, UK and a Visiting Professor of Management of International and Supranational Organizations at the SDA Bocconi School of Management of Bocconi University, Milan. Previously he held positions at Northumbria University, as Professor of International Public Services Management.

Since September 2013 Professor Ongaro is the President of EGPA, the European Group for Public Administration. In the 2006-2009 period he chaired the EGPA Permanent Study Group on Intergovernmental Relations, and in the 2010-2013 period chaired the Permanent Study Group on EU Administration and Multi-Level Governance.

[8] Walter Kickert is emeritus professor of Public Management at the department of Public Administration, Erasmus University Rotterdam, the Netherlands.

[9] COCOPS (i.e. *Coordinating for Cohesion in the Public Sector of the Future)* was a public management research consortium consisting of 11 universities in 10 countries, funded by the European Commission. COCOPS was one of the largest comparative public management research projects in Europe. Work Package 7 (COCOPS WP7) investigated how the financial crisis affected government's managerial and policy making capacity - in particular concerning resource allocation - and formulated policy recommendations with regard to successfully cope with the long-term consequences of the financial crisis savings.

Hungary's public sector and administrative reforms'. The article was published by Public Policy and Administration (SAGE Publications) in April 2019[10].

My contribution to the second stream is an article titled: '*The politics of fiscal consolidation and reform under external constraints in the European periphery: Comparative study of Hungary and Latvia*' published by the journal of Public Management Review (RPXM)[11]. The article was written together with Aleksanders Cepilovs[12].

After having studied the influence of external agents on the fiscal consolidation, and public sector reform, I got increasingly interested in the topic of policy change under external constraints. I continued to further investigate the combination of factors facilitating large scale policy shifts with the broad aim to test and potentially refine existing theories of policy change, to compare their explanatory power. Therefore I commenced another research. I studied a specific policy area in Hungary with the target to uncover the various stages of the change process; the rationale behind the choices of national elite decision makers; the influence of external agents; and the interplay between the considerations of fiscal consolidation need and policy reform.

My selected case was the change of the Hungarian tax policy in the 2009-2018 period. A lengthy time-span of relative stability regarding the overall revenue structure of the tax system was followed by large-scale changes in Hungarian tax system starting from 2009 in Hungary. This was signalled by a dramatic shift of the tax burden from labour and capital income to consumption. The 2008-2010 time period was

---

[10] - DOI: 10.1177/0952076718789731, https://journals.sagepub.com/doi/10.1177/0952076718789731

[11] DOI: 10.1080/14719037.2019.1618384[11]. Article ID: RPXM 1618384

[12] Aleksandrs Cepilovs is a project manager at the Ragnar Nurkse Department of Innovation and Governance, Tallinn University of Technology, Estonia. He received his PhD in Technology Governance from Ragnar Nurkse Department of Innovation and Governance, Tallinn University of Technology. His research interests include innovation policy and innovation in public administration, as well as policy transfer, in particular focusing on the region of Central and Eastern Europe. Both authors contributed equally to the article.

characterized by an IMF-bail-out program[13] with its conditionality criteria, and a deep economic crisis. Hungary was also the subject of the European Commission's Excessive Deficit Procedure in the 2004-2013 period. I was interested in that under the given circumstances what factors could explain the large-scale change of the Hungarian tax policy and how do anwers relate to policy change theories' findings? I found that academic discourse had only insufficiently covered the questions raised. Therefore I prepared a conference paper to the 2nd UECEP[14] conference and wrote the article which is titled '*Necessary Factors Facilitating Large Scale Policy Change Hungarian Tax Reform 2009*-2018'[15]. The article focuses on the combination of factors facilitating large-scale policy change in ligh of the stipulations of the various streams of policy change literature.

All the three papers are embedded into the academic field of public policy change. They equally share the ambition to test and refine existing theories of policy change and to contribute to the emerging stream of public administration applied research agendas on public sector reform by making visible and understandable the main contexts and the interacting processes shaping public policymaking.

The selected case of the dissertation is Hungary – all three articles deal with the Hungarian developments. In the same time, other EU and OECD[16] countries are also looked at for comparisons. The EU, the IMF and the OECD are considered by the dissertation as external agents. The case selection is partly driven by my professional experiences as a macroeconomic analyst described above: I considered my familiarity

---

[13] In 2009 altogether 42 countries were participating in an IMF program – these were mainly poor and developing countries in Africa, South-America and Asia. 3 EU member-states (Hungary, Latvia and Romania) was also in IMF bail-out program in 2009 – see Appendix 5. IMF program countries in 2009 (by program types)

[14] UECEP stands for Undestanding East Central European Politics, Budapest 17 May 2019.

[15] Political Science Online published the article in December 2019. One opponent of the draft dissertation suggested to revise the original article including the reconsideration of the title with regards to using the word "necessary". In the rest of the dissertation I will refer to this article as Factors Facilitating Large Scale Policy Change Hungarian Tax Reform 2009-2018.

[16] OECD stands for: Organisation for Economic Co-operation and Development - an intergovernmental organization with 36 member countries (including most EU member-states). Hungary is a member of the OECD since 1996.

of the case as an advantage. The other reason for the case selection is that Hungary was a definitive basket case for the research interests: in the critical years the country witnessed external influence coming from the EU in the form of the Excessive Deficit Procedure; participated an IMF-bail-out; experienced land-sliding political changes, deep economic crisis; and went through a series of fiscal consolidation and public sector reform attempts. As case studies typically strive for explaining the features of a broader population, they aim to be something larger than the case itself (Gerring, 2004; Gerring and Seawright, 2008). The Hungarian case is considered here an apt choice for the above considerations to elucidate large scale policy change and national policy reform under external constraints in general.

The time frame of all the three article is the financial crisis and the crisis management years, strictly speaking the 2008-2012 period plus the pre-crisis and post-crisis years. The time-span is not necessarily always precisely bounded though[17]. The European Commission's Excessive Deficit Procedure (in case of Hungary the 2004-2013 period) is considered by the dissertation as an explicit source of policy influence coming from an external agent. Therefore, this time period needed to be fully engulfed by the research. Moreover, for facilitating comparative exercises, it is meaningful to look at periods without the attribute of the explicit external influence such as the pre-2004 and post-2013 periods. Accordingly, the dissertation's broad time frame is the past two decades (2000-2019).

The following dissertation is a portfolio dissertation: the above mentioned three scholarly articles (all published in 2019) are edited here, and they are amended with an introduction in the beginning and a conclusion at the end. The central theme of each of the articles is policy change under the circumstances of external constraints with the focus on the influence of external agents on national policy making. A special focus was put on the domestic fiscal consolidation, the fiscal measures affecting public

[17] The financial crisis hit the European markets in the autumn of 2008 and significantly eased by mid-2010. The euro-area debt crisis fell to the 2011-2012 period. European crisis management therefore was particularly active in the 2008-2012 period, though it was still running to some extent in the post-2012 years. Hungary's crisis started early and lasted longer though. From a public finance perspective, the crisis and the subsequent crisis management is identical with the EDP that is 2004-2013.

sector reforms and the influence of external agents on the decisions on particular policy outcomes.

In the remaining sections of Chapter 1, the key terminology is established and the relevant academic literature is presented (1.2. Policy Change – Concepts and Theories), then the research approach is introduced, the research theme is contextualised and the methodological considerations are presented (1.3. Research Approach and Methodological Considerations). Finally, comes the section on the structure of the dissertation (1.4. The Structure of the Dissertation). This section highlights the objectives and the findings of the individual articles' while also delivers an explanation on how the individual articles relate to each other, and how they relate to the broader (policy change, policy reform) and to the narrower (policy change and policy reform under the circumstances of conditionality by external agents) research areas.

1.2. Policy change – concepts and theories

Policy change lies at the centre of the interest of the dissertation. The focus of the dissertation is narrowed to a special type of policy change: fiscal consolidation and public sector reforms amidst the circumstances of an economic crisis, initiated and supervised by external agents (i.e. international organizations) in a form of coercive policy transfer. The dissertation is embedded in the scholarly literature that aims to explain the policy change process.

1.2.1 Key terminology

Public policy change refers to shifts in existing structures deriving from a change in attitude or in principle (Bennett and Howlett, 1992; Cerna 2013). It can refer both to incremental refinements in existing structures and the introduction of new and innovative policies replacing existing ones. Accordingly, it posits a change in attitude or in principle of the decision-makers (Hogwood and Peters, 1983; Polsby, 1984; Bennett and Howlett, 1992; Cerna, 2013).

Policy reform normally refers to a significant policy change. In the scholarly literature there is an uncertainty about the notions of ‘policy reform’ and ‘large-scale policy change’ though. Some scholars claim that the term ‘policy reform’ generally refers to a major change that goes beyond day-to-day policy management. Policy reform potentially involves structural changes (Alesina et al, 2006), and it is understood as a ‘deliberate attempt (…) to change the system as a whole’ (Fullan, 2009: 102). Others argue that such a categorization is unsatisfactory, and claim that there is no clear difference provided by the literature between the terms ‘policy reform’ and ‘large-scale policy change’, therefore they should be treated as being inter-changeable (Cerna, 2013).

While one can claim that every policy reform is also a policy change, obviously not every policy change is a policy reform. Nevertheless, it is indeed highly challenging to determine the exact attributes of a policy change process in order to qualify it as a policy reform. Apparently, the above definition-type inquiry has not been reassuringly answered by scholars. I argue that the underlying reason for such a hiatus is that the myriads of policy types and their changes are just simply incomparable given their widely different characteristics those vary alongside the dimensions of time, place, actors, goals, techniques, content etc.. Moreover, reform is indeed inherently political as it represents a selection of values, a particular view of society and is has distributional consequences vis-à-vis the allocation of benefits and costs (Reich, 1995). No wonder, in political communication the term ‘policy reform’ is attached with various political values[18], and the usage of the term is burdened with adherent political biases. The dissertation text consciously reflects the imprecision of

[18] Hereby it is noteworthy to mention that while political communication normally attaches a positive value content to ’reform’ – there are instances when this is the other way round, especially when there is a ’reform-fatigue’ typically followed by a massive wave of policy reforms perceived negatively by the population. One example for such a case was the 2008-2012 period in Hungary, when politicians preferred to avoid to use the term ’reform’

the academic literature and uses the terms ‘policy reform’ and ‘large scale policy shift’ – as suggested by Cerna - interchangeably.

Public sector reforms (or large scale policy changes), government-wide in scope and cross-cutting all public services are understood as changes to the structures and processes of public sector organizations, i.e. re-form previously existing arrangements by the attributes of a new structure, form, or process, driven by specific considerations and by political actors’ interests (Barzelay, 2001; Ongaro, 2009). Accordingly, there is no normative attribute involved in the policy change process, in the policy reform exercise. Policy change does not necessarily equal improvements with regards to efficiency or quality of the public services or by any other considerations. In this sense, the dissertation considers the terms policy change/policy reform as they are value free ones.

Nothwothstanding, it is far from easy to accomplish policy reforms. Large-scale change is considered as ‘not the norm’ (Wilsford, 1994:251), moreover ‘difficult, if not impossible’ (Birkland, 2005:41). Why policies change and when, is indeed a challenging question and a rather poorly understood phenomena (Rodrik, 1996). Evidence also suggests that many policies - even dysfunctional ones – are going through long periods of stability before they change.

As such, it is well justified to pose the questions: Why can policy change eventually happen? What are the circumstances under which policy change can come about? What are factors those facilitate policy change to happen? The axiom that ‘policy change can and does happen under the proper conditions’ (Birkland, 2005: 41) gives little practical help in answering the above questions. Nevertheless, a detailed description of these ‘proper conditions’ is offered by the policy change theories. Public policy theories – ie. path dependency; multiple streams; punctuated equilibrium; policy learning / policy diffusion; advocacy coalition framework - are centred around the challenge to uncover the ways how the policy agenda is constituted and to find those factors – or rather the interaction of multiple factors - from where the change of those policies emerge (Cerna, 2013; Sebők, 2014). In their quest, scholars looked at the role of new ideas and arguments in the above processes.

While there is a certain degree of heterogeneity with regards to the above theories' scholarly ambitions, their actual scopes, and their academic approach, they are the key building blocks in the academic enterprise of fostering policy change studies. In the following section the paper gives a brief overview of the various policy change theories, with the explanation how they relate to the current research.

1.2.2. Mapping the theories on policy change

The approach to study the interplay of individual agents, ideas, institutions and external factors (i.e. multiple streams) approach was a major step in understanding policy formation. This was initiated by Kingdon in his seminal book "Agendas, Alternatives, and Public Policies" (Kingdon, 1984). Policy formation was understood by the multiple streams approach as the joint combination of the streams of problems, policies and politics. The particular circumstances where they congregate and result in policy change decisions is labelled by Kingdon as the policy window. Kingdon argued for continual change and adaptation of public policies as opposed to the stability of decision-making in policy communities.

'History matters, and it matters a great deal' (Wilsford, 1994: 279) – this is centre thought of the theory of path dependency (Wilsford, 1994; Pierson, 2000; Mahoney, 2000). According to the theory, the policy process within an existing institutional framework is subjugated to the 'decentralized interaction of policy actors' (Wilsford, 1994: 281). This can lead to the lengthy survival of certain - even suboptimal - policy outcomes. As such, public policies and formal institutions are difficult to change by design: decisions made in the past encourage policy continuity. Because institutions are sticky and actors protect existing models, it is difficult to change policies (Pierson, 2000; Greener 2002).

The historical context - such as the strength of the welfare state, civil society organisations and public-sector unions, as well as the nature of civil service regulations - is considered to be a key factor shaping the process and content of policy change. Thus, for example in case of a comprehensive fiscal consolidation program, the decisive implementation of administrative reform is difficult in a country with strong public-sector unions, regulations limiting the possibility of severe pay cuts and lay-offs in the public sector. In a country with historically strong welfare state, the government is more likely to face opposition in a form of protests whenever targeted program-specific cuts announced and implemented (Christensen and Laegreid, 2017; Randma-Liiv and Kickert, 2018).

Still, under certain conditions, a big change that departs from the historical path can be possible. 'By developing the interplay of structure with conjuncture, the occasional accomplishment of big change can be systematically understood' (Wilsford, 1994: 253). To introduce a major change, policy makers have to wait for a critical juncture (Capoccia and Kelemen, 2007) or a window of exceptional opportunity called conjuncture (Wilsford 1994). The theory of path dependency helps to explain why policy continuity is more likely than policy change, but it also reveals that 'critical junctures' facilitate policy change to come about (Cerna, 2013).

A critical juncture (Capoccia and Kelemen 2007) or a window of exceptional opportunity called conjuncture (Wilsford 1994) is identified by the literature as an independent variable facilitating policy change. However, to develop a working concept for a situation of 'critical conjuncture' is rather challenging - especially as the risk of being tautological may emerge (i.e. policy change comes when there is a critical conjuncture or a window of opportunity – window of opportunity or a critical conjuncture results in policy change). It is possible to avoid the above caveat though, as the thoeriy does not postulate an explicit assertion that the relation is true in every case.

How can such a critical moment (i.e. conjucture) emerge then? What are the necessary circumstances of such a policy window or window of opportunity? Theory claims that such a critical juncture/conjuncture is provided by the constellation of a crisis sitaution. How does it facilitate policy change? The window of opportunity - provided by a crisis situation - 'delegitimizes long-standing policies underpinning the status quo' (Kickert and Randma-Liiv, 2017: 91). For example, economic crises by nature deliver welfare losses. A deep economic crisis may deliver policy reforms because the perceived political costs of not reforming (i.e. policy continuity scenario) is larger than the costs of the reform scenario (Drazen and Grilli, 1990). The hypothesis that crisis leads to fiscal consolidation and public sector reforms has become part of the 'conventional wisdom' (Tommasi and Velasco, 1996). Public sector policy change scholars (Kickert et al., 2015) argue that the depth and immediacy of the crisis would influence the selection of specific measures (e.g. hiring freezes, lay-offs, or program-specific cuts) and the approach to cutback management (e.g. cheese-slicing or targeted cuts). I would argue though for a broader understanding of the critical juncture: the window of opportunity applies when the previous stickiness of existing policies gets damaged either by internal (i.e. by the arrival of new elite decision makers with different policy concepts versus the outgoing ones; by the unviability of the earlier policy because of financial constraint or technological advancement etc.) or by external factors (i.e. policy change as a condition of financial assistance).

Scholars found empirical evidence for a usual pattern of policy change cyclicality: long periods of stability are followed by major (fast - and sometimes dramatic) policy changes. This pattern is described and unfolded by the punctuated equilibrium theory. According to the theory, once an idea gets attention, it will expand rapidly and become unstoppable (Baumgartner and Jones, 1991; Baumgartner and Jones, 1993). Punctuated equilibrium is the process of interaction of beliefs and values concerning particular policy (termed policy images) with the existing set of political institutions or venues of policy action (Christensen, Aaron and Clark 2003, Christensen et al. 2006). Punctuated equilibrium theory connects to both path dependency (regarding the recognition that existing policy frameworks have a long-serving characteristics and tend to be sticky) and the policy learning and the advocacy coalition stream of thoughts (regarding the acknowledgement of the transferability of policy ideas from one place to another and the emphasis on policy images and the value and the belief system of elite decision makers). Punctuated equilibrium model connects institutions with ideas. Institutions enclose a set of political participants into the policy process, while ideas are the elementary building blocks of the various policy agendas. According to the punctuated equilibrium theory, policy-makers' perceptions and the institutional framework determine the way policy problems are defined.

Policy learning deals with the question how ideas can be transmitted from one place to another. The terms 'policy-oriented learning' or 'diffusion' is used by the theory as a major determinant of policy innovation and change (Sabatier, 1988;

Sabatier and Jenkins-Smiths 1993; Cairney, 2015; Rose, 1991; Dolowitz and Marsh, 1994). Policy diffusion is a process in which policy innovations spread from one government to another (Shipan and Volden 2008). Policy diffusion occurs when one government's policy choices are influenced by the choices of other governments - the 'knowledge about policies, administrative arrangements, institutions in one time and/or place is used in the development of policies, administrative arrangements and institutions in another time and/or place' (Dolowitz and Marsh 1996: 344). Policy makers rely on examples and insights from those who have already experimented with the relevant policies (Shipan and Volden 2008; Shipan and Volden, 2012). Policy diffusion and its role in public policy formation can take various forms (i.e. political leaming, government leaming, policy-oriented leaming, lesson drawing and social leaming). These concepts are used to describe the process by which programs and policies developed in one country are emulated by, and diffused to others (Rose, 1991; Cerna, 2013).

Policy transfer refers to the process whereby actors borrow policies, administrative arrangements, and institutions developed in one setting to make them work within another setting (Dolowitz and Marsh, 1996). Policy transfer can refer to policy goals; structure and content; administrative techniques (i.e. policy instruments); institutions; ideology; ideas or concepts (Robertson and Waltman, 1992). Dolowitz and Marsh defined in their seminal article 'Who learns from whom: A review of the policy transfer literature'[19] that external influence eventually is the transfer process of policies, administrative arrangements, institutions, and ideas from one entity to another (Dolowitz and Marsh, 1996). Policy transfer occurs on a continuum between 'purely voluntary' policy transfer and 'purely coercive' policy transfer (Bennett and Howlett, 1992; Heclo, 1974; Rose, 1991). Most cases fall along the continuum rather than at one pole. Nevertheless, when conditionality is involved in the relationship between two actors, (as this is the case in bail-out programs between the IMF and the bailed-out country) then there is inherently a certain degree of coerciveness. Coercive policy

[19] Dolowitz, D., Marsh, D. (1996): Who learns from whom: A review of the policy transfer literature. Political Studies XLIV: 343–357.

transfer – also termed as facilitated unilateralism or hierarchical policy transfer - occurs via the exercise of transnational or supranational authority; when a state is obliged to adopt policy as a condition of financial assistance (Bulmer and Padgett 2014).

Some scholars argue that the importance of foreign pressure is overstated and in reality it has only a weak effect (Alesina 2006, Mahon 2004). Others claim that in IMF-supported programs' conditionalities are critical to fiscal consolidation, but the eventual success depends on the individual governments those are responsible for policy selection, policy design and implementation (Crivelli and Gupta, 2014). Public sector policy change scholars argue that countries facing external pressure in a form of conditionality related to financial assistance (i.e. by the IMF, the European Commission and the European Central Bank), are forced to implement swift and radical policy change (Christensen and Laegreid, 2017; Randma-Liiv and Kickert, 2018). Bulmer and Padgett (2014) claim that the quality of the coercive policy transfer and its eventual outcome depends on variables such as the degree of authority accrued by supranational institutions and the density of rules and the availability of sanctions and incentives. Concerning policy transfer capabilities of governments under the circumstances of coercive policy transfer, Bulmer and Padgett (2014) distinguish the muddling through and the problem solving type of attitudes of the political executives. While the muddling through process brings about a weaker form of policy transfer, problem solving results in stronger policy transfer outcomes.

Policy transfer can happen alongside qualitatively different mechanisms, such as copying, emulation, hybridization, synthesis, and inspiration (Rose, 1991). Emulation refers to a case where not every detail is copied. Hybridization and synthesis describe the process of combining elements of programs found in two or more cases, in order to develop a suitable policy for the actual problem, while the domestic policy legacy is taken into account, and expert decision making is prioritized. Hybridization and synthesis assumedly work better under peaceful circumstances in general then under crisis situation.

The success of policy transfer depends on the actual qualities of the process. Generally, it is helpful if the domestic policy legacy and institutional/cultural setting is taken into consideration (hybridization, synthesis) and/or if the domestic agents internalize the policy change process (inspiration). In other words, reform (or policy change) ownership of elite decision makers is crucial vis-à-vis the success of the policy transfer process. These qualitative features (i.e. levels) of the policy transfer process are going to be scrutinized in the dissertation.

Changes in the main aspects of a policy usually result from shifts in external factors such as macro-economic conditions or the rise of a new systemic governing coalition. This latter is termed as the 'Advocacy Coalition Framework' (Sabatier 1988, Sabatier and Jenkins-Smith 1993). Policy change can be understood through the examination of political subsystems (advocacy coalitions) those seek to influence governmental decisions. The theory recognizes that there are various competing sets of core ideas about causation and value in public policy. Coalitions form around these core idea sets because certain interests are linked to them. The members of advocacy coalitions are coming from a variety of positions (elected and agency officials, interest group leaders, researchers etc.) and they shape the particular belief system - a set of basic values, causal assumptions and problem perceptions (Sabatier, 1988; Sabatier and Jenkins-Smith, 1991). Policy options are therefore the function of the position of the particular advocacy coalition vis-à-vis the elite political decision makers: shifts in the government have an impact on the advocacy coalition. The scholars of both the advocacy coalition framework and the punctuated equilibrium theory pay ample attention to the relevance of discursive factors in policy change, the role of beliefs in shaping policy ideas. Sabatier uses the term devil shift to describe the situation when policy actors inflate the malevolence of their policy opponents (Sabatier et al., 1987). In punctuated equilibrium theory, reframing plays a key role in changing the policy image (Baumgartner, 2013; Princen, 2013).

The form of political executive affects – among other things – reform ownership (Pollitt and Bouckaert, 2011). Top-down reforms driven by elite decision making – influenced by ideas and pressures– constitute the core of the reform process. Shifts in the locus of authority is recognized as a highly critical component of the policy change process (Hall, 1993). Hall makes an important distinction between first order change (i.e. incrementalism, routinized decision making – usually associated with the policy process – involving neither the change of the policy goals, nor the insrtuments employed to reach them), second order change (change affecting the policy instruments but not the policy goals) and third order change (i.e. radical shifts both in the hierarchy of policy goals and in the policy instruments employed to reach them). Using the Hallian conceptualisation, especially the distinction between second order and third order policy changes, is particularily useful in explaining the different policy reform trajectories through a comparative lens and interpreting the relation between ideas (paradigmatic beliefs) and the actually chosen reform trajectories.

A public sector reform is more likely to happen if one political group (or advocacy coalition) becomes a dominant player (Alesina, 2006). This political group is understood as being mainly domestic – however in some cases external players (mainly supranational institutions) also perform critical role. Empirical evidence has been found that fiscal consolidation and broad reforms are more likely to occur when new governments take office; when governments are politically strong; and when there are fewer institutional constraints (Reich, 1995; Alesina, 2006). Large scale policy shifts are more likely to occur immediately after an election, presumably when the new government enjoys a mandate and when new elections are a long time away (Alesina, 2006). The form of the political system influences also the decision-making patterns: one-party governments in majoritarian systems are able to implement quick and decisive reforms, while coalition governments tend to engage in long negotiations often without a result (Kickert, Randma-Liiv and Savi, 2015). Broad reforms are possible when there is sufficient political will and when changes are designed and implemented by capable actors. The larger the number of institutional constraints on the executive, the more delayed and less successful policy reforms become (Hamann and Prati, 2002).

Table 1.1. compiles the theories on policy change (alongside their identified factors and mechanisms facilitating policy change).

Table 1.1. A typology of the policy change theories: factors and mechanisms

<table>
<tr><th></th><th>Path dependency / Multiple streams</th><th>Punctuated equilibrium</th><th>Policy learning</th><th>Advocacy Coalition Framework</th></tr>
<tr><td rowspan="3">Factors and mechanisms facilitating policy change</td><td>window of opportunity
policy window
(conjuncture/ critical juncture)</td><td>change of policy images (values and beliefs)
reframing</td><td>policy diffusion</td><td>belief system of advocacy coalition</td></tr>
<tr><td>econonomic crisis
arrival of new elite decision-makers</td><td>shifts in external factors (e.g. macroeconomic conditions)</td><td>policy transfer
(policy goals
structures
content
technique
concept)
(voluntary or coercive)</td><td>ecoomic crisis
shifts in systemic governing coalition
devil shift</td></tr>
<tr><td>delegitimize long-standing policies</td><td>capable managers with new policy images</td><td>one government influences the other
copying
emulation
hybridization
syntetization
inspiration
(reform ownership)</td><td>reform ownership (strong political mandate, fewer institutional constraints)</td></tr>
</table>

Source: Author

1.3. Research approach and method

The politics of fiscal consolidation, policy change and public sector reform under external constraints, and the influence EU (and IMF) on domestic government's political decision-making is the main theme of the dissertation. The research covers the politics of fiscal consolidation and reform under external constraints and the effects of the European Union and the International Monetary Fund on Hungary's public sector and administrative reforms, with a special focus on the factors facilitating large scale policy change of the Hungarian tax system. The following section first gives an account on the general EU-wide developments in order to contextualize the Hungarian case and to shed light of the general research approach of the compiled articles (1.3.1. External inducements - EU and IMF influence in national policy making). Then the case protocol is presented that describes the methods and data used in the analysis (1.3.2.).

1.3.1. External inducements - EU and IMF influence in national policy making

This section provides an account on the development of the mechanisms of external inducement during the crisis-management period in the aftermath of the financial crisis in the EU. The purpose is to give a general background knowledge for the dissertation's case studies.

The global 2008-2009 financial and real economic crisis was the most severe crisis since the Great Depression started in late 1920's. The crises in the post World War 2 period were restricted to either sectors (i.e. banking sector crisis in Scandinavia in the early 1990's), or markets (i.e. the stock market's dotcom bubble in the early 2000's) or regions (i.e. the Mexican "tequila" crisis in 1994; Asian and the Russian crisis in the late 1990's etc.). These crisis episodes provoked intensive academic debate. The commonly shared lesson was that macroeconomic imbalances and policy mistakes both played key role in the run up to the crisis (Radelet and Sachs 1998; MacIntyre, 2001).

Macroeconomic imbalances may take many forms: they could appear as large differences of inflation, cost levels, unemployment rates, income levels, competitiveness, external and internal balances, stock of debt etc. between regions and between countries. In international economics, imbalances are mainly associated with balance-of-payment items, such as current account deficits/surpluses and capital flows, which translated into the changes of foreign currency denominated loans (Borio and Disyatat, 2011).

In the seminal publication of Reinhart and Rogoff (2010) - "Is the 2007 U.S. sub-prime financial crisis so different?" - the argument was made that economic policies (mainly monetary and exchange policies) generated the toxic mix of credit market distortions. These market distortions eventually were responsible for the build-up of global imbalances and laid the foundations of the 2008 financial crisis. Especially global current account imbalance is identified as one of the fundamental reasons of the global financial crisis. Current account imbalaces had contributed to the liquidity glut (i.e. excess savings in countries with current account surpluses flowing abundantly into countries with current account deficits) and therefore generated significant distortions in financial incentives (Obstfeld and Rogoff. 2009; Reinhart and Rogoff, 2010). Three main factors were identified having contributed to the build-up of financial imbalances, such as global imbalances reflected by capital flows, inappropriately loose monetary policy and finally inadequate supervision and regulation (Nier and Merrouche, 2010). In economists' debate the axiom is clearly made that policy mistakes, global imbalances and the financial crisis are closely interlinked with each other.

Looking at the interpretations of the European crisis, it was pointed out that the slack in financial conditions generated the global credit boom, and crisis is embedded in the discontinuation of the previous financial flows from North to South (Gros, 2012). The focus of the mainstream interpretations is primarily on imbalances in macroeconomic fundamentals, such as budget deficits and current account imbalances between member states. The European Commission also argued that large macroeconomic imbalances made the finances of EU member states more vulnerable to economic shocks (EC 2010).

Having recognized that macroeconomic imbalances matter, the scope of interest of European policy makers got broadened. Previously the attention of EU institutions' responsible for economic policy (most prominently DGEcfin) was predominantly centred on fiscal policy and the promotion of sustainable public finances. The usual recipe to overcome the problems of overly lax fiscal policies was fiscal austerity – i.e. the consolidation of the public budget by the implementation of painful reforms. This was supposed to serve the purposes of fundamental remedy and to help rebuilding trust and confidence in financial markets.

Crisis literature's axiom stipulates that policy mistakes, global imbalances and the financial crisis are closely interlinked with each other, current account imbalances reflect unsustainable national macroeconomic policies and a lack of competitiveness. This had been evidenced in the Euro-area also: member states with difficulties regarding public (Greece, Portugal, Italy) or private (Spain, Ireland) debt were challenged by deteriorating competitive positions, ran large current account deficits (Collingnon at al. 2008) and eventually became the ones most prominently affected by the crisis[20].

The 2008 financial crisis was followed by a severe economic recession in most EU member states with detrimental social and political implications. The first reaction of national governments – with some notable exceptions[21] - was fiscal policy loosening, i.e. the introduction of counter-cyclical measures designed to ease the negative domestic developments. However, the result was surging budget deficits and swelling public debt, with an increasingly poor outlook vis-à-vis the debt metrics in several member states – especially in the problem-ridden periphery of the EU. This, in turn, provoked the European debt crisis in 2011-2012 whereas the viability of the public debt servicing in the longer run was evaluated negatively by financial markets. Moreover, even the very existence of the Euro was questioned first by several players in the financial and capital markets and later on by a much broader public audience – with certain negative implications to the functioning of the European Union and with concerns raised over the future of the grand European political project.

These dangerous trends prompted the European Commission to counteract and to introduce measures designed to reverse the negative financial market sentiment and the negative economic trends alike. These measures were complex, and targeted a wide array of related fields starting from pure politics ranging to the tightening of the grip of financial regulation as well as to the details of monetary policy engineering. Part of the policy package was strengthening European economic governance (i.e. increasing

[20] See the unattractive abbreviation PIGS referring in financial market and media to this group of countries, i.e. Portugal, Italy, (Ireland), Greece, Spain.

[21] Most notably Hungary, where – due to the country way already in the EDP since 2004 and had to bailed-out by the IMF in the autumn of 2008 – such an action was ruled out totally.

the influence of the European Commission over member states) including (1) imposing tighter rules adopted for the already existing Excessive Deficit Procedure (EDP) – aimed at reducing government deficits and public debt levels where they exceed established thresholds – and (2) installing new mechanisms designed with the purpose to detect, prevent, and correct macroeconomic imbalances.

Having learnt the importance of a wide set of macroeconomic indicators' role in the emergence of the crisis, DGEcfin acknowledged that fiscal policy should not be viewed in isolation, the principles of sound and competitive macroeconomic policies need to take into consideration a bigger scope of macro variables. In order to address this issue, a new policy framework, the so called Excessive Imbalance Procedure was established. The Excessive Imbalance Procedure was designed with the purpose to monitor, prevent and correct unsustainable imbalances and persistent distortions in competitiveness, with the ultimate aim to prevent economic problems from getting worse and affect other EU members - i.e. to fend off the contagion, or the spill-over effect.

Macroeconomic imbalances were persistent in several member states in the pre-crisis years. Such imbalances are considered to be as the main source of financial vulnerability and responsible for the depth and the length of the economic recession itself. Macroeconomic imbalances are considered being toxic as they have important cross-border spill-over effects. Resolving them is thus a matter of the common interest of all the member states (especially that of the members of the European Monetary Union i.e. EMU). According to the European Commission this could only be managed if there were some constraints on national policymaking, including the possibility to impose certain sanctions on consistently misbehaving members-states. In order to identify and tackle these imbalances, the European Commission (i.e. DGEcFin) established in 2011, a new complex framework, a surveillance tool incorporating rules to prevent future imbalances: the Macroeconomic Imbalance Procedure (MIP). MIP was modelled on the EDP in its architecture. MIP consists of selected indicators which are considered to be vital for the purpose of tracking the development of macro imbalances. Numerical thresholds are set in order to decide whether the indicators can be considered as healthy or not. DGEcFin prepares analysis on each and every member state in order to evaluate their economic trends to assess whether they comply or not to the MIP rulebook.

The European Commission took several measures in 2011-2012 in order to more thoroughly monitor and control the economic and fiscal policies of member-states such a new fiscal and economic policy framework, the 'European Semester', the 'six pack' (automatic penalty for countries breaching deficit and debt rules), the 'two pack' (stricter monitoring and control) and 'fiscal compact' (intergovernmental treaty ratified by parliaments)[22]. Accordingly, Brussels' role expanded: the DGEcFin does not solely intervenes in fiscal and economic affairs any longer but also provides with structural reforms recommendations, public sector reform policy blueprints (in policy fields such as labour market, pension system etc.). Member-states therefore need to submit besides the 'stability/convergence program' also a 'national reform program' outlining structural reforms those promote economic growth and employment. The magnitude of EU influence was determined by the severity of the economic, financial and fiscal crisis in a given member state. Accordingly, in cases when a member state had no excessive deficit problems, there was no EU-intervention. However, in case a member-state did not comply with the EU's budget rules (i.e. violates the rules of the Stability and Growth Pact - SGP), then the 'Excessive Deficit Procedure' (EDP) is brought into effect. The Commission and Council then present 'country specific recommendations.[23]

---

[22] The procedure is the following. In November: EU Commission presents priorities and guidelines; In February: EU Commission presents report for each country; March-April: member-states submit national reform program and stability/convergence program; May-July: member-states receive specific recommendations; August-October: member-states incorporate recommendations in their budgets.

[23] The Stability and Growth Pact (SGP) contained the 'Excessive Deficit Procedure' (EDP). Its basic principles were (1) public budget deficit below 3 percent of GDP, (2) public debt to GDP ratio below 60 percent, (3) countries have a medium-term objective (MTO). When a country's deficit became excessive, the procedure of the 'corrective arm' of the SGP was enacted. The sequence is set as follows: In April the member-state needs to submit 'stability and convergence program'. EU Commission and Council formulates an 'opinion', which is a recommendation for country's next year public budget. In October the member-state submits draft-budget to Brussels. If it deviates from SGP,

DGEcfin's analysis of a broad range of economic data serves the purpose of monitoring member states' economic developments and identify potential problems (i.e. risky or unsustainable policies; deterioration in competitiveness; etc.). The reports labelled as Annual Growth Survey, and Alert Mechanism Report contain the findings of the monitoring exercises. Annual Growth Survey focuses on the long-term, strategic priorities such as employment and general macroeconomic trends. Alert Mechanism Report concentrates on potential internal and external imbalances and identifies problem-prone countries and issues based on a scoreboard – the so called Macroeconomic Imbalance Procedure (MIP) scoreboard. The findings are presented by the Alert Mechanism Report. Then further examinations and consultations (also with the member states) are exectued and finally the European Commission decides whether which member states face with the problem of excessive imbalances. In the cases of excessive imbalances are recognized, the potentially harmful macro imbalances are further scrutinized, their origin, their nature and their severity assessed by the In-Depth Reviews.

The member states inspected by In-Depth Reviews have to submit corrective action plans with a clear roadmap and deadlines. EMU member states can be fined for failing to address serious macroeconomic imbalances, if these are considered to have spill over effect and therefore evaluated as damaging to other member states. Once the European Commission has formally qualify a member state's imbalances "excessive" and the European Council has agreed to it, a non-interest bearing deposit (equalling 0.2% of GDP) can be imposed. This deposit could be transformed into a fine in the event of non-compliance with the Commission's recommendation to correct the imbalance at later stages. The decision to fine a Member State is proposed by the Commission and can only be blocked if a large majority of governments oppose the measure. If a member state repeatedly fails to act on recommendations or does not present a corrective action plan sufficient to address excessive imbalances, it will have to pay a yearly fine. The fine would equal to 0.1% of GDP of the member state concerned. Therefore the corrective arm looks fairly constraining.

EU Commission and Council formulate an 'opinion', which is discussed in Euro-group (ministers of Finance).

As explained above, at the beginning the principal target was fiscal consolidation i.e. the reduction of budget deficits and debt accumulation. First it was a predominantly economic exercise focussing on to cut the policy sector expenditures and to decrease the running costs of administration. The key actor in domestic fiscal consolidation at the national level is normally the Finance Ministry, while at the European level it is the European Commission's Directorate-General of Economic and Financial Affairs (DGEcFin). At this early stage public sector reforms or administrative reform were not in focus. The primary role of both on the national and the EU level policy makers was to restore confidence in the financial markets. Accordingly, the main actors' rationale was narrowed to reducing deficits (and debt accumulation) in the most effective way (without harming economic recovery too much). There came the reduction of wages and staff size, and increasing cost-efficiency in public administration. Spending-based fiscal adjustments are not only more likely to reduce the deficit and debt than tax-based adjustments, they are also less likely to trigger an economic recession. (Alesina and Ardagna 2010; Alesina 2012; Alesina, Favero and Giavazzi 2014; Sutherland et al. 2012, Blöchliger et al. 2012).

If the financial situation in a member-state gets out of control and the danger of a debt-default is getting priced increasingly by the financial markets through massively elevated credit default swaps (CDS) then a sovereign debt crisis is looming (see Appendix 7. Development of Credit Default Swap in selected EU member-states, 1 January 2008 - 1 January 2014). This situation can be settled through an appeal to the IMF and EU to provide a temporary loan (bail-out) - the term Troika refers to the consortium of the European Commission the European Central Bank and the International Monetary Fund that provides financial assistance together in a bailout-case. Nevertheless, the loan program is provided upon strict conditions. The Troika intervened in fiscal and economic affairs, and also required to carry out structural reforms in e.g. labour market, pensions and tax administration[24]. In bailed-

---

[24] The IMF has a range of lending instruments, of which the Stand-by Arrangement (SBA) is commonly used in middle-income and advanced economies. The SBA's duration is usually one or two years. The IMF loans are provided upon conditionalities, the most important being that a country recovers its finances and economy in order to pay back the loan. The IMF has developed a number of more specific loan-conditions, such as 'prior actions' a country has to take before getting a loan,

out euro-area member states like Greece, Ireland and Portugal, the Troika, in bailed-out EU member-states which were not members of the euro-area, like Hungary, Latvia[25] (then) and Romania, the EU (more precisely the DGEcFin) the IMF and the Worldbank urged structural reforms in pension system and the rationalization and modernization of public administration as conditions for loans. IMF loans in general are provided upon ‘conditionalities’. These include (1) ‘structural conditionalities’ consisting of measures to improve the financial sector, and (2) public financial management reforms (such as accounting, reporting and auditing, expenditure control, legal frameworks, etc.). Evidence was found, that the IMF was more interested in short-term fiscal and financial conditions, while the DGEcFin focused on medium-term structural reforms agenda (including public administration, health, labor market, the judicial system etc.) with detailed structural conditions (Pisany-Ferry et al 2013).

The timing of stabilizations may be affected by external factors. A binding agreement with the IMF may increase the costs of delaying actual policy adjustments. However, theoretically it is also possible that an agreement with the IMF that provides more resources to the country and does not force the country to commit to any particular set of policies may delay the stabilization as it decreases the cost of delay by providing easier access to borrowing (Alesina at al., 2006). In the stand-by loan agreements (SBA) conditionality covers both the design of IMF-supported programs – i.e. macroeconomic and structural policies - and the specific ways to monitor progress towards the goals. While formally the bailed-out country has primary responsibility for selecting, designing, and implementing the policies that will make the IMF-supported program successful – in practical terms these are typically closely and strictly aligned to IMF recommendations. The program’s objectives and policies depend on country circumstances, but the principal goal in each case is to restore macroeconomic stability (Crivelli and Gupta, 2014).

‘quantitative performance criteria’ related to economic, monetary and financial variables, and ‘structural measures’ to implement in key policy-areas, and the regular ‘reviews’. The ‘structural conditionalities’ vary and e.g. consist of measures to improve the financial sector, and public (financial) management reforms.

[25] Latvia joined to the Euro-zone in 2014.

1.3.2. Methodological consideration

This section explains what the dissertation tries to achieve and how it plans to achieve it. Moreover it provides a link between these research tasks and the data needed to answer them. It also describes how the data collected and analysed.

The dissertation has the underlying ambition to uncover the politics of fiscal consolidation under the circumstances of economic crisis, to study the external inducement in making policy reform at the national level in the wider area of the public sector and in the narrower case of tax policy in Hungary. The dissertation looks for causal mechanisms in qualitative in-depth single case studies, it has theoretical ambitions that reach beyond the case; it is concerned primarily with causal inference, rather than with inferences that are descriptive or predictive in nature. The reseach includes both systematic mechanisms and case-specific mechanisms in the explanation and makes within-case inferences about how outcomes come about.

Process tracing is treated as one method in the case study method literature, usually a component of case study research. It relies heavily on contextual evidence (Gerring 2007). Process tracing method is assumedly makes possible the study of causal mechanisms (George and Bennett, 2005; Beach and Pedersen 2013). Therefore it is considered to be an adequate case study tool in deciphering the causal mechanisms of the given sequence of policy changes. Accordingly, the articles apply the process-tracing method for within-case analysis in order to establish causal relations (Bennett and George, 2005; Beach and Pedersen, 2013). The first and the third articles (Chapter 2. and Chapter 4.) apply within-case analysis, while the second article (in Chapter 3.) utilizes the most similar system design and adopts a two-country comparative case study methodology. They are comprised of exploratory and explanatory research. The dependent variable is ultimately the policy outcome of the policy change procedure. There are a series of independent variables, such as the influence of the EU and the IMF; economic crisis; reform ownership of elite decision makers etc. (see more detailed description in the relevant chapters).

In order to establish causal relations (Bennett 2004; George and Bennett 2005) four data sources were consulted during the empirical research. First, extensive desk research was conducted, analysing publicly available official reports issued by the national institutions (e.g. National Reform Programs and Convergence Program); Country-Specific Recommendations issued by the European Commission (EC); EC staff working documents; World Bank, OECD and IMF reports. Second, semi-structured interviews were conducted with representatives of ministries and public agencies, former and current members of parliament, and fiscal council representatives[26]. Third, in order to incorporate the broader public debate into the picture, relevant media sources were consulted. Fourth, statistical and financial market data were collected in order to fully track the developments and the policy outcomes of public sector reform and fiscal consolidation. The statistics on the macro developments were sourced from Eurostat, and where applicable from national statistical offices database. Financial market data was sourced from Bloomberg, while the tax statistics was sourced from OECD and Worldbank database.

Altogether, 10 persons were interviewed in the 2015–2017 period in Hungary (by the author of the dissertation) and 9 person in the 2013-2016 period in Latvia (by the co-author of the article 'The politics of fiscal consolidation and reform under external constraints in the European periphery: Comparative study of Hungary and Latvia'- see details in Appendix 1. List of interviews). The interviewees were selected with the intention to get a broad account of the case both horizontally (public sector representatives, central bank and fiscal council representatives, EC and IMF representatives) and vertically (junior employees, executives, high level decision makers, experts and political appointees). A peculiarity of the interviews was that in most cases the interviewed persons changed their positions throughout the time period

[26] Hungary: Interviews were conducted between November 2015 and February 2017 with representatives of National Bank of Hungary, the Fiscal Council, the IMF Resident Representative Office, Ministry of Finance, Ministry of National Economy, European Commission.

Latvia: Interviews were conducted between January 2013 and July 2016 with representatives of the Bank of Latvia, Ministry of Finance, Finance and Capital Markets Commission, State Employment Agency, State Social Insurance Agency. Some of these were conducted as part of the project, Understanding policy change: Financial and fiscal bureaucracy in the Baltic Sea Region, supported by the Norwegian–Estonian Research Cooperation Programme.

under investigation, and therefore they could report relevant information from multiple viewpoints.

1.4. The structure of the dissertation

This section introduces the three individual articles; it presents their goals, their findings and the actual ways how they had reached their results. The section also explains the relationship between the articles; and the articles' relationship to the broader (policy change, policy reform) and the narrower (policy change and policy reform under the circumstances of conditionality by external agents) research areas.

1.4.1. EU and IMF influence on public sector reforms

Chapter 2. contains the article 'Unintended outcomes effects of the European Union and the International Monetary Fund on Hungary's public sector and administrative reforms'. The article covers the period 2004–2013, an era that the country spent under the EU's Excessive Deficit Procedure (EDP) and investigates European Union (EU) and International Monetary Fund (IMF) influence on Hungary's public sector reforms in the period 2004–2013[27].

In Hungary public sector reforms deviated from the externally proposed trajectory and took the opposite direction: instead of fostering decentralization of the state administration and deepening the Europeanization process Hungary's restructuring of the public sector delivered centralization and a 'power grab' that eventually impinged on some core values of the EU 'constitution'. This is the puzzle the article studies by in-depth analysis of how external influence was exerted and became interwoven with dynamically changing domestic factors in circumstances of

[27] EU's Excessive Deficit Procedure started in 2004 and ended in 2013. The IMF bailout programme started in 2008 and ended in 2010.

conditionality. The article examines the applicability of policy transfer and the relevance of public sector reform theories.

This article aims to (1) uncover the connections between fiscal consolidation and public sector reform to map their processes and their substantive content, (2) analyse the instrumental role of domestic factors of elite decision making on the reform process and reform content, (3) identify EU and IMF influence on public sector reforms, and (4) interpret the interaction of the two (i.e. external influence and domestic decision making) in light of the literature on policy transfer and on public sector reform. The research question (RQ) posed in the article is: How applicable are existing policy change theories for interpreting the empirical puzzle embodied in the Hungarian case?

Policy transfer theories and the scholarly literature centred on explaining the policy change process constitutes the theoretical frame. The study applies the process-tracing method for within-case analysis in order to establish causal relations (Bennett and George, 2005; Beach and Pedersen, 2013). Four sources of data are used: (1) relevant media sources; (2) publicly available official reports issued by the national and supranational institutions (e.g. national reform and convergence programs, country-specific recommendations, IMF documents); (3) interviews with representatives of ministries, the central bank, the fiscal council as well as the IMF and the EC – both on expert level and on decision-maker level; (4) macroeconomic statistical data (from Eurostat).

The analysis supports the thesis that the success of a policy transfer is a function of the actual qualitative features of the policy transfer process and echoes mainstream texts on public management reform, especially those that postulate that the nature of the executive government affects perceptions about the desirability and the feasibility of policy reform; the actual reform content; the implementation process; and the eventual extent of the achieved reform. The main finding of this study is that the Hungarian case gives evidence of how EU-influenced public sector reforms could eventually produce outcomes with consequences that are the exact opposite of what was intended. The article argues that the deviation from the public reforms prescribed by EU policy models and values in the post-2010 period is well explained by the particular socio-economic, political, and administrative factors and the form of the political executive. Therefore it is worthwhile to amend and refine policy transfer theories with the findings of the study, i.e. public sector reform content is aligned to the dominant elite decision makers' agenda.

1.4.2. The politics of fiscal consolidation and reform under external constraints

'The politics of fiscal consolidation and reform under external constraints in the European periphery: Comparative study of Hungary and Latvia' can be found in Chapter 3.

The paper looks at fiscal consolidation in Hungary and Latvia with a special interest in the influence of the EU and IMF on the national government's decision-making and their impact on fiscal consolidation and public sector reforms. The paper approaches the topic from the aspect of the politics of the consolidation. Fiscal consolidation outcome is understood here, as the dependent variable. The financial crisis had major impact on the economies of many EU member states, but a significant variety of effects as well as country responses were observed. This paper discusses the different factors that explain the variety of responses in Hungary and Latvia. These countries were hit severely by the financial crisis and became the first candidates of an IMF bail-out in the European Union. Hungary and Latvia apparently shares lots of similarities regarding their background (both are new member states of the EU; both were part of the Communist bloc before the regime change; both outside the euro-area when the crisis hit; both are relatively small and relatively little known cases etc.). The role of external agents in program design, policy prescriptions, conditionalities, and monitoring were similar during the bailout program period in both cases, however the outcome of fiscal consolidation and public sector reform turned out to be remarkable different.

The two countries exhibited rather different crisis management trajectory. While Latvia overcome the economic problems relatively fast and eventually joined the euro-area in 2014, Hungary stepped out of the IMF program pre-mature and had a lengthy, fragmented and cumbersome fiscal consolidation lasting altogether for 8 years[28]. Latvia became the poster child of successful IMF stabilization and fostered the Europeanization drive. In contrast, Hungary made a U-turn vis-à-vis the earlier path of Europeanization and moved towards the centralization of the public sector. The question the article aims to investigate what are the explanations for such strikingly different routes and outcomes.

This article, which utilizes the most similar system design and adopts a two-country comparative case study methodology, is comprised of exploratory and explanatory research.

The research questions of the article are: (RQ1) How did the international institutions affect fiscal consolidation and reforms? (RQ2) Why were the outcomes of the crisis so different despite the seemingly similar initial conditions?

At the first stage the background information is provided for both countries. Here the attention is paid to the political context and to the socio-economic developments before the bail-out. The two countries are then compared, the major differences highlighted: in Latvia the regime change delivered national independence and sovereignty; in Hungary the regime change was viewed as an extension of personal freedom and opportunity for economic prosperity; Hungary had long history with public debt issues and various IMF programs previously vs. Latvia without similar episodes; the European Commission launched the Excessive Deficit Procedure against Hungary just after EU membership was gained in summer 2004 – Latvia had more fiscal discipline as it was an essential element of newly born independence.

The paper investigates fiscal consolidation step by step especially with regards to how did EU and IMF affect decision-making: the sequence and the time-frame and the actual trigger and the content of the fiscal consolidation. The conditionalities of

[28] At least not until 2014 when GDP growth was 4.2%. In the 2006-2013 period average GDP growth in the Euro-area was 0.6% versus only 0.2% in Hungary. In the core crisis year (2008-2012) the respective data are -0.3% (Euro-area) versus -1.0% (Hungary) Source: Eurostat Database

the bail-out program were looked at, the two countries were compared: how the conditionality was applied (the consequence of no-compliance) and how did it evolve over time? How receptive the IMF (and the EU) was on domestic issues, political characteristics, local sensitivities? The article examines how the fiscal consolidation were received by the domestic actors (parliament, political parties, civil organizations, trade unions, population) and how did it shape the domestic political landscape. Semi-structured interviews were conducted with with representatives of ministries and public agencies (both key and middle-ranked decision-makers involved). Publicly available official reports issued by the national institutions, by the European Commission (EC), by the World Bank, OECD and the IMF were as well as relevant media sources consulted. Statistical and financial market data were collected in order to fully track the developments and the policy outcomes of public sector reform and fiscal consolidation.

This article argues that socio-economic structures and key political decision makers' reform ownership is crucial in the explanation of the different trajectories Hungary and Latvia displayed during their fiscal consolidation and reform under external constraints.

1.4.3. Factors facilitating policy reform

The third article is to be found in Chapter 4: 'Factors Facilitating Large Scale Policy Change - Hungarian Tax Reform 2009-2018'

The paper aims to investigate the causal mechanisms and identify the factors facilitating large shifts in public policy and therefore it aims to contribute to the emerging stream of public administration applied research in public sector reform. The paper provides a weak test of existing policy change theories and proposes the synthesis of the findings in order to get a more comprehensive understanding of the nature of policy reforms. The paper also aims to provide a better understanding in the main contexts and in the interacting processes those shaping public policymaking for practical policy analysis purposes; to uncover the drivers, the mechanisms and the processes of tax policy change.

The case under investigation is the major change of tax policy that took place in the past decade in Hungary (2009-2018). In order to achieve better contextualization of the topic, the study looks at the previous history of tax policy changes in Hungary (i.e. the 2004-2008 period), and examines the tax policy developments in other (mainly EU and OECD) countries as well. The time period under investigation is segmented into four episodes of the four consecutive governments.

The hypothesis of the article is that the coexistence of economic crisis, strong external influence and reform ownership of the domestic elite decision makers facilitated the causal mechanisms leading to the large scale tax policy shift in Hungary.

After a long time period characterized by relative tax regime stability, a major revamp of the tax system had taken place in the 2009-2011 period in Hungary. This consisted of radical income tax cuts with flat personal tax introduced, massive increase of consumption related taxes amended by the introduction of special sector taxes and other innovations. Comparably, this was the largest change of the tax revenue structure in the EU. What factors can explain such an abrupt and fundamental change of the Hungarian tax policy? The ambition of the paper goes further than tracing the single case under investigation, and aims to transpose the topic into a more universal one: that is the terrain of policy change theories. The broad aim of the paper is to provide a weak test of existing theories of policy change.

The dependent variable of the article is the outcome of tax policy change in Hungary in 2009-2018. The research question (RQ) of the paper is the following one:

What combination of independent factors facilitated the Hungarian tax reform in the 2009-2018 period?

Derived from the exhibited scholarly literature and utilizing Mahon's propositions (Mahon, 2004) the following factors are operationalized as independent variables:

1. Domestic cleavage structures which define reform ownership through the political capabilities of elite decision makers and the belief system of the advocacy coalitions.

2. The window of opportunity in the form of economic crisis as it delegitimizes previous long-serving policies and undermines the status quo.

3. International influence that makes policy learning, policy diffusion and policy transfer happen either in voluntary or in coercive form.

The research is organized in an embedded case study design purporting within-case analysis. In doing so, the paper utilizes various statistical datasets, official documents and semi-structured interviews with key players. The analytical work was based on macroeconomic datasets (Eurostat; OECD, Worldbank; KSH, MNB, Hungarian Government), official government documents, official reports and working papers of international organizations (IMF, OECD, European Commission), advocacy coalition policy papers, as well as semi-structured interviews with members of various advocacy coalitions.

The finding of the paper is that the coexistence of all the various identified independent factors facilitated major policy change or policy reform - that goes beyond day-to-day policy management and involves structural changes. It is that the theories of path dependency, punctuated equilibrium, policy learning and advocacy coalition framework have already developed individually the elements of the big puzzle of policy change. The paper proposes to bring on a common platform of the existing streams of thoughts to develop the framework for a policy reform theory.

1.4.4. The relation between the articles

The chapters are embedded into the terrain of policy change theories (i.e. the theory of path dependency, multiple stream, punctuated equilibrium, advocacy coalition framework, policy learning and diffusion). They equally share the ambition to test and refine existing theories of policy change and to contribute to the emerging stream of public administration applied research agendas on public sector reform by making visible and understandable the main contexts and the interacting processes shaping public policymaking. The paper proposes to bring on a common platform of the existing streams of thoughts to develop the framework for a policy reform theory. In order to facilitate such an enterprise, the paper suggests continuing to study the causal mechanism of large scale policy shifts in other cases. The main aspects of the three chapters are exhibited in table 1.2. These include the research topic (EU and IMF influence on public sector reforms - Hungary, fiscal consolidation in Hungary and Latvia; and Hungary's tax reform); the research ambition; research question; data and method. The eventual results of the chapters led to the proposals to (1) to refine existing theories (i.e. chapter 2. and chapter 3.) and (2) develop a general framework for a policy reform theory.

Table 1.2. The map of the chapters

Chapter	Chapter 2.	Chapter 3.	Chapter 4.
Article title	**Unintended outcomes effects of the European Union and the International Monetary Fund on Hungary's public sector and administrative reforms**	**The politics of fiscal consolidation and reform under external constraints in the European periphery: Comparative study of Hungary and Latvia**	**Factors Facilitating Large Scale Policy Change Hungarian Tax Reform 2009-2018**
Research Topic	EU and IMF influence on public sector reforms - Hungary (2004–2013)	Fiscal consolidation in Hungary and Latvia (2008-2013)	Hungary tax reform (2009-2018)
Research Ambition	Uncover the connections between fiscal consolidation and public sector reform / map their processes and their substantive content	Uncover the influence of the EU and IMF on the national government's decision-making	Identify the factors facilitating large shifts in public policy
	Analyse the instrumental role of domestic factors of elite decision making on the reform process and reform content	Uncover the influence of the EU and IMF the impact on fiscal consolidation and public sector reforms	Explore the causal mechanisms of large policy change
	Identify EU and IMF influence on public sector reforms		Test existing policy change theories
	Interpret the interaction external influence and domestic decision making		Better understand the context and the processes of policy change
Research Question	How applicable are existing policy change theories for interpreting the empirical puzzle embodied in the Hungarian case?	How did the international institutions affect fiscal consolidation and reforms?	What combination of independent factors facilitated the Hungarian tax reform in the 2009-2018 period?
		Why were the outcomes of the crisis so different despite the seemingly similar initial conditions?	
Method	Process-tracing method for within-case analysis	Most similar system design / a two-country comparative case study	Embedded case study design purporting within-case analysis
Data Sources	Official reports issued by the national and supranational institutions		
	Interviews with policy-makers		
	Relevant media sources		
	Statistical data		
Finding	Public sector reform content is aligned to the dominant elite decision makers' agenda	Socio-economic structures and key political decision makers' reform ownership is crucial in the policy outcome	The coexistence of all the various independent factors facilitated major policy change / reform
	Suggests to refine existing theories		Proposes to develop the framework for a policy reform theory

Source: Author

Chapter 2.

Effects of the EU and the IMF on Hungary's public sector and administrative reforms

2.1. Introduction

This article analyses the influence of the European Union (EU) and the International Monetary Fund (IMF) on fiscal consolidation and public sector reforms in Hungary in the period 2004–2013. The Hungarian case – although it gained some fame internationally – is relatively unknown in detail, but it provides an interesting insight into how external influence is actually exerted in circumstances of conditionality. The case is especially remarkable because in the last phase of the time period under investigation (i.e. post-2010) there was a reversal in the direction of public sector reforms and a divergence from Hungary's earlier Europeanization drive. This empirical puzzle is investigated here. The research process is mainly inductive in its thrust and provides a thick description of the main features of the reforms. The doctrines behind the trajectory taken are then examined and the effects analysed. The research topic lies at the interface of the streams of literature dealing with policy transfer and public sector reform. The study focuses on (1) the applicability of policy transfer theories whose aim is to explain how public policy models or existing policy practices (or models) are transferred from one place to another and (2) the relevance of public sector reform theories, arguing that reforms are shaped by multiple factors, including various socio-economic forces, the political and the administrative system, and even chance events (Pollitt and Bouckaert, 2011).

Hungary, a country with 10 million citizens, is a unitary state with a unicameral parliament and a majoritarian political system. The government administration is composed of three plus one layers: central level, county level, and municipality level, with the additional regional level (between national and county level).[29] Hungary's public administration system had its roots in the centralized and hierarchical traditions of the Austro-Hungarian Empire (Nunberg, 2000). After the fully-fledged centralization of the post-World War II Soviet-type communist regime, the political changes from 1989 onwards brought the decentralization of public administration. Hungary became a member of the EU in 2004. The process of adopting the *acquis communautaire* in the pre-accession period is labelled as a general Europeanization drive (Shimmelfenning and Sedelmeier, 2004; Hughes et al., 2004; Bruszt, 2007), whereby the doctrines underlying the public sector reforms were derived from the Washington consensus in general and the new public management (NPM) approach in particular (Csáky, 2009; De Vries and Nemec, 2013). Public sector decentralization led to a high degree of independence from central state administration for municipalities and for various state agencies. This also resulted in increasing functional inefficiencies, the proliferation of state organizations on all levels, financial waste, and an environment that hindered central decision makers' ability to facilitate change (Hajnal, 2014; Vass, 2001). Central governments made recurrent attempts to reverse the previous trends throughout the 2000s, but the centralization breakthrough (i.e. cutting state agencies' authority, hollowing out the functions of mezzo and local governments) did not happen until after the 2010 elections when Fidesz[30] gained an absolute (two-thirds) parliamentary majority that allowed the government party to change most rules of the political game, to rewrite the constitution, and to dismantle the strong system of checks and balances (Hajnal, 2013; Hajnal and Kovács, 2015; Greskovits, 2015; Kornai, 2015; Körösségyi, 1999). This latter metamorphosis of the Hungarian public administration constitutes the main interest of this study.

29 The regional level was created in order to comply with the EU's NUTS 2 regional category – it is not rooted in Hungarian administrative traditions and serves mainly as a statistical and planning body (Bruszt, 2007; Hughes et al., 2004).

30 Fidesz is an abbreviation of Fiatal Demokraták Szövetsége (Alliance of Young Democracts) – an initially radical democratic political party formed in 1987. Later on, Fidesz changed its political stance, and by the 2010s it had become a populist party.

The article covers the period 2004–2013, an era that the country spent under the EU's Excessive Deficit Procedure (EDP). In 2008–2010, Hungary participated in an IMF bailout program. The EDP is an action initiated by the European Commission (EC) against those member states whose public budget deficit runs above the set threshold.[31] According to EDP rules, the national government is responsible for the content of the program designed to eliminate the excessive deficit, whereas the role of the Directorate General for Economic and Financial Affairs (DGEcFin) is to formulate country-specific recommendations on the necessary policy measures (including public sector reforms) and to track their implementation. If a member state fails to comply with the approved fiscal consolidation trajectory and does not reduce its public sector deficit accordingly, a financial penalty may be imposed. The macroeconomic situation, the level and the intensity of external influence on national level decision making, and elite decision makers' ownership of public sector reforms were rather heterogeneous during these 10 years. Accordingly, this article distinguishes and analyses three qualitatively distinct phases: (1) the first phase of fiscal consolidation and public sector reforms in 2004–2008; (2) the IMF bailout program in 2008–2010; and (3) the post-2010 public sector reforms and fiscal programs.

Both the EDP and the IMF bailout program have inherent conditionality features (more implicitly in the first case and absolutely explicitly in the second). These circumstances provided a wide window of opportunity for the EU and the IMF to influence domestic public policy reforms. Persistent direct and explicit coercive policy transfer interplayed with the domestic context exemplified by the dynamics of socio-economic factors and the specificities of the political and the administrative system. How then did coercive policy transfer mechanisms work, and how did the actual public sector reforms unfold amidst the dynamically changing environment

---

[31] Originally, this was defined by the Maastricht Treaty as below 3% of GDP. In the aftermath of the 2009 financial crisis, the Stability and Growth Pact was amended with a more rigorously set public debt criteria. Accordingly, EU member states need to adjust their structural budgetary positions at a rate of 0.5% of GDP per year as a benchmark and reduce their government debt level above 60% of GDP to diminish at a satisfactory pace (i.e. to be reduced by 1/20 annually on average over three years).

characterized by deep economic and social crises and major repositioning of domestic political actors in Hungary during the 2004–2013 period?

This study aims to (1) uncover the connections between fiscal consolidation and public sector reform to map their processes and their substantive content, (2) analyse the instrumental role of domestic factors of elite decision making on the reform process and reform content, (3) identify EU and IMF influence on public sector reforms, and (4) interpret the interaction of the two (i.e. external influence and domestic decision making) in light of the literature on policy transfer and on public sector reform. The research question (RQ) posed in this article is: How applicable are existing policy change theories for interpreting the empirical puzzle embodied in the Hungarian case?

The article proceeds as follows. First, the terminology is defined, the methodology is presented and the theoretical frame is outlined, with the underlying objective of exploring the suggestions that policy change theory might have for our case and how the emerging stream of public sector reform literature might be helpful in understanding the empirical puzzle. In the subsequent sections, the article recounts and discusses the three qualitatively different periods of the 10 years under investigation in chronological order. In these sections, the relationship between fiscal consolidation and public sector reform is investigated, as well as the role of domestic elite decision making and EU and IMF influence in the whole process. In the Discussion section, the reform trajectory suggested by the policy change literature and the actual developments exhibited by our case are compared in order to answer the research question (How applicable are existing policy change theories for interpreting the empirical puzzle embodied in the Hungarian case?). Ultimately, the study aims to amend and refine the emerging public administration applied-research agendas on EU influence on public sector reform, especially those of Ongaro (2014), Ongaro and Mele (2014), and Kickert and Randma-Liiv (2017).

2.2. Theories and Method

This section first provides this study's interpretations of the terms used referring to external (EU and IMF) influence on domestic policymaking in the field of fiscal consolidation and public sector reforms, and the theoretical framework of the study is then introduced. Fiscal consolidation is understood here as government policies aiming to cut the public deficit and debt accumulation (OECD, 2001). Public sector reforms are 'deliberate changes to the structures and processes of public sector organisations with the objective of getting them (in some sense) to work better' (Pollitt and Bouckaert, 2011: 25; Ongaro, 2008). However, reform may not necessarily result in modernization or general improvement. This study puts the emphasis on the original meaning of the expression: i.e. re-form the previously existing arrangements and give them a new structure, form, or process, driven by specific considerations and political actors' interests. Here, public sector reforms are understood in line with the concept as used by authors like Barzelay (2001) and Ongaro (2009), i.e. government-wide in scope and cross-cutting all public services. Thus, the focus here is on broad-scope public sector reforms; specific sectoral reforms are not encompassed in the investigation, mainly for reasons of space.

Policy change lies at the centre of our investigation. Public sector reforms inherently entail a process of change. We are interested in circumstances under which the need for policy change gets articulated and the sources of the newly set policy directions and content in a given jurisdiction. We are also looking at the evolution of the policy change process and aim to identify the factors facilitating (or, conversely, hindering) change. Therefore, the emerging scholarly literature centred on explaining the policy change process appears a particularly suitable theoretical frame of our investigations. This public administration-based literature finds its roots in the seminal book *Public Management Reform* by Pollitt and Bouckaert, first published in 2004. Their initial findings were most recently further enriched by literature on state responses to the crisis (Kickert 2011; Kickert and Randma-Liiv 2017; Ongaro 2014).

The public sector policy change literature identifies various factors that facilitate policy change. These include: (1) the window of opportunity provided most notably by a crisis situation 'since it delegitimizes long-standing policies underpinning the status quo' (Kickert and Randma-Liiv, 2017: 91); (2) external pressures, including pressures emanating from supranational institutions (Christensen and Laegreid, 2017); and (3) the form of political executive that affects – among other things – reform ownership (Pollitt and Bouckaert, 2011). In our case, Hungary's deep economic crisis embodies the window of opportunity particularly in the second part of the period under investigation (2008–2013); in the first part (2004–2008), the crisis was less evident. Accordingly, the window of opportunity theory would suggest that public sector reforms were more successful in the second part. External pressure, on the other hand, existed throughout the whole period under investigation, albeit its strength varied across the periods (it peaked during the IMF program). We find the Pollitt and Bouckaert model instructive for our case because top-down reforms driven by elite decision making – influenced by ideas and pressures from elsewhere – constitute the core of the process. In the model, elite decision making is circumscribed by economic and socio-demographic factors, political and intellectual factors, and administrative factors; and the form of the political executive influences the degree of leverage to launch reform and the stability and the ownership of the reform (Pollitt and Bouckaert, 2011). We are interested in the evolution of domestic reform ownership and its impact on the outcomes of public sector reforms. Therefore, we utilize the elite decision-making model for the evaluation of public sector reforms in our case study. According to the model, a political weak government theoretically results in low levels of reform ownership and eventually hinders durable public sector reforms (valid for the 2004–2010 period in Hungary), whereas a politically strong government (2010–2013) results in resilient reforms.

As our case is characterized by external influence on policy change, we are interested in the content and the techniques of the inherent policy transfer processes. Policy transfer therefore is the second theoretical frame used. The theory suggests that public sector reforms could emerge as a result of the presence of external pressure in the entire period. Moreover, the reform content is supposed to be tailored by, or at least aligned to, the agenda of the external agents.

External influence heralded both the pre-2004 and post-2004 periods. The adoption of the *acquis communautaire*, the general Europeanization trend ahead of EU membership (not within the scope of the current study), the conditionality features of the EC's EDP, and more pronouncedly the IMF bailout program (characterizing the 2004–2013 period in Hungary) inherently entail some forms of policy transfer. It is therefore reasonable to investigate the applicability of policy transfer theory in our case.

The notion of policy transfer refers to the process whereby actors borrow policies, administrative arrangements, and institutions developed in one setting to make them work within another setting (Dolowitz and Marsh, 1996). Policy transfer can refer to policy goals; structure and content; administrative techniques (i.e. policy instruments); institutions; ideology; ideas or concepts (Robertson and Waltman, 1992). In our case, this would translate into the most commonly agreed, accepted, and shared institutions, structures, and mechanisms of modern liberal democracies' public sector arrangements in the Western world. Policy transfer can happen voluntarily or coercively (Bennett and Howlett, 1992; Heclo, 1974; Rose, 1991).

When conditionality is involved in the relationship between two actors, then there is inherently a certain degree of coerciveness. Policy transfer occurs on a continuum between 'purely voluntary' policy transfer and 'purely coercive' policy transfer. Most cases fall along the continuum rather than at one pole (extreme). Hungary, however, fell quite squarely into the coercion case, exemplified by the EDP (i.e. a window of opportunity for the EC to exert more direct influence than otherwise on public sector reforms) and the IMF bailout program (i.e. involving straightforward conditionality in the form of policy prescriptions).

Policy transfer theories therefore suggest that the Hungarian public sector reform trajectory in the 2004–2013 period should have resulted in an extended format of the pervious Europeanization drive, including decentralization and voluntary collaboration of stakeholders; demand-driven and responsive government; performance evaluation; customer orientation; local capacity building; territorial development strategies; novel budgeting techniques; various public–private partnerships, and so on – i.e. the public sector recommendations of the EC and the IMF.

Policy transfer can happen alongside qualitatively different mechanisms, such as copying, emulation, hybridization, synthesis, and inspiration (Rose, 1991). Emulation refers to a case where not every detail is copied. Hybridization and synthesis are about combining elements of programs found in two or more cases to develop a suitable policy for the actual problem. Hybridization and synthesis take into consideration the domestic policy legacy, and they prioritize expert decision making. They work better under tranquil circumstances in general.

Crises times (2008–2013) provide a less appropriate environment for such a policy transfer trajectory, whereas the apparent lack of crises theoretically would have facilitated it in the first phase (2004–2008) under investigation. Inspiration happens when familiar problems in an unfamiliar setting can inspire fresh thinking about the necessary solutions (Rose, 1991). Such a policy change trajectory is viable when external pressure is limited.

The success of policy transfer depends on the actual qualities of the process. Generally, it is helpful if the domestic policy legacy and institutional/cultural setting is taken into consideration (hybridization, synthesis) and/or if the domestic agents internalize the policy change process (inspiration). The qualitative features (i.e. levels) of the policy transfer process are scrutinized in the analysis. We adopt policy transfer as our theoretical framework, coupled with the Pollitt and Bouckaert model of public management reform processes, with amendments from recent public sector reform studies (Ongaro, 2014; Kickert, 2011).

The study applies the process-tracing method for within-case analysis in order to establish causal relations (Bennett and George, 2005; Beach and Pedersen, 2013). Three sources of data are used: (1) relevant media sources; (2) publicly available official reports issued by the national and supranational institutions (e.g. national reform and convergence programs, country-specific recommendations, IMF documents); (3) interviews with representatives of ministries, the central bank, the fiscal council as well as the IMF and the EC – both on expert level and on decision-maker level. Altogether, 10 persons were interviewed in the 2015–2017 period (see Appendix 1. List of interviews). The interviewees were selected with the intention to get a broad account of the case both horizontally (public sector representatives, central bank and fiscal council representatives, EC and IMF representatives) and vertically (junior employees, executives, high level decision makers, experts and political appointees). A peculiarity of the interviews was that in most cases the interviewed persons changed their positions throughout the time period under investigation (2004–2013), and therefore they could report relevant information from multiple viewpoints.[32]

2.3. Empirical research

2.3.1. The first phase of reforms (2004–2008)

The year 2004 was a busy one: Hungary joined the EU in May, EDP was launched in early summer, the government parties (the socialist MSZP and the liberal SZDSZ) lost the European Parliament elections[33] in June, and the ensuing internal coalition crisis resulted in a change of prime minister[34] in August. The incoming Prime Minister Gyurcsány busied himself restoring the popularity of the government party, as the next (national) parliamentary elections were scheduled for within 18 months. The Hungarian government had no intention of implementing unpopular fiscal austerity measures.[35]

---

[32] For example, a junior ministry expert in the early 2000s could advance and become a high level official eight years later; a central bank economist could become an expert at DGEcFin or at the IMF. To preserve anonymity, only the most relevant position of the interviewees is indicated here.

[33] The government parties (MSZP and SZDSZ together) won 11 EP seats out of the total 24 – the then opposition Fidesz won 12 EP seats.

[34] Prime Minister Medgyessy resigned in August 2004 – Gyurcsány (former Minister of Youth Affairs and Sports) became prime minister in September 2004. Early elections were not held; the coalition government continued.

[35] Interview with former high level decision maker at the Ministry of National Economy, 12 September 2016 (Budapest, Hungary).

In order to formally comply with the EDP, the Ministry of Finance prepared a national program in autumn 2004 – without consulting fellow ministries, the central bank, or economic think-tanks.[36] The fiscal consolidation program and structural reform proposals were aligned with the EU recommendations – although they lacked any detailed action plans, and they were not implemented.[37] The EC preferred not to interfere in internal political developments (such as parliamentary elections); this explains the absence of strong pressure on the Hungarian government to start fiscal consolidation before the elections.

This changed after the elections however, and fiscal consolidation had to commence. The prime minister won the 2006 election, but the government coalition remained fragile: it had a narrow parliamentary majority, and the prime minister's political profile was damaged.[38] The lack of a strong political coalition weakened political leaders' capacity to implement comprehensive reforms.

All decisions were made eventually by the prime minister.[39] Ministry of Finance staff provided technical assistance, i.e. calculating the financial impact of the measures.[40] Political consent was secured by party-politicking through behind the scenes deals among the coalition parties. Various interest groups were only minimally involved in policy formulation. Previously well-functioning and influential corporatist institutions, most importantly the National Interest Reconciliation Council (a tripartite

---

[36] Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary).

[37] Interview with analyst at the European Commission Directorate-General for Communication, Representation in Hungary, 24 February 2017 (Budapest, Hungary); Interview with former high level political representative of Hungary in the European Commission, 20 September 2016 (Szentendre, Hungary).

[38] A secret political speech by the prime minister was made public in which he acknowledged that he had lied to voters before the elections. This provoked violent street demonstrations lasting for several months.

[39] Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary).

[40] Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary).

council dealing with labour market and general economic policy issues involving the government, the trade unions, and the various employer groups), were side-lined (Sárközy, 2012; Hajnal, 2013).

In order to enhance the efficiency of the austerity program's implementation, a centralization process took place within the state bureaucracy. On the institutional level, the number of ministries and central executive agencies was cut (merged or subordinated to their parent ministry), and agencies' autonomy was curtailed. Within the government structure, the position of the administrative state secretary was eliminated (typically a bureaucrat responsible for professional administration as opposed to the political state secretary who was typically a politician). At the same time, new coordinating institutions were created in order to improve the management of key policy areas (e.g. National Development Agency responsible for EU funds, Committee on State Reform responsible for the implementation of the fiscal package).

The prime minister became the chairman of the most critical cabinet committees. The prescribed roles and functions of the ministers were transformed: whereas previously the minister represented the ministry and the corresponding policy area in the cabinet with a high level of autonomy, now the minister represented the cabinet at the top of the ministry and subordinated to the prime minister (Sárközy, 2012). The prime minister–minister relation became that of a principal–agent type. Strengthening political control and containing organizational resistance facilitated the implementation of the fiscal austerity measures (Hajnal and Kovács, 2015).

Public sector reforms – aimed at improving spending efficiency – were also included in the program. Elite political decision makers' attitude to public sector reforms was dominated by the inertia of the Europeanization drive pursued in pre-EU accession times. These reforms aimed to: exploit economies of scale through voluntary collaboration between local governments; invest in local capacity building (with training programs for civil servants and effective monitoring and evaluation mechanisms for government performance); foster territorial development strategies; adopt performance-oriented budgeting practices; introduce a private insurance system-based healthcare system. These reform ideas did not take into consideration domestic policy legacies, lacked sufficient political ownership, and resulted mostly in virtually no action at all or quasi (symbolic) action. Implemented reforms (i.e. performance management system in public administration; co-payment in healthcare and education) faced professional and institutional resistance, political blocking, and popular discontent, and therefore they were ultimately withdrawn.[41] Centralization (decision making, public sector arrangements, implementation, and so forth) was a means to overcome domestic political resistance.

Instead of lasting public sector reforms, the actual outcome of the government efforts was a cut in public administration funding at all levels. The emphasis was put on fiscal consolidation (i.e. cutting budget deficit), focusing on the revenue side (i.e. increasing tax rates over all and introducing new taxes[42]). Other measures that were not directly linked to short-term fiscal consolidation needs (such as the public sector performance management system, or healthcare reform) were eventually withdrawn (Table 2.1).

Table 2.1. General public sector reforms and fiscal consolidation measures in the 2004–2008 period

General public sector reforms	Fiscal consolidation measures
Political control strengthened in central public administration	Public sector layoffs – wage freeze
Number of ministries cut (from 22 to 18)	Income tax hikes, new sector taxes (energy, banking)
New coordinating bodies to steer implementation	Social security contribution hike
Public sector performance management system (withdrawn)	Co-payment in healthcare and higher education (withdrawn)

Source: Ministry documents, author

In this period, there was a lack of urgency on the part of domestic elite decision makers (i.e. no perceived crisis). There was external pressure (especially in the 2006–2008 period), although the interaction between the EU and the national government

[41] Interviews with National Bank of Hungary experts, 20 October 2015; 24 May 2016; 4 July 2016 (Budapest, Hungary); Interview with former representative of the Fiscal Council, 18 December 2015 (Budapest, Hungary).

[42] The government increased personal and corporate income taxes and social security contributions and introduced a sector tax on the energy and banking sectors.

was high level political; the content of the fiscal consolidation was not up for discussion.[43] Internal political support for the government was weak; there was a lack of reform ownership (Table 2.2).

Table 2.2. Domestic factors and EU influence on reforms in the 2004–2008 period

Domestic factors	EU influence on reforms
Weak government – weak reform ownership	Strong pressure to cut public budget deficit
No crisis perception	Interaction on high political level
No action (2004–2006) – Quasi reforms (2006–2008)	No direct influence on reform content

Source: Author

The main ingredients facilitating reforms stipulated by theories (i.e. window of opportunity, sufficient reform ownership, and coercive policy transfer) were weak or missing. Existing scholarly literature explaining policy change therefore is helpful for interpreting public sector reform developments (i.e. no actions, failed reforms) in this time period.

2.3.2. The second phase: the IMF bailout (2008–2010)

The IMF bailout program took place in a period of major economic crisis and was characterized by strict conditionality. Amidst the emerging global financial crisis in autumn 2008, a complete freeze on the government primary bond market necessitated a call for financial assistance in order to avoid the country defaulting on its debt servicing. In late October 2008, the government signed a stand-by arrangement (SBA) with the IMF, supplemented by a loan contract signed with the EU and another

[43] Interview with former high level political representative of Hungary in the European Commission, 20 September 2016 (Szentendre, Hungary); Interview with DGEcFin expert, 13 July 2016 (Brussels, Belgium).

one with the World Bank.[44] The EU was involved in the bailout program under the terms of the EU Treaty. According to article 119, before a non-Euro-area member state seeks financial assistance from an outside source, it has to consult with the EC and the Economic and Financial Committee. Hungary's IMF bailout package was such a case – actually the first case in the history of the EU.

The IMF arrived for the very first preliminary negotiations with a detailed set of policy prescriptions about what to do and how to do it.[45] The IMF required the Hungarian government to deliver additional fiscal adjustment, focusing mainly on expenditure-side measures.[46] The SBA included detailed policy prescriptions with (1) quantitative targets in the form of policy measures with numerical objectives and (2) qualitative targets in the form of public sector reforms. The implementation of both the quantitative and the qualitative policy targets was strictly monitored. The program had firm conditionality features involving several quantitative performance criteria (i.e. indicative macro and fiscal targets, structural performance criteria, and so on). The Hungarian government had to report monthly; the IMF–EU missions conducted quarterly monitoring. Each mission started with an expert level consultation (on the macro trends), followed by scrutiny of the fiscal trajectory with the policymakers, and ended with the chief negotiators bargaining on the next fiscal measures. A successful round of quarterly screening was necessary before the loan window would be opened (i.e. access to the next loan tranche).

Whereas formally the program was a joint product of the IMF–EU and the Hungarian government, in reality the IMF delegation prepared a list of policy measures that served as a menu, and the Hungarian government had the choice of which ones to select. More precisely, the Hungarian government had to implement most of them, but

[44] The size of the SBA loan was EUR 12.5bn, the EU loan was EUR 6bn, the World Bank loan was EUR 1bn.

[45] Interview with analyst at the European Commission Directorate-General for Communication, Representation in Hungary, 24 February 2017 (Budapest, Hungary); Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary).

[46] Interview with DG EcFin expert, 13 July 2016 (Brussels, Belgium); Interview with analyst at the European Commission Directorate-General for Communication, Representation in Hungary, 24 February 2017 (Budapest, Hungary).

it had a small amount of freedom to reject some. The focus was on the cumulative financial impact of the selected policy measures.[47]

Under the IMF bailout program (2008–2010), the perceived task of the central government was crisis management, with the underlying objective of implementing the agreed (i.e. prescribed) fiscal consolidation measures and the public sector reforms. Prime Minister Gyurcsány resigned in March 2009, and the incoming caretaker government was headed by Bajnai, a former manager, until the next elections (scheduled for one year later).

Early elections were not called. Bajnai's government had several members from outside politics (businessmen, experts), and the operating processes started to resemble business-like mechanisms, at least at the top echelons of central state administration. It would be an exaggeration to label it as an NPM approach, but its operational mechanisms (efficiency-driven management approach, corporate governance-style leadership patterns) resembled NPM.[48] Nevertheless, the caretaker government acted as the agent of the IMF and the EC, without a high level of domestic support or political legitimacy.

The IMF-prescribed fiscal consolidation program contained (1) short-term efficiency-enhancing measures with prompt expenditure cuts, (2) long-term structural reforms, and (3) correction of the Hungarian tax system. Hungary adopted a fiscal responsibility law and established a fiscal council[49] (with three members and a fairly large secretariat staff) to oversee compliance with the fiscal rules authoritatively.

The pension system was reformed (including a change in the indexation methodology, an increase in the retirement age, axing the thirteenth month pension; revisiting and controlling disabled pension schemes), although the changes to the

---

[47] Interview with analyst at the European Commission Directorate-General for Communication, Representation in Hungary, 24 February 2017 (Budapest, Hungary); Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary).

[48] Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary).

[49] Both instigated by DGEcFin.

pension system (i.e. raising the retirement age from 62 to 65) were planned to take effect gradually between 2016 and 2024. Further measures including the reform of central and local level state administration, healthcare, and education did not fit into the short-term timeframe.

Strict discipline was introduced on the management of budgets, with general expenditure cuts across the public sector in order to advance fiscal consolidation. Public sector real gross wages were reduced. Housing and farm subsidies were cut. Social transfers were cut and transformed (e.g. withdrawal of high wage earners' family tax allowances, community work in exchange for social benefits). On the revenue side, the program prescribed tax cuts (social security contributions, personal and corporate income taxes) with a broadening of the tax base and tax increases (consumption taxes). The underlying objective of the IMF-prescribed measures was to support the sustainability of the fiscal position by elevating the economy's growth potential through institutional changes in the longer term – fiscal consolidation measures were subordinated to this aim (Table 2.3.).

Table 2.3. General public sector reforms and fiscal consolidation measures in the 2008–2010 period

General public sector reforms	Fiscal consolidation measures
Number of ministries cut (from 18 to 15)	Public sector layoffs – general public sector expenditure cuts
Fiscal responsibility law (fiscal council)	Tax base widening
Pension system reform	VAT hike

Source: Ministry documents, author

Under the SBA, the IMF had largely taken over economic policymaking from the national government. Domestic decision-making authority was severely curtailed. The emergency situation paralysed the domestic political elite and reduced domestic resistance, that is, it opened the window of opportunity for public sector reforms. The policy measures were prescribed by the IMF and the EC (i.e. coercive policy transfer) and therefore fully aligned to the policy agenda of the external agents. Reforms targeted structures and institutions. The content of the reforms was derived from NPM doctrines and resulted in a reinforced Europeanization drive. Reform ownership was high – as the opposite would have delivered the catastrophic scenario of a potential country default (Table 2.4.). The empirical evidence is in accordance with the stipulations of policy change theories.

Table 2.4. Domestic factors and EU/IMF influence on reforms in the 2008–2010 period

Domestic factors	EU and IMF influence on reforms
Strong reform ownership	Strong conditionality of the bailout program
Major financial crisis	Reform measures prescribed by IMF
NPM-like operational mechanisms	EU focus on fiscal target; IMF focus on sustainability

Source: Author

2.3.3. The post-IMF program (2010–2013)

The post-IMF program period brought about radical changes in the direction of reforms. Opposition party Fidesz campaigned with anti-austerity rhetoric and tax-cut promises ahead of the 2010 parliamentary elections. Eventually, Fidesz won a two-thirds parliamentary majority. The new government led by Prime Minister Orbán faced the challenge of pleasing voters (i.e. deliver tax cuts, refrain from further austerity measures), while also continuing with fiscal consolidation and public sector reforms according to the IMF program and the EDP. First, the government introduced a banking tax – without any consultation with the IMF or the EC.[50] This was a violation of the program. Several other policy measures followed that contravened EU rules (e.g. allowing home distilling of the fruit brandy *pálinka*, curbing the independence of the central bank and the fiscal council). Given the confrontational stance of Prime Minister Orbán, the relationship between the new government and the IMF/EC soured rapidly. Experts (both on the national side and the IMF/EC missions) worked

[50] After the government change, it turned out that the public deficit was running above plan; therefore, the measure was implemented in order to fix the fiscal problem quickly.

diligently, however, in order to keep the program running.[51] Finally, the IMF and the EC decided to terminate the bailout program prematurely in summer 2010.[52] The EDP was still in place though, and therefore fiscal consolidation had to continue. The details of the national program and its fiscal impact were actively discussed with DGEcFin at expert level.[53]

The centralization drive – a main political initiative of the Orbán government – was fully accomplished. The parliamentary supermajority allowed a quick and fundamental redesign of the whole political system, including that of central and local state administration. The previous ministry structure was abandoned, and eight integrated super-ministries were created (previously 13 ministries). The personal competencies of the prime minister were strengthened as he took charge of all senior appointments in the central administration (Sárközy, 2012). Central control increased not only over central government, but also over county and local governments (i.e. the concentration of discretionary decision power, the establishment of regional government offices, the changing of the regulatory framework). Decision-making powers shifted within the central government: public service officers and executives lost their previous roles in the decision-making process; all important decisions were taken at state secretary level (Hajnal, 2014). Central political control was the key feature of civil servants' new recruitment and promotion system. Appointments even to middle and lower level management positions required the approval of the state secretary. The county level offices of central executive agencies were integrated into the newly created County Government Offices. Political appointees were put in charge of these entities, and they operated under government control. Several important

---

[51] Interview with former employee of the IMF Resident Representative Office, 14 June 2016 (Budapest, Hungary); Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary); Interview with former high level decision maker at the Ministry of National Economy, 12 September 2016 (Budapest, Hungary); Interview with DG EcFin expert, 13 July 2016 (Brussels, Belgium).

[52] The officially set end date for the programme was October 2010.

[53] Interview with former high level decision maker at the Ministry of National Economy, 12 September 2016 (Budapest, Hungary).

functions and institutions were transferred from elected county level governments to the politically appointed leaders of County Government Offices.

Similar changes occurred at municipality level. District Government Offices were established, subordinated to the County Government Offices. Culture, education, and healthcare competencies and duties together with their financing were removed from the municipalities (whose budget shrank to one quarter of the original).[54]

The National Interest Reconciliation Council and other consultative, tripartite arrangements aimed at collective bargaining, as well as sectoral level consultative forums, were either abolished or replaced by new institutions with limited authority. The corporatist nature of the Hungarian civil service was largely curtailed. As far as the general public sector reforms were concerned, some earlier 'conventional' or 'mainstream' reforms continued (social welfare system, pension system, tax regime reforms started under the IMF bailout program). The Orbán government's public sector reforms also targeted the simplification of administrative procedures: move towards e-government, implement one-stop-shops.

Because of the EDP, additional fiscal consolidation measures were needed. As most of the 'low hanging fruit' had already been harvested, there was a tendency to look for out-of-the-box (also referred as 'unorthodox' or 'unconventional') policy measures.[55] The government axed the obligatory pension funds and nationalized their assets, introduced sector taxes on selected industries (bank, retail, energy, and telecoms), and withdrew the fiscal council funding (resulting in the abolition of the secretariat, and the economists were laid off), replaced its members, and cut its authority. The tax system was further modified by increasing the VAT rate (to 27%, the highest in the EU) and by introducing various consumption and turnover-related taxes (unhealthy food tax, financial transactions levy, telephone usage tax, advertisement tax, and so forth). On the other hand, income taxes (both personal and

[54] Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary).

[55] Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary); Interview with former high level decision maker at the Ministry of National Economy, 12 September 2016 (Budapest, Hungary).

corporate) were cut. Further measures included additional expenditure cuts (cutting pharmaceutical subsidies, curbing ministry spending, a wage cut in the public sector, and so on). Social transfers were cut, and strict conditionality criteria were attached to them. Early pension privileges (for soldiers, fire-fighters, and so on) were cut, and disability pension schemes were further scrutinized (Table 2.5). In this period, public sector reforms were designed in order to strengthen the elite political decision makers. Fiscal consolidation measures (mainly focusing on unorthodox policies) ran parallel without being directly linked to the general public sector reform stream.

Table 2.5. General public sector reforms and fiscal consolidation measures in the post-2010 period

General public sector reforms	Fiscal consolidation measures
Political control in central, mezo and local level public administration	Public sector layoffs – wage cuts
Number of ministries cut (from 15 to 8)	General public sector expenditure cuts
Decrease role of independent consultative bodies and curtail authority of independent institutions	VAT, social security contribution hike, new sector taxes
E-governance, one-stop-shops	Centralization of healthcare and education funding

Source: Ministry documents, author

In the post-IMF program period (2010–2013), the Orbán government aimed to reduce external influence as much as possible. Freedom of policy choice became a prime objective. The IMF bailout program and its strict conditionality were quickly dispatched, but the EDP remained in place. The underlying government goal was to exit the EDP as soon as possible in order to further limit external influence. The government had very strong political support: a single-party government with a parliamentary supermajority and a continuously high popular approval rate.[56] This provided a domestic political window of opportunity for public sector reforms in the form of strong reform ownership and capable managers (i.e. not constrained by

[56] No opposition parties could challenge Fidesz's position as the most favoured political party – Source: Medián, Ipsos, Tárki, Századvég polls.

internal political forces, such a coalition partner or strong opposition). Table 2.6. lists the domestic factors and EU/IMF influence on reforms in the 2010–2013 period.

Table 2.6. Domestic factors and EU/IMF influence on reforms in the 2010–2013 period

Domestic factors	EU and IMF influence on reforms
Strong government – strong reform ownership	Strong pressure to cut budget deficit (EDP)
Financial and economic crisis	EU policy recommendations
Centralization of political power	No direct influence – expert level consultation

Source: Author

Major public sector reforms took place in the post-2010 period in Hungary. Existing policy change theories are applicable for the case as long as the indispensable ingredients of such developments were present in the period (window of opportunity, strong reform ownership, external pressure). The reform contents were largely running contrary to the agenda of external agents though.

2.4. Discussion

Hungary's three phases of public sector reforms and fiscal consolidation represent qualitatively different episodes regarding the economic environment, the key players' political support, their ambitions, and the role of the EU and the IMF. Theory stipulates that policy change is facilitated by a window of opportunity (provided by a crisis situation), external pressures (including pressures emanating from supranational institutions), and the form of the political executive (a weak political executive results in a low level of reform ownership and eventually hinders durable public sector reforms, whereas a politically strong government results in resilient reforms). An excessive public budget deficit is by definition the *raison d'être* of the EDP (EU influence); therefore, in the Hungarian case, the underlying ambition of successive governments was to reduce it. Accordingly, this article focuses on that fiscal consolidation (i.e. government policies aiming to cut the public deficit and debt accumulation) (OECD, 2001). In this quest, quantitatively (i.e. regarding the size of the overall fiscal consolidation impact) the revenue-side measures (i.e. increasing tax rates, widening the tax base, introducing new types of taxes) played a big role, whereas, comparatively, expenditure-side measures (i.e. public sector reforms) played a smaller role.

Public sector reforms are understood in this study as changes to the structures and processes of public sector organizations, i.e. re-form previously existing arrangements by the attributes of a new structure, form, or process, driven by specific considerations and political actors' interests (Barzelay, 2001; Ongaro, 2009). The previous sections gave an account of these measures by analysing the instrumental role of domestic factors of elite decision making, by mapping the processes and the substantive content of the reforms, and by identifying EU and IMF influence on public sector reforms.

The attributes of the 2004–2008 period were: weak political reform ownership (strong domestic resistance, conflicts among stakeholders, strong bargaining power of interest groups, poor government capacity to act); imported public sector reform plans (copy and paste EC blueprints); external pressure on high political level (policy details were out of its scope); and no visible economic crisis. Practically none of the factors stipulated by policy change theories were available that would have supported public sector reforms. In reality during this time period, most public sector reforms existed as rhetoric and at the level of formal decisions, and their actual transformative implementation exhibited a particularly poor track record. This finding is in line with the scholarly literature.

In the second phase (IMF bailout 2008–2010), the deep financial crisis and the risk of country default eliminated domestic resistance and opened the window of opportunity for reforms. The autonomy of domestic elite decision makers was curtailed, and fiscal consolidation and public sector reforms were prescribed by the IMF. However, they were adjusted to the domestic circumstances (hybridization, synthesis) by the policy experts. Public sector reforms were not aimed at short-term budget deficit-cutting targets; rather, they were designed to modernize domestic structures, arrangements, and processes – alongside the IMF's NPM doctrines – in order to support the long-term sustainability of the public finances.

In the post-2010 period (after the IMF bailout program), external pressure continued in the form of the EDP (until 2013). The underlying objective of elite decision makers was to reduce external influence (i.e. to achieve the termination of the EDP). Reform ownership was strong, and it was backed by the parliamentary supermajority. Additional fiscal consolidation measures consisted mainly of revenue-side actions in the tax system amidst the continuation of a major economic crisis. Policy transfer was executed by motivated domestic elite decision makers through policy inspiration. At the same time, several previously implemented reforms were re-formulated (i.e. fiscal council, public work scheme, pension reform), which this study considers as a politically driven policy synthesis. The qualities of the various factors facilitating public sector reforms (such as window of opportunity, level of external pressure, domestic reform ownership, and dominant policy transfer quality) and the existence of public sector reforms exhibited by the Hungarian case are in accordance with theory (Table 2.7).

Table 2.7. The characteristics of public sector reforms in Hungary

	2004–2008	2008–2010	2010–2013
Window of opportunity (in the form of financial/economic crisis)	No	Yes	Yes
External pressure (in the form of coercive policy transfer)	Moderate	Strong	Moderate
Reform ownership (of domestic elite decision makers)	Weak	Strong (under conditionality)	Strong
Dominant policy transfer quality	Copying	Hybridization and synthesis (by experts)	Inspiration and synthesis (by elected politicians)
Sustained public sector reforms	No	No/Yes	Yes

Source: Author

Nevertheless, policy transfer theory also suggests that, because of sustained external influence, Hungarian public sector reform qualities in the 2004–2013 period should have aligned to the external agents' policy agenda. This should have resulted in – among other things – decentralization, voluntary collaboration of stakeholders, demand-driven and responsive government, performance evaluation, and local capacity building. Although in the 2004–2008 and in the 2008–2010 period the direction of the public sector reforms aligned to such a trajectory, this was reversed in the post-2010 period, when the main political objective was the power grab that resulted in centralization across the various public sector levels (Table 2.8).

Table 2.8. Does the Hungarian case support policy transfer theories?

	2004–2008	2008–2010	2010–2013
Formal criteria (existence of reforms)	Yes	Yes	Yes
Substantive criteria (content of reforms)	Yes	Yes	No

Source: Author

How then are existing policy change theories useful for interpreting the empirical puzzle embodied by the country's derailment from its previous Europeanization drive concerning public sector reforms? The empirical puzzle presented by the case shows that the term 'reform' denotes changes that do not necessarily represent modernization, general improvement, or technically optimal arrangements.

Indeed, the analysis corroborates the thesis that the success of a policy transfer is a function of the actual qualitative features of the policy transfer process and echoes mainstream texts on public management reforms, especially those that postulate that the nature of the executive government affects reform perceptions of desirability and feasibility, reform content, the implementation process, and the extent of reform achieved. Moreover, the empirical puzzle provides evidence that the theory must adopt a more granular approach in order to fully seize the various policy reform trajectories. Both the complexity of the real-life situation (i.e. socio-economic factors, domestic policy legacy, previous reform trajectories, actual qualities of external influence) and the cultural and political attributes and motivations of domestic elite decision makers need to be taken into consideration.

Accordingly, in the Hungarian case: the deviation from the public reforms prescribed by EU policy models and values in the post-2010 period is well explained by the particular socio-economic, political, and administrative factors and the form of the political executive. These features are embodied in the emerging stream of public administration applied-research agendas on EU influence on public sector reform (Ongaro, 2014; Kickert and Randma-Liiv, 2017).

This article argues that it is worthwhile to amend and refine policy transfer theories with the findings of this study, i.e. public sector reform content is aligned to the dominant elite decision makers' agenda. The main finding of this study is that the Hungarian case gives evidence of how EU-influenced public sector reforms could eventually produce outcomes with consequences that are the exact opposite of what was intended.

CHAPTER 3.

THE POLITICS OF FISCAL CONSOLIDATION AND REFORM UNDER EXTERNAL CONSTRAINTS IN THE EUROPEAN PERIPHERY: COMPARATIVE STUDY OF HUNGARY AND LATVIA

3.1.Introduction

One decade has passed since the onset of the global financial crisis, during which different European Union (EU) member states have had different experiences. Some, such as the Baltic States, experienced a severe contraction, but just a couple of years later returned to relatively strong growth (Bohle 2017). Other countries, such as some member states in Central Eastern and Southern Europe, have experienced a weaker recovery (e.g. Hungary) or went through an almost decade-long recession and only now are returning to growth (e.g. Greece). Some countries have retained relative political stability despite severe fiscal consolidation and economic hardship (e.g. Latvia[57] and Estonia), whereas other countries under similar conditions have gone through a remarkable political transformation (e.g. Hungary or Greece).

---

[57] Although the Godmanis government resigned in early 2009, it resigned not due to mass protests, but largely due to the internal disagreement on the implementation of the austerity measures agreed upon with the international institutions. In 2011, as a result of a referendum, the parliament was dismissed, however, it was largely the result of political manoeuvring by the President Zatlers, exploiting the general dissatisfaction with political institutions to his own political advantage (his

The interest of the paper is the politics of consolidation and the influence of the European Union (EU) and the International Monetary Fund (IMF) on fiscal consolidation and public sector reforms: fiscal consolidation outcome is understood here, as the dependent variable. The available pool of cases are EU member states subject to conditionalities imposed by the international institutions following the financial and economic crisis in the form of European Commission's Excessive Deficit Procedure and IMF's Stand-by Agreement. We purposively sampled the cases, which share some independent variables, but differ significantly in terms of outcomes (i.e. most similar system design applied).

We narrowed our selection down to two comparable cases: Hungary and Latvia. Both Hungary and Latvia were severely hit by the financial crisis and were among the first countries to seek financial assistance from the EU and the IMF (Lütz and Kranke 2014). Hungary and Latvia share many similarities, especially in regard to their initial conditions in the run-up to the crisis: both were new EU member states; both were part of the Communist bloc before the regime change; both were outside of the Eurozone in advance of the crisis; both are small and open economies; private sector and especially mortgage lending in both countries was predominantly in foreign currencies; and both countries represent relatively little-known cases beyond the regular media coverage. Nevertheless, the two countries exhibited rather different crisis management trajectories. Whereas Latvia overcame the immediate economic challenges relatively quickly and joined the Eurozone in 2014, Hungary stepped out of the IMF program prematurely and subsequently had a lengthy, fragmented, and cumbersome fiscal consolidation, lasting altogether for eight years. The current paper aims to address the following research questions:

How did the international institutions affect fiscal consolidation and reforms?

Why were the outcomes of the crisis so different despite the seemingly similar initial conditions?

---

newly formed party came in second in the extraordinary elections in autumn 2011 (for an overview see Auers, 2011)).

This article, which utilizes the most similar system design and adopts a two-country comparative case study methodology, is comprised of exploratory and explanatory research. Comparative analysis of these two cases contributes to the debate on fiscal consolidation, public sector reforms, and EU post-crisis governance as follows. First, it allows us to understand the effect of initial conditions on the patterns of fiscal consolidation and public sector reforms. Second, it allows us to explain how domestic political environments and dominant cleavage structures affect local political decision making, focusing on fiscal consolidation measures. Finally, the combination of factors allows us to explain the diverging crisis management patterns and eventual outcomes.

In order to establish causal relations (Bennett 2004; George and Bennett 2005) in our within-case analysis, three data Sources were consulted. First, we conducted extensive desk research, analysing publicly available official reports issued by the national institutions (e.g. National Reform Programs and Convergence Programs). We also analysed Country-Specific Recommendations issued by the European Commission (EC) as part of the European Semester policy coordination framework, EC staff working documents, and World Bank and IMF reports. Second, we conducted semi-structured interviews with representatives of ministries and public agencies, former and current members of parliament, and fiscal council representatives58. Third, in order to incorporate the broader public debate into the picture, we consulted relevant media sources.

The paper is structured as follows. First, the theoretical framework is presented, second the paper provides background information on both countries, focusing on the political context and socioeconomic developments before the bailout. Then the paper

---

58 Latvia: Interviews were conducted between 2013 and 2016 with representatives of the Bank of Latvia, Ministry of Finance, Finance and Capital Markets Commission, State Employment Agency, State Social Insurance Agency. Some of these were conducted as part of the project, Understanding policy change: Financial and fiscal bureaucracy in the Baltic Sea Region, supported by the Norwegian–Estonian Research Cooperation Programme. Hungary: Interviews were conducted between 2015 and 2017 with representatives of National Bank of Hungary, the Fiscal Council, the IMF Resident Representative Office, Ministry of Finance, Ministry of National Economy, European Commission.

analyses fiscal consolidation in the two countries, including its sequence and content, the influence of the external agents, the relation between the EU and the IMF, and the conditionalities of the bailout programs; and the domestic responses to the austerity measures are looked at and compared. The last section is devoted to an assessment of the reasons for, and outcomes of, the different trajectories.

3.2. Theoretical framework

There is an abundant literature dealing with the topic of public sector policy change. The research interest of this article is narrowed to a special type of policy change: fiscal consolidation and public sector reforms amidst the circumstances of an economic crisis and initiated and supervised by external agents (i.e. international organizations) in a form of coercive policy transfer. Policy change literature identifies various factors those facilitate policy change including (1) the window of opportunity provided most notably by a crisis situation 'since it delegitimizes long-standing policies underpinning the status quo' (Kickert and Randma-Liiv, 2017: 91); (2) external pressures, including pressures emanating from supranational institutions (Christensen and Laegreid, 2017); and (3) the form of political executive that affects – among other things – reform ownership (Pollitt and Bouckaert, 2011). First we look at the findings of existing policy change literature of these three conditions vis-à-vis fiscal consolidation and public sector reforms. Then immediately we interrelate the attributes found in our selected cases (Hungary and Latvia) with those stipulated by scholarly literature.

The window of opportunity: A critical juncture (Capoccia and Kelemen 2007) or a window of exceptional opportunity called conjuncture (Wilsford 1994) are identified as an independent variable facilitating policy change. Such a critical juncture/conjuncture is provided by the constellation of economic crisis. Political economy scholars even claims that the hypothesis that crises lead to fiscal consolidation and public sector reforms is part of the "conventional wisdom"

(Tommasi and Velasco, 1996). However, public sector policy change scholars (Kickert et al., 2015) argue that the depth and immediacy of the crisis would influence the selection of specific measures (e.g. hiring freezes, lay-offs, or program-specific cuts) and the approach to cutback management (e.g. cheese-slicing or targeted cuts).

Deep economic crisis of our two cases embody well the window of opportunity. The critical conjuncture in both cases allowed the political executives to implement those changes both in terms of fiscal consolidation and public sector reforms those were blocked in normal times as we will exhibit later in the paper.

External pressure: In our understanding, it is practical to derive from the definition stipulated by the seminal article of Dolowitz and Marsh that external influence eventually is the transfer process of policies, administrative arrangements, institutions, and ideas from one entity to another (Dolowitz and Marsh, 1996). While literature distinguishes between coercive and voluntary transfer, in this article we deal with latter. Coercive policy transfer – also termed as facilitated unilateralism or hierarchical policy transfer - occurs via the exercise of transnational or supranational authority; when a state is obliged to adopt policy as a condition of financial assistance (Bulmer and Padgett 2014). Some scholars argue that the importance of foreign pressure is overstated and in reality it has only a weak effect (Alesina 2006, Mahon 2004). Others claim that in IMF-supported programs' conditionalities are critical to fiscal consolidation, but the eventual success of a program rests on the individual governments those are responsible for policy selections, design and implementation (Crivelli and Gupta, 2014). Public sector policy change scholars argue that countries facing external pressure in a form of conditionality related to financial assistance (i.e. external lending by the IMF, the European Commission and the European Central Bank), are forced to implement swift and radical policy change (Christensen and Laegreid, 2017; Randma-Liiv and Kickert, 2018). Bulmer and Padgett (2014) offers a resolution of these apparently disharmonious views that quality of the coercive policy transfer and its eventual outcome depends on variables such as the degree of authority accrued by supranational institutions and the density of rules and the availability of sanctions/incentives. The very same rules of the IMF Stand-by Agreement were applied to Hungary and Latvia. The individual country targets set by the EU, and the monitoring procedures of the external crisis management were also displaying largely similar attributes.

The form of political executive: Political economy scholars find that fiscal consolidation and broad reforms are more likely to occur when new governments take office (i.e. when elections are a long time away); when governments are politically strong (strong mandate, strong state, narrow coalition, strong leadership); and when the executive branch faces fewer institutional constraints (Reich, 1995; Alesina, 2006). The form of the political system influences also the decision-making patterns: one-party governments in majoritarian systems are able to implement quick and resolute fiscal cutbacks, while coalition governments in consensual democracies will engage in protracted negotiations (Kickert et al., 2015). The historical context, such as the strength of the welfare state, civil society organisations and public-sector unions, as well as the nature of civil service regulations also considered to be factors shaping the process and content of fiscal consolidation. Thus, in a country with strong public-sector unions, regulations limiting the possibility of severe pay cuts and lay-offs in the public sector, decisive implementation of cutbacks will be difficult. In a country with a historically strong welfare state, the government will likely face opposition in a form of protests whenever targeted program-specific cuts will be implemented. (Christensen and Laegreid, 2017; Randma-Liiv and Kickert, 2018). Concerning policy transfer capabilities of the under the circumstances of coercive policy transfer, Bulmer and Padgett (2014) distinguishes between bargaining/muddling through and problem solving type of attitudes of the political executives whereas the muddling through approach would lead to weaker forms of policy transfer while problem solving attitude results stronger policy transfer outcomes.

As far as the sequence of fiscal consolidation, and the pattern of the decisions are concerned the cutback management literature gives additional cues (for a thorough overview see Raudla et al., 2015) suggesting that the fiscal cuts are implemented through several stages, especially during protracted fiscal crises. First, there is the stage of denial, followed by several rounds of across-the-board cuts, cutting deeper the more politicians realised the severity of the crisis. Only in case of protracted and severe fiscal crises did the authorities resort to targeted cuts, which also affected public service delivery and social transfers (Hood and Wright, 1981; Levine, 1979, 1985;

Kickert and Randma-Liiv, 2015; Pollitt, 2010). Therefore, we can expect that in case of rapidly deteriorating public finances (e.g. bank bailout), the government will be forced to make unpopular decisions early on in the crisis. In addition, the composition of cutback measures will be affected by the depth and the duration of the crisis: When fiscal situation deteriorates over a longer period of time, the more complex and strategic would the cutback measures become; if the crisis is deep from the start, the more drastic and resolute cutbacks without the necessary evaluation would be implemented in the beginning (Randma-Liiv and Kickert, 2018).

Our two cases under investigation in this article experienced both the deep economic crisis and the inducement for public sector reforms and fiscal consolidation coming from external agents in a form of coercive policy transfer. However, the sequence and the eventual outcome of the fiscal consolidation process differed significantly in the two countries. We find the Pollitt and Bouckaert model instructive for our analysis because top-down reforms driven by elite decision making – influenced by ideas and pressures from elsewhere – constitute the core of the process. In the model, elite decision making is circumscribed by economic and socio-demographic factors, political and intellectual factors, and administrative factors; and the form of the political executive influences the degree of leverage to launch reform and the stability and the ownership of the reform (Pollitt and Bouckaert, 2011). We are interested in the evolution of domestic reform ownership and its impact on the outcomes of public sector reforms. Therefore, we utilize the elite decision-making model for the evaluation of public sector reforms in our case study. According to the model, a political weak government theoretically results in low levels of reform ownership and eventually hinders durable public sector reforms.

The dependent variable of the article is the outcome of fiscal consolidation and public sector reforms under external constraints. We operationalize the independent variables derived from the exhibited scholarly literature alongside the qualities of the execute decision makers; and the socio-economic context (detailed in Table 3.1.).

Table 3.1. Independent variables for the politics of fiscal consolidation and reform under external constraints - comparative study of Hungary and Latvia

	High likelihood of policy change	Low likelihood of policy change
political support	strong mandate	weak mandate
institutional constraint	insignificant	significant
objective	problem-solution	muddle through
reform ownership	strong	weak
magnitude of the crisis	small	large

Source: Authors

3.3. Background conditions and developments leading to the crisis

3.3.1. Political environment

Hungary and Latvia are on the Eastern periphery of the EU. Both countries joined the EU in May 2004. Both countries are small in terms of their geographical size and population; both are underdeveloped with living standards at around 2/3 of the EU average (exhibited in Table 3.2.).

Table 3.2. General information on Hungary and Latvia

	Hungary	Latvia
Country surface (square km)	93,030	64,589
Total population in 2016 (million)	9.83	1.97
GDP per capita in PPS in 2015 (EU28=100)	68.2	64.4

Source: Eurostat

Hungary, a country with 10 million citizens, is a unitary state with unicameral parliament and a majoritarian political system. In the bipolar post-World War II period Hungary became part of the Soviet-bloc as a quasi-independent satellite-state with a communist dictatorship installed. One-party system was established and civil (especially political) rights of the citizens were severely restrained. The transformation of the political system started in the late 1980's. This process was facilitated by peaceful negotiations (often referred to as the "round-table" talks) between the ruling communist elite and the newly formed various democratic grassroots movements. First democratic elections were held in 1990.

The Hungarian government administration is composed of three plus one layers: central-level, county-level and local-level governments with the additional regional-level one (between national and county level). The system of Hungary's public administration roots back to the centralized and hierarchical traditions of the Austro-Hungarian monarchy times (Nunberg, 2000) which had close relationship with the German administrative tradition and its Weberian culture. In the post- World War II period, the centralization of public administration was made far-reaching with an all-encompassing political influence of the communist party.

Based on historical and cultural heritage the Hungarian population widely shared the sense of belonging to Europe and therefore there was a concealed desire for Europeanization throughout the decades of the communism as opposed the political, economic, and cultural orientation towards the Soviet Union. Therefore, the drive of "returning to Europe" was indeed framing domestic discourse, beliefs and expectations. This resulted in the adoption of a new institutional design in governance. Nevertheless, apart from the formal changes, no fundamental changes were taking place as far as the essential features of the formal rules, attitudes, norms and public values were concerned – i.e. the Hungarian case exhibits no real transformation, but rather absorption. The explicit goal of Hungarians was a quick political integration with the "West" based on the country's fast advancing track-record on legal convergence. It was a disappointment therefore that the EU was inclined to provide only a slow-track accession process and opted for a strategy of allowing the East Central European countries to acquire EU membership together in one block only in May 2004.

Latvia, with a population of just under 2 million people, is a unitary state with a unicameral parliament, and a proportional representation system. Latvia along with its neighbours – Estonia and Lithuania – was annexed by the Soviet Union in 1940, which opened these countries to large scale migration, the repercussions of which still affect the political realm, especially in Latvia (Auers, 2015). Similar to Hungary, civil liberties were severely constrained also in Latvia during the Soviet times. Eventually, in the late 1980s, the national movements across the Baltic states, including Latvia seized the new opportunities provided by the policies of 'glasnost' and 'perestroika' introduced by Gorbachev to delegitimise the Soviet annexation and initiated protest movements, which, in turn led to political sovereignty and later also full independence. The protest movements across the Baltic states culminated in the 1989, in the form of the 'Baltic Way' – a chain of humans holding hands across the three Baltic states. The initial transition towards independence was not entirely peaceful, as forces loyal to the Soviet Union tried to threaten the independent movement in Latvia with military force that culminated in the January 1991 Barricades in Riga. Although initially there were two pro-independence factions – the radical nationalists that formed Citizens' Committees, and the moderate and inclusive Popular Front – eventually the Popular Front also shifted to the right, alienating its Russian-speaking members. Thus the independence project was also a project focused on re-building a mono-national state of the interwar period.(Auers, 2015; Hiden and Salmon, 2014) This set the direction for development of the political system in Latvia.

The government administration in Latvia is now organised on two levels: central government and local government. Public administrations had to be re-built from scratch after re-gaining the independence, and were based on the best practice borrowed from a variety of Western democracies, creating a system that combined some principles of Weberian public administration with a significant influence of New Public Management. Already by 1995, following the first banking crisis, politicians lost interest in development of effective public administration structures, slowing the pace of reforms, and leaving Latvia well behind other East Central European states in terms of effectiveness of public administrations (Meyer-Sahling, 2009; Reinholde, 2004).

The political party structure of Hungary was from the inception of the new democratic regime a highly polarised one with the democratic grassroots movements on the one side (nationalist, liberal, conservative, social-democratic in various mixtures), and ex-communists on the other. The polarisation of the Hungarian political scenery is a sticky phenomenon even though the very division line moved time-to-time (new democratic parties vs. ex-communists; political left and right; populist and mainstream parties). Nevertheless, throughout the 1990's the main strategic goals (modernization of the economy with foreign capital import; pro-Western orientation in foreign policy with the ultimate aim of NATO and EU membership) were commonly shared by all major political parties. In the 1990-2010 period Hungary had coalition governments. These coalitions proved to be relatively stable where coalition agreements played a major role in reconciling political conflicts of government parties. This has changed with the single party Fidesz-government from 2010 on.

Latvian political party system has been characterised by unceasing change since the early 1990s, with new parties entering the political arena every election cycle. One of the peculiarities having a significant effect on the functioning of the political system is the substantial Russophone minority. Latvia adopted a rather restrictive citizenship law in 1994. The European Commission argued that Russian-speaking minorities should be granted greater access to professions and democratic participation (European Commission, 1997), therefore the law was somewhat liberalised in 1998, still maintaining though the requirement for examination in Latvian language, history. This effectively created a significant minority not able to effectively participate in democratic processes neither on the central nor on the local government level. However, as growing numbers of Russian-speaking population in Latvia gained citizenship, the political landscape started to change.

Party politics have been very volatile throughout the first two decades of independence, with volatility somewhat diminishing with the changes in the electoral campaign laws. Still, every election is marked by creation of at least one start-up party. However, despite the frequent changes in fortune of political parties, there has been remarkable ideological and policy continuity – in part explained by lack of legitimate alternative from the left of the political spectrum, which would be acceptable to both Latvians and Russophones, as well as the widely shared common goals of becoming part of the wider Europe by joining first the EU and NATO, later the Eurozone and the OECD (Auers, 2015).

Volatility in the political sphere was reflected not only in the frequent change of political parties, but also in the number of governments – twenty governments with 14 prime ministers. The longest serving prime minister – Valdis Dombrovski -, presided over governments during the times of economic uncertainty, instability, severe austerity, and general social distress (Woolfson and Sommers, 2016). In the years following the economic crisis, there has been some shift in the political preferences of the electorate, which could be observed in the election results. First, the Concord party, which has been historically linked to the Russophone electorate, which has been growing in numbers as more of the non-citizens passed naturalisation, has won both two subsequent local government elections in Riga – the major municipality. Concord also gathered substantial support in the national elections, claiming 29 seats in 2010 elections (from 17 seats in 2006), then claiming 31 seats and effectively winning the extraordinary elections after the dissolution of the parliament initiated by the President Valdis Zatlers, and then once again outpacing the opponents in 2014 with 24 seats. Despite the three subsequent successful elections, Concord – the only left-leaning party – remained in opposition in the Parliament, which since re-gaining independence in 1991 and until 2016 has remained dominated by a coalition of centre-right and nationalist parties. The right wing nationalist party National Alliance gained 8 seats in 2010, 14 seats in 2011, and 17 seats in 2014 parliamentary elections, thus substantially strengthening its voice in the coalition.

In contrast to Hungary, Latvia had only a short experience as an independent state during the interwar years, until the annexation by the Soviet Union (1918-1940). As part of the Soviet Union, Latvia was deeply integrated in the latter's governance and economic structures. Therefore, after the disintegration of the Soviet Union, Latvia had to develop its administrative structures from scratch. Simultaneously, Latvia attempted to reject the Soviet legacies while effectively re-building a modern version of the pre-war independent Latvia, largely based on nationalist ideology and unrestrained capitalism (Hiden and Salmon 1994).

The initial economic policy choices vis-à-vis the transformation of the economy comprised in both countries radical privatization and liberalization of trade and financial flows. Hungary arrived to the regime change with high (over 70% in GDP percentage) public debt, while Latvia with virtually no public debt. Latvia opted for a fixed exchange rate and a concomitantly tight monetary and fiscal policies, as well as a limited welfare state (Auers 2015; Bohle and Jacoby 2017). Hungarian governments carried on with loose fiscal policy (i.e. extending the welfare state served the goal of mitigating the social problems caused by regime change economic shocks). Hungary also experienced recurrent waves of currency devaluations.

Both states are unitary states with strong central government responsible for policy making across a variety of policy domains and limited decentralisation. The electoral systems in the countries are different: In Hungary the electoral system is mixed-member majoritarian, while Latvia has a proportional electoral system (Scheppele, 2014; Sárközy 2012).

Polarization is a characteristic feature of Hungary's political party structure: the division line was initially between ex-communists and democratic parties; than political left and political right, followed by the mainstream vs. populist divide (Körösségnyi 1999). In Latvia the division line is drawn between centre-right and outright right-wing nationalist parties with a strong preference for neoliberal policies (forming the various government coalitions) versus left-wing parties largely focussing on the Russian-speaking minority as their core electorate (prohibited to join or form a coalition government) (Auers, 2015). Table 3.3. presents a synopsis of the political background in Hungary and Latvia.

Both countries' governments shared a similar pro-European stance, however the position towards joining the Eurozone was much clearer in Latvia, while in Hungary the commitment to join the Eurozone was only formal in the pre-2010[59] and it was officially abandoned after (Kovács, 2016). As opposed the Hungarian trajectory the Latvian government (lead by Dombrovskis) while also tasked with resolving the crisis maintained the commitment to single currency as the only possible exit strategy despite the calls for currency devaluation. Part of the explanation lies in the fact that Latvia gave up its own monetary policy by pegging its national currency first to the currency basket and then to the Euro, while Hungary retained control over monetary

[59] Eurozone entry target dates were delayed several times, while the country drifted further away meeting the Maastricht criteria.

policy, which allowed for some additional policy tools (e.g. exchange rate adjustments) when dealing with the crisis (see e.g. Josifidis et al., 2013).

Table 3.3. Political background in Hungary and in Latvia

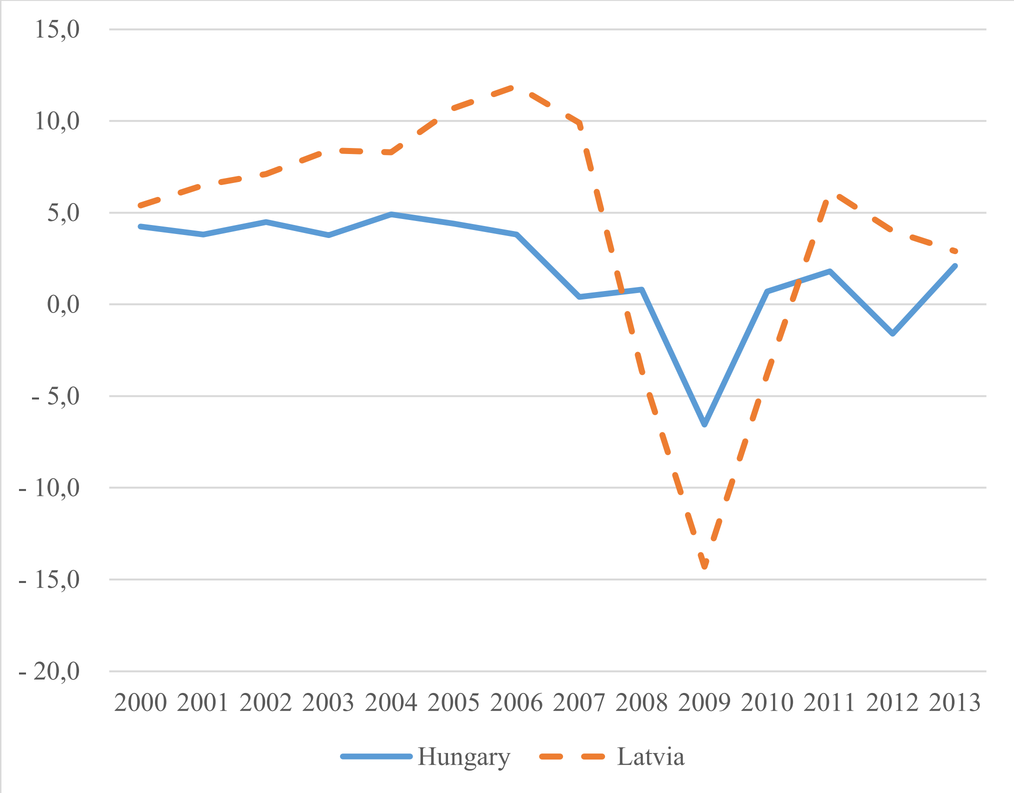
	Hungary	Latvia
Regime change	Peaceful negotiations between democratic movements and the Communist elite	Some confrontation with pro-Soviet forces and economic sanctions
Political objectives	Political consensus on democratization and Western orientation	Consolidation of pro-independence movement around the national state
Elections	First free elections in 1990	First free elections in 1993
State building	Continuity of the nation state / amending the constitution	Rejection of Soviet legacies / modern state building
Economic policy	Neo-liberal elements mixed with social market economy	Radical neo-liberal economic policy
Party structure	Polarized – left vs. right / coalition governments until 2010	Main cleavage around nationality – language / centre-right in power since independence
Europeanization	Driven by personal freedom and economic prosperity	External security, economic prosperity, and being part of Europe

Source: Authors

3.3.2. Socioeconomic developments before the crisis

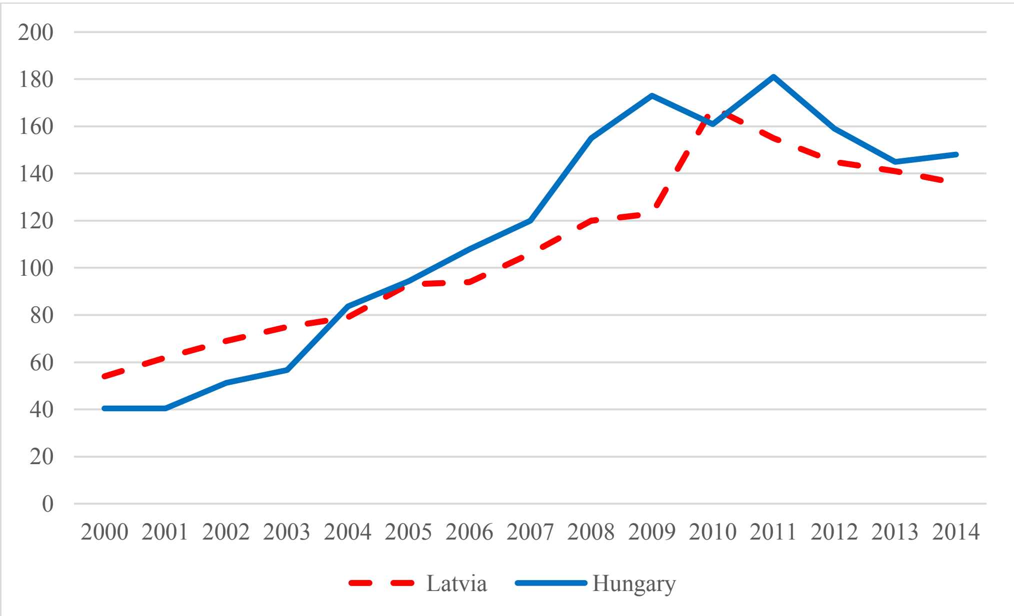
Following accession to the EU, both Hungary and Latvia set out on spectacular convergence trajectories with strong economic growth (Graph 3.1.) and improving socioeconomic conditions, but coupled with the building up of macroeconomic imbalances, growing external indebtedness (Graph 3.2.) and increasing foreign currency exposure of domestic borrowers (Blanchard, Griffiths, and Gruss 2013; Bohle 2017).

Graph 3.1. Annual change of real GDP in Hungary and Latvia (2000-2013)



Source: Eurostat

Graph 3.2. External debt in GDP percentage in Hungary and Latvia (2000-2014)



Source: Bloomberg

Hungary consistently had a loose fiscal policy, high public debt, high inflation, and a relatively low unemployment rate. At the same time, Latvia maintained a relatively more prudent stance towards macroeconomic policies, keeping a relatively low public debt and deficit, although at the cost of a relatively high unemployment rate (see Tables 3.4. and 3.5.). In Hungary, political priority was social stability financed by expensive welfare programs (i.e. the continuation of the Goulash-Communism[60]) whereas in Latvia the priority was stabilizing state sovereignty by radical policies rejecting the previous Soviet regime.

Table 3.4. Economic indicators in the pre-crisis period*

	Hungary	**Latvia**
Economic growth rate**	Medium (around 4% in the pre-crisis years)	Very high (8–12% in the pre-crisis years)
Unemployment rate	Low (6% on average in 2000–2007)	High (11% on average in 2000–2007)
Public budget deficit	High (7–9% of GDP in the pre-crisis years)	Very low (below 1% of GDP in the pre-crisis years)
Public debt	High (67% of GDP in 2007)	Very low (8.4% of GDP in 2007)
Gross foreign debt	High and increasing (almost 100% of GDP in 2007)	High and rapidly increasing (over 120% of GDP in 2007)
Inflation	High (6.4% on average in 2000–2007)	Moderate (3.5% on average in 2000–2007, but reaching 15% in 2008)
Currency regime	Floating	Currency peg (fixed rate)

*Source: Authors; * Data Source for all indicators is Eurostat processed by the authors; ** Economic growth rate is understood here as real GDP change year-on-year*

[60] The term is applied for Hungary's softer policy stance adopted after the 1956 revolution to stabilize Communists in power, i.e. a deviation away from soviet-type communism providing higher living standards and more personal freedom to citizens compared to peer countries.

3.4. The pace and composition of fiscal consolidation: Hungary and Latvia compared

Both Hungary and Latvia had to implement substantial fiscal consolidation measures. However, the two countries' experiences with consolidation efforts were quite different.

To start with: the main reasons of the fiscal consolidation (i.e. "the original sin") were different. In Hungary it was generally loose fiscal policy ('fiscal alcoholism') and large accumulated public debt in Hungary, while in case of Latvia it was the vulnerability of financial sector. In Hungary loose fiscal policy carried out by the subsequent governments lead to the problem of aggravating public debt. Excessive deficit was an issue already when Hungary joined the EU in 2004, and the EC's excessive deficit procedure was launched just month after EU membership was gained. In Latvia, the fiscal stance was fairly prudent (a must under the fixed currency regime), and it was the 2008 global financial crisis that revealed the vulnerabilities of the country's banking system (i.e. high proportion of foreign currency lending, and excessive risk taking of the second largest bank in Latvia – Parex). According to a number of interviewees, in addition to a liberal regulatory regime, lack of experience with capital inflows of such magnitude proved to be the main challenge for policymakers. When the liquidity crunch reached Latvia, Parex – relying on foreign short-term lending to refinance its debt, most of which was also carrying a currency risk – was not able to refinance its debt obligations and was taken over by the Latvian Government (Griffiths 2013; Sommers 2014).

The timing and the sequence of the fiscal consolidation also display markedly different trajectories. In Latvia it was front-loaded and focussed, in Hungary it was segmented, reluctant and cumbersome (nearly a decade-long procedure with the involvement of 3 consecutive governments). In Latvia, the EC and IMF assisted fiscal consolidation, the process was frontloaded, and it brought about quick results (i.e. one cycle). The government effectively utilized the 'living beyond one's means' rhetoric, constructing fiscal austerity in terms of 'virtuous pain after the immoral party' (Blyth 2013, 13). This helped to mitigate or soften the public reaction to austerity. Besides, also in contrast to the situation in Hungary, the Latvian welfare state was never particularly strong, requiring people to be self-reliant rather than rely on the state to provide social support. After the fall of the Godmanis government, in March 2009, a new government led by Valdis Dombrovskis – a broad coalition including five centre-right and right-wing parties – began its work. Dombrovskis government had an explicit mandate from the international institutions to implement consolidation measures proposed earlier. Fiscal consolidation measures (amounting to 9.5% of GDP) were implemented over three years, and the fiscal consolidation effort was largely frontloaded – most of the expenditure cuts were made within two years of the crisis. In Hungary, fiscal consolidation span over 3 governments and 8 years. The first episode (2006–2008) cutback measures were frontloaded, domestically designed, and focused on the revenue side. The aim of the government was to protect welfare spending budget and to muddle through until the next elections. While a large budget deficit cut was achieved (9.3% of GDP in 2006 vs. 3.6% in 2008), global financial crisis resulted in the need for an IMF bail-out in late 2008 (Staehr 2010). A temporary care-taking government took over (2009-2010) with the primary mandate to deliver the IMF program. The 2010 election resulted in a political landslide - the incoming government (with 2/3 parliamentary supermajority) rejected fiscal austerity and promised voters to end austerity. This resulted in an early termination of the IMF program in the summer of 2010 (interviews with former representatives of the IMF Resident Representative Office, the Ministry of National Economy, the EC Directorate-General for Economic and Financial Affairs conducted between June and September 2016). Eventually, with the deployment of auxiliary fiscal measures (including several unorthodox ones[61]), fiscal consolidation ended in 2013.

[61] Sector taxes and various new taxes (i.e. on financial transaction); flat personal income tax; social transfers changed to extensive public works schemes; full abolishment of the three-pillar pension system (i.e. obligatory pension funds axed) etc.

Table 3.5. The sequence of fiscal consolidation

	Hungary	Latvia
Trigger	Loose fiscal policy continued after joining the EU Excessive Deficit Procedure (EDP) launched in 2004 IMF bailout in 2008	Economic boom in the post-accession years led to a more lax fiscal policy; however, the final trigger was the bank bailout in late 2008, which required international assistance
Timeframe	Started after the 2006 elections; ended in 2013 (EDP lifted)	Started in late 2008; ended in 2013 with accession to the Eurozone
The sequence	1.Non-compliance (2004–2006) 2.Gyurcsány government fiscal austerity (2006–2008) 3.IMF bailout (2008–2010) 4.Orbán government unorthodox measures (2010–2013)	1.Global financial crisis and bank bailout (late 2008) 2.Austerity measures under Dombrovskis government (2009–2013) followed by additional measures in 2014 to comply with the fiscal discipline law. 3.Joining the Eurozone (2014)

Source: Authors

On the revenue side, the Hungarian fiscal consolidation started with a massive increase in the tax burden in 2006. Then, in accordance with the IMF program, the weight of income taxes was reduced (corporate income tax was cut, a flat and low personal income tax was introduced), the tax base was expanded, consumption and transaction-type taxes were increased, and sector taxes were introduced. In the Latvian case, the IMF argued for a more progressive tax regime, putting greater emphasis on taxing property and not income or consumption.

However, the Latvian government implemented a broad range of revenue-enhancing measures. First, VAT was increased from 18 to 22 per cent, followed by an increase in a range of excise taxes, the introduction of a luxury car tax, a real estate tax, and a capital gains tax. These somewhat progressive taxes were counterbalanced by regressive changes to the special VAT rates on certain types of goods and services (e.g. medicines).

On the expenditure side, in Hungary both cheese-slicing and targeted policy reforms took place including public sector wage freeze and public sector lay-offs in recurrent waves. In Latvia fiscal consolidation was also implemented through a broad mix of measures, including across-the-board cuts and more targeted measures. The former included cuts to public sector wages, wage and hiring freezes, and a reduction of staff numbers in the public sector. The latter included more severe cuts in specific sectors, such as healthcare (by some 20 per cent) and education (by some 45 per cent). National defence experienced, perhaps, the deepest cuts. More than 60 per cent of government agencies were either closed or merged, with functions either integrated into other agencies (often with no or very limited additional funding to carry out these functions), or delegated to NGOs, or abandoned entirely. Public sector wages were cut by up to 30 per cent, with additional cuts to non-wage benefits as well as substantial public sector employment cuts (see also Savi and Cepilovs 2017).

Public administration reforms in Latvia focused on the transparency of wage setting via the introduction of a unified wage scale for the public sector; transparent hiring practices based on competencies; performance evaluation; and performance pay. The crisis also opened the possibility of reviewing public services, with the aim of identifying non-core activities that could potentially be outsourced or privatized (see e.g. Eversheds Bitans 2011) (see Table 3.6.). Reforms proposed by the IMF technical assistance staff as well as the World Bank (whose technical assistance was focused on specific areas of welfare, education, and healthcare) related mostly to the consolidation of the education and healthcare systems. In Hungary the centralization of decision making, execution, and monitoring was the characteristic phenomenon of the public sector reforms. Local governments' autonomy and authority were severely curtailed by the central government. In addition, non-governmental stakeholders' involvement in policymaking was effectively abandoned (Hajnal and Kovács 2015). This direction was opposite to the previous Europeanization drive, and went against the guidelines of the external agents.

Concerning public finance management, substantial institutional reform took place in both cases: the Minister of Finance's power to veto budget requests from line ministries was enhanced in the two countries. In Latvia, the Ministry of Finance created a fiscal policy department mainly tasked with implementing the EU requirements – signalling a very strong domestic commitment to the success of fiscal consolidation with the objective of European Monetary Union (EMU) membership. In Hungary, there was no such objective; the political elite's objective was to decrease external influence in domestic policy-making.

Fiscal discipline law was also adopted in both cases. Fiscal councils were created, following the requirement of the Stability and Growth Pact. In Latvia however, the idea of a fiscal council had initially been proposed by some members of parliament (i.e. domestic ownership), whereas in Hungary the fiscal council was essentially a pre-requisite of the IMF loan tranches (i.e. no domestic ownership). In the post-2010 period, the Hungarian government cut the fiscal council's funding, and implemented a fundamental re-design of it.

Content-wise, despite the many similarities of commonly shared mainstream crisis management receipts (cutting expenditures, raising taxes) the most visible divide comes on the side of public sector reform measures (transparency drive in Latvia vs. centralization drive in Hungary)

Table 3.6. The sequence and content of fiscal consolidation

	Hungary	**Latvia**
Timeframe	8 years	5 years
Size of fiscal consolidation	8% of GDP	9.5% of GDP
Sequence	3 cycles: orthodox measures in 2006–2008; IMF program 2008–2010; unorthodox measures 2010–2013	1 cycle: IMF/EC program, frontloaded
Expenditure side	Across-the-board cuts, public sector wage cuts and layoffs, social transfer cuts, pension cuts	Across-the-board public sector cuts, 30% public sector wage cut, public sector layoffs, complemented by some targeted cuts, such as reduction of capital investment and spending on defence, healthcare and science and education for example.
Public sector reforms	Centralization of state administration; pension system reform (thirteenth month pension cut, indexation changed, elimination of the obligatory pension funds)	Transparency of public sector employment (wages, hiring, etc.), public finance management, school and hospital system reform
Tax reforms	Consumption and turnover taxes increased, income taxes cut, property tax not introduced	Property, excise, and consumption taxes increased, income taxes cut, and new taxes introduced

(Source: Authors; based on the official documents (i.e. IMF staff reports; EC surveillance reports; Government reports; Country Convergence Programs and National Reform Programs); Interviews).

3.5. The role of external actors in domestic policymaking

During the bailout program, the different international institutions involved in the program complemented each other's expertise in both Hungary and Latvia (see Table 3.7.). The EC's lack of the necessary expertise to deal with such an acute crisis meant that IMF participation was required as it has led a number of crisis management programs all over the world. The IMF was first and foremost interested in a fiscal consolidation that would allow the repayment of the loans granted to the two countries, whereas the EC was interested in fiscal consolidation combined with structural reforms sustainable in the long term. The World Bank added to the mix, providing its expertise in reforming social security and pension systems, education, and healthcare. The IMF's monthly two-week-long missions not only evaluated the proposed fiscal consolidation measures, but also provided an analysis of the economy and offered advice on the development of local modelling and analytical capabilities, including building a model on fiscal effects of EU structural funds in the Ministry of Finance.

In the case of Hungary, the fiscal consolidation saga contained a pre- and post-IMF bailout periods as well. In these episodes the involvement and influence of external agents differed markedly from the IMF bailout. In the pre-IMF bail-out period (2006-2008), the role of the EC was to kick-start the fiscal consolidation. The content of the program was the sole responsibility of the national government. In the post-IMF bail-out period (2010-2013), the national government worked closely with the Directorate-General for Economic and Financial Affairs (DGECFIN) at expert level in designing policies (interview with former high-level decision maker at the Ministry of National Economy in 2016). This change resulted from the EU's strengthened macroeconomic prudential framework developed in response to the crisis.

Table 3.7. Role of external agents

	Hungary	Latvia
Program design	2006–2008: No direct involvement (no meaningful consultations)	IMF bailout program – direct involvement
	2008–2010: IMF program – direct involvement	
	2010–2013: No direct involvement (consultations at expert level)	
Public sector reforms	2006–2008: Recommended	Prescribed
	2008–2010: Prescribed	
	2010–2013: Recommended	
Consequence of non-compliance	2006–2008: Loss of EU structural funds – politically negotiable	Loss of access to external agents' loans – risking insolvency
	2008–2010: Loss of access to external agents' loans – risking insolvency	
	2010–2013: Loss of EU structural funds – politically non-negotiable	
Domestic ownership / Objective	Limited / Muddle through, dispense with external agents' influence in domestic policymaking (i.e. independence)	Strong / Achieve European Monetary Union membership (independence, i.e. deepen ties with EU, detachment from Russia)

(Source: Authors).

3.6. The conditionalities of the bailout program

The Stand-By-Arrangement included policy prescriptions with (1) quantitative targets in the form of policy measures attached to numerical objectives and (2) qualitative targets in the form of public sector reforms. The implementation of both the quantitative and the qualitative policy targets was strictly monitored. The program had firm conditionality features involving several quantitative performance criteria, continuous performance criteria, inflation consultation clause, indicative targets, structural performance criteria, and structural benchmarks – these were thoroughly scrutinized by quarterly monitoring. Only a successful round of quarterly screening opened the loan window (i.e. access to the next loan tranche).

The IMF was interested in sustainability and achieving good fiscal metrics, and paid attention to a large number of indicators. Moreover, it was aware of the negative repercussions of additional fiscal tightening. Negotiations between the Hungarian delegation and the IMF–EU mission centred on how the specific measures of fiscal consolidation would impact the budget numerically, to what extent they could be implemented, and what revenue increases and expenditure cuts they would therefore eventually generate – the IMF, the EU, and the Ministry of Finance had strong and often conflicting views on that.

The IMF–EU delegation paid quarterly visits. Each mission lasted around 10 days. In the first couple of days, the IMF–EU delegation consulted at expert level with the central bank and with the Ministry of Finance staff on the macro outlook. The aim was to agree common terms regarding the evaluation of the economic situation and the macro outlook. Then the talks moved on to the fiscal trajectory – policymakers were already involved at this stage. The last item on the agenda was to agree on the necessary additional fiscal measures at chief negotiator level (in Hungary, this was typically the Finance Minister). A large amount of politicking was involved in this bargaining process: the IMF–EU side typically demanded too many fiscal measures, an exaggeratedly tight fiscal stance, whereas the Hungarian side demanded just the opposite (as confirmed by negotiators on both sides: interviews with National Bank of Hungary experts, former employees of the IMF Resident Representative Office, and DGEcFin experts in 2015–2016). The overall influence of external actors on fiscal consolidation in Latvia was similar to that in Hungary.

The main objectives of the program were set in the initial Letter of Intent submitted by the government of Latvia to the IMF in December 2008, and the subsequent Memorandum of Understanding (MoU) signed between Latvia and the EC in early 2009. The main requirement of the IMF and the EC was that the government's fiscal consolidation strategy should be built around spending cuts and not revenue increases, as the former were deemed more sustainable, given the persisting shadow economy as well as the generally uncertain economic environment. Emphasis was also placed on structural reforms aimed at improving the performance of the public sector and the economy more generally, with a particular focus on reforms in education, healthcare, pensions, and labour market flexibilization (World Bank 2010).

In December 2008, the lenders had already imposed a requirement to set aside 10 per cent of budget appropriations in a contingency reserve in order to put additional pressure on line ministries. The IMF set the tone of the program early on, as it expected the loan to be repaid in a matter of a couple years, but also because of its experience in orchestrating bailouts and technical assistance in countries in financial distress around the world.

The institutions broadly followed a 'show me what you've got approach', although with some exceptions. Given that the IMF and the EC representatives had the final say over whether the budget package would be approved or not, the government often had to re-draft the list of proposed consolidation measures, often over several iterations until agreement was reached. Furthermore, the IMF was running a macro-model of the Latvian economy in parallel with the Ministry of Finance, and it was the IMF model that was used as reference to evaluate the fiscal effect of certain proposals. In terms of influence at different stages of the bailout, the IMF was very active during the very initial stage, given their experience in country bailouts as well as lack of capacity on the side of the EC, but also given their interest in the loan being repaid in due course (interview with a former senior civil servant from the Ministry of Finance of the Republic of Latvia).

In contrast to the Latvian government's pursuit of fiscal consolidation and generally market-oriented policies at all costs, the EC along with the IMF and the World Bank took on an unusual role of social policy advocates, often expressing concerns about the economic hardship experienced by the most vulnerable and calling for stronger social policy measures (Eihmanis, 2018).

3.7. Discussion

The role of external agents in program design, policy prescriptions, conditionalities, and monitoring were similar during the bailout program period in both cases, however the outcome of fiscal consolidation and public sector reform turned out to be remarkable different. Latvia became the poster child of successful IMF stabilization and fostered the Europeanization drive with the eventual adoption of the euro in 2014. In contrast, Hungary made a U-turn vis-à-vis the earlier path of Europeanization and moved towards the centralization of the public sector.

The sequence of the two fiscal consolidation cases differed too. In Latvia, fiscal consolidation was relatively fast (over five years, with the bulk of consolidation undertaken in the first three years), whereas in Hungary it was very lengthy (eight years). These developments occurred despite some underlying similarities of the two countries' conditions (i.e. new EU member states; historic experience with Communism; small and open economies; private sector lending in foreign currencies etc.).The different trajectories therefore need to be explained by some other factors. We utilized a relatively long list of independent variables those identified by policy change literature as determinants of the quality of change. In this section we discuss the EU and the IMF influence on domestic fiscal consolidation and analyse whether and how the independent variables led to the observed outcomes.

The magnitude economic problems were not the same. In Latvia, the problem was stemming from the inadequate regulation of the financial sector, the rapidly growing external debt in foreign currency and the costs of the state bail-out of the country's second largest bank. The Hungarian case proved to much more complex. Hungary had high public debt versus very low public debt in Latvia. Hungary ran a consistently loose fiscal policy, whereas Latvia maintained a more conservative fiscal stance (as required to support its fixed exchange rate). Consequently crisis management through fiscal consolidation and public sector reform as a far bigger challenge in Hungary than in Latvia – in accordance with the Pollitt and Bouckaert (2011) model of elite decision making.

Political support

In Hungary, the enduring hardships of the fiscal consolidation coupled with the economic difficulties of the crisis caused 'reform fatigue' and the insurgence of anti-austerity sentiment in society after the first three or four years of reforms (Ágh 2011). This provided the political opportunity for anti-austerity political rhetoric and the rise of political populism, which concluded in Fidesz' landslide victory in 2010. At the same time, in Latvia, tolerance of austerity developed through decades of hardship during the Soviet era and in the early years of independence, leading to what Bohle (2016) aptly named austerity nationalism, which entails a sense of pride for not being like the 'profligate and lazy' South of Europe, and being able to suffer through harsh austerity and restore economic competitiveness.

An exemplary exposition of such austerity nationalism is a book co-authored by the former Prime Minister Dombrovskis, who was responsible for implementing the austerity package (Åslund and Dombrovskis 2011). The successive governments led by Dombrovskis enjoyed strong mandate to effectively resolve the crisis by governing by external constraint (Woll and Jacquot 2010). In the same time, the elite political decision-makers were selectively instrumentalizing EU and IMF conditionalities and recommendations in order to effectively shift the blame for particularly unpopular decisions. The weak political support of fiscal cutback measures is identified as one explanatory variable hindering reform in Hungary, while austerity nationalism assisted Latvia's government in the fast advancement with the reform measures. We found evidence that the form of political executive indeed infuenced reform ownership (Pollitt and Bouckaert, 2011).

Institutional constraint: Latvia had traditionally followed radically neo-liberal economic policies, whereas Hungary resorted to a more social-democratic approach with its history of a relatively developed welfare state. For many Hungarians, the regime change did not bring about the expected rise in living standards. In Hungary, the pre-regime change period was evaluated as an era of economic prosperity and social security, especially when compared to the economic hardship after the regime change (i.e. unemployment, growing inequality). The subsequent governments after the regime change utilized amendments of the welfare system (i.e. rents provided for various social groups) to keep social stability. The maintenance of the relatively high level of social spending was one of the reasons of the country's large fiscal deficit. Cutting these privileges was considered politically difficult and undesired, that in turn obstacle fiscal cutbacks. At the same time, in Latvia, given the historical circumstances (i.e. rebuilding the nation state as a focal point during the first decade that allowed neoliberal policies to be pursued with a disregard for social welfare), a strong welfare state did not develop. Hence, the implementation of policies that undermined the institutional constraint embodied by the welfare state was not outside the spectrum of ‘normal’. Fiscal consolidation could run in a more uninhibited manner and despite the harsh austerity measures, mainstream centre-right parties remained in power. This finding is consistent with the stipulation of the various streams of policy change theory (Alesina, 2006; Reich, 1995; Christensen and Laegreid, 2017; Randma-Liiv and Kickert, 2018).

Reforms objective: For Latvia, in the pursuit of the fiscal consolidation and public sector reforms, the main aim – and an effective exit strategy – was joining the Eurozone (Kattel and Raudla 2013). The Dombrovskis government relied on a strong mandate from the electorate of the centre-right parties and supported by the international lenders to continue the course of European integration by joining the EMU, removing the remaining currency risks. This was particularly important for businesses and households, as well as for the Nordic banks, given that most of the private sector loans at the time of the crisis were denominated in Euro, hence carrying significant balance sheet effects in the event of devaluation. Moreover, the centre-right parties kept playing the anti-Russophone card in order to retain their core electorate (Auers 2015; Auers and Kasekamp 2013). Therefore, conflicts around economic issues were consistently displaced by ethnic or nationalist conflicts (Bohle 2017; Ost 2006; Sommers 2014). Altogether, Latvia’s governments displayed strong reform ownership. For the executive decision maker this made the case for problem-solving attitude, that indeed, resulted in stronger form of policy transfer outcomes – as stipulated by Bulmer and Padgett (2014).

In Hungary, the political centre-left was deemed to have started fiscal consolidation, first without the direct involvement of external agents (2006–2008), then in cooperation with them (IMF bailout 2008–2010). Not only did reform fatigue develop during these years (moreover, ‘reform’ had become a swear word and a taboo expression in political communication by the late 2000’s), but also a pronouncedly anti-austerity sentiment grew amongst voters. Fiscal consolidation and public sector reforms meant additional hardship for the population, mainly because they entailed tax hikes, social transfer cuts, and public sector layoffs. The opposition centre-right Fidesz utilized the anti-austerity sentiment to move into populist terrain. This strategy was successful and resulted in the 2010 election victory. However, the anti-austerity rhetoric ran counter to the mainstream IMF bailout program. This concluded in the premature termination of the IMF program and necessitated alternative ways to conclude the fiscal consolidation process (i.e. unorthodox solutions).

The underlying objective of the successive Hungarian governments was the preservation of social stability. Their reform mandate was generally weak – which resulted in weak reform ownership and a bargaining/muddling through attitude. This approach led to weaker forms of policy transfer (Bulmer and Padgett, 2014), and in turn was one explanation for the protracted nature of the fiscal consolidation process.

To sum up, we have identified major structural differences (Table 3.8.) that are considered to provide sufficient explanation for the very different fiscal consolidation trajectories in Hungary and Latvia. The two cases share some similarities at first glance, but deeper examination provides a substantially different macroeconomic picture, political endowments, and a consequently contrasting reform ownership.

How then are existing policy change theories useful for interpreting the qualitatively different trajectories of Hungary and Latvia vis-à-vis public sector reforms and fiscal consolidation? Indeed, the analysis corroborates the thesis that the success of a policy transfer is a function of the actual qualitative features of the policy transfer process and echoes mainstream texts on public management reforms, especially those that postulate that the nature of the executive government affects reform perceptions of desirability and feasibility, reform content, the implementation process, and the extent of reform achieved. The particular socio-economic, political, and administrative factors and the form of the political executive are all relevant in explain the outcomes. These features are embodied in the emerging stream of public administration applied-research agendas on EU influence on public sector reform (Ongaro, 2014; Kickert and Randma-Liiv, 2017).

This article argues that it is worthwhile to amend and refine policy transfer theories with the findings of this study: socio-economic structures and key political decision makers' reform ownership is crucial in the explanation of the different trajectories Hungary and Latvia displayed during their fiscal consolidation and reform under external constraints.

Table 3.8. Differences explained

	Variables supporting policy change	Variables inhibiting policy change
political support	strong mandate (Latvia)	weak mandate (Hungary)
institutional constraint	insignificant (Latvia)	significant (Hungary)
objective	problem-solution (Latvia)	muddle through (Hungary)
reform ownership	strong (Latvia)	weak (Hungary)
magnitude of the crisis	small (Latvia)	large (Hungary)

(Source: Authors).

CHAPTER 4.

FACTORS FACILITATING LARGE SCALE POLICY CHANGE - HUNGARIAN TAX REFORM 2009-2018

4.1. Introduction

Change is one of the most commonly used term in our everyday life. Public policy change refers to shifts in existing structures deriving from a change in attitude or in principle (Bennett and Howlett, 1992; Cerna 2013). The realm of public policies is in a perpetual flow of change as elite decision makers adjust them according to their perceived interests shaped by socioeconomic trends, electoral preferences, technological developments, etc. Nevertheless, the advancement of public policy change often comes unevenly, concerning its speed and concerning its scope. In such instances periods characterized by relative stability of public policies are followed by periods of major changes[62].

Public policy making has an imperative financial dimension: financial resources are raised by the government and then they are allocated to various activities delivered "A state's means of raising and deploying financial resources tell us more than could any other single factor about its existing (and immediately potential) capacities…" (Skocpol, 1985:17).

---

[62] The paper uses the notions of "policy reform" and "large-scale policy change" inter-changeable, as no clear difference is provided in their definitions by the relevant literature (Cerna, 2013).

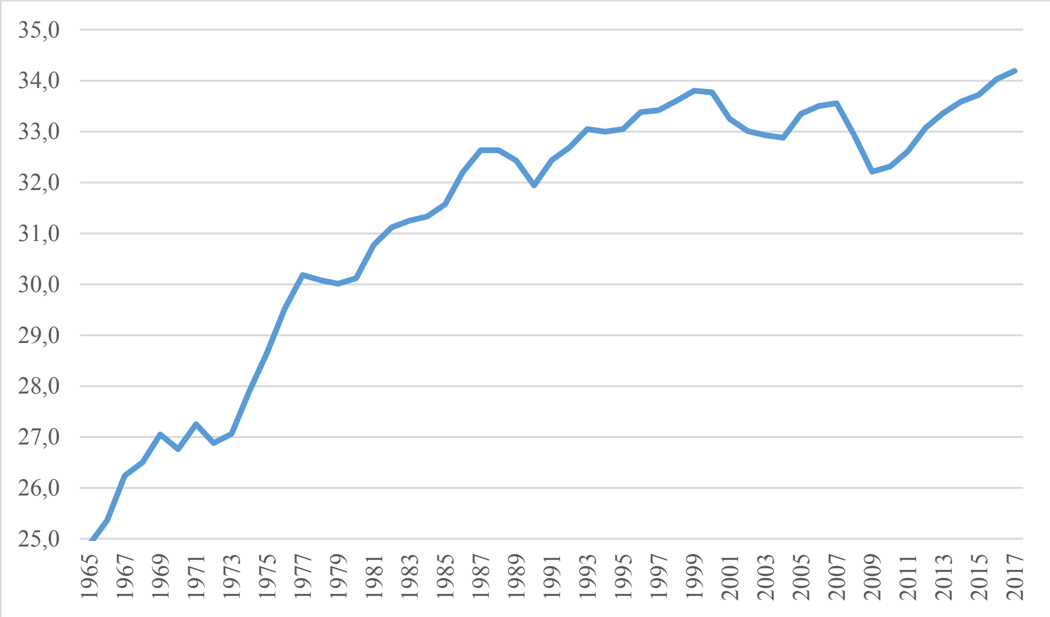
The revenue side is predominantly made up by tax revenues – typically well above 90% of public sector revenues are coming from taxes in modern states. Taxes account for 30-50% of GDP in modern states[63] (Graph 4.1.)- the average tax-to-GDP ratio was 40.2% in the EU in 2017[64]. Taxes directly affect the daily lives of individual citizens while also provide "the sinews of state"[65]. Taxation gives the government access to private economic resources; the formulation of the tax system is the choice of the government on how to raise money: what taxes to levy, on whom to put the tax burden and on what size. The tax system influences the behaviour of the economic agents (both individuals and corporations) and alters the distribution of wealth among different groups. "How a society employs taxation reveals much about the relation between its citizens" (Hettich and Winer, 1999:1).

[63] OECD countries' average tax burden was 30-34% of GDP in the past four decades (i.e. 1978-2017), whereas Scandinavian countries' had 43.3%; Non-EU members OECD countries' average was 25.9% (OECD Database https://data.oecd.org/tax/tax-revenue.htm#indicator-chart)

[64] The highest was in France (48.4%), the lowest in Ireland (23.5%) – in Hungary the ratio was slightly below average (38.4%) – Eurostat database

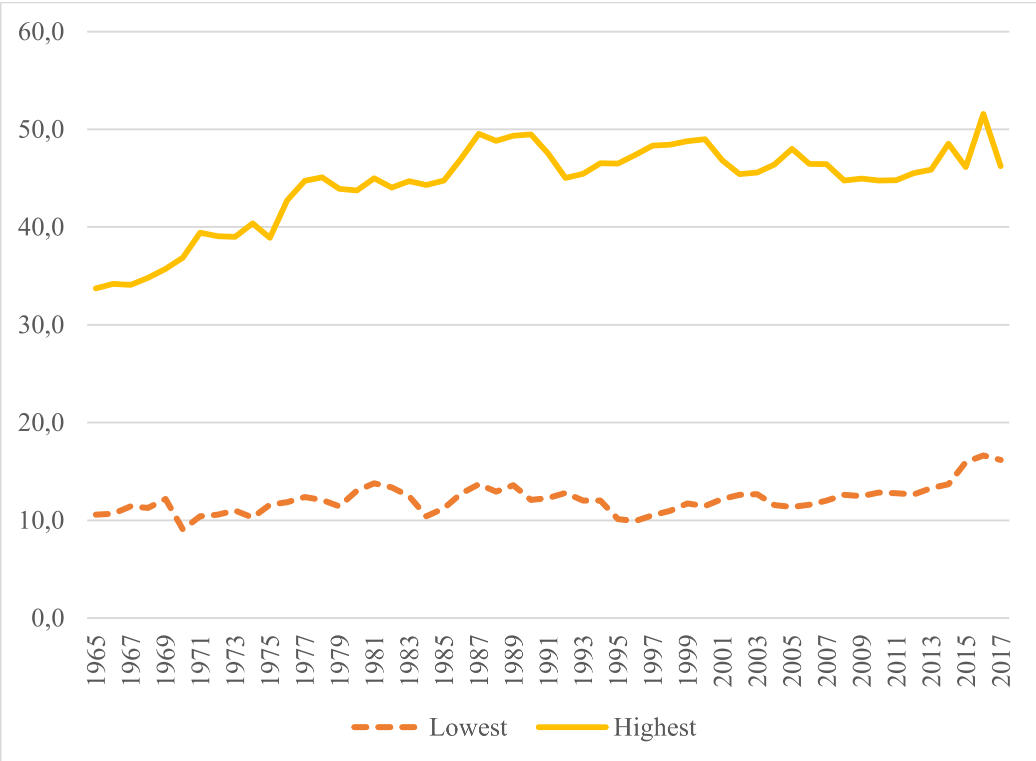
[65] The original sentence of Marcus Tullius Cicero was "Endless money forms the sinews of war." This sentence was adjusted by modern scholars to "Taxes are the sinews of State" (see Hettich and Winer, 1999)

Graph 4.1. Total tax revenue in GDP percentage (OECD average) 1965-2017



Source: OECD

Graph 4.2. The lowest and the highest total tax revenue in GDP percentage amongst OECD countries 1965-2017



Source: OECD

After a long time period characterized by relative tax regime stability, a major revamp of the tax system had taken place starting from 2009 in Hungary[66]. The essence of this policy change was a dramatic shift of the tax burden from labour and capital income to consumption. While tax policy changes in the same period happened in other European Union (EU) and OECD[67] member states as well, Hungary clearly stands out with regards to the direction and magnitude of the changes implemented. Why is it so? What factors can explain such an abrupt and fundamental change of the Hungarian tax policy? Interestingly, as I will argue later, the topic provides an unanswered riddle, yet little academic discourse has emerged around it[68]. The intention is to make this to happen with the current study.

This paper focuses on the large-scale policy changes, and aims to uncover the combination of factors facilitating such trajectories. As such, the research is embedded into the terrain of policy change theories. Public sector- and tax policy change literature constitutes the conceptual framework of the study.

The broad aim of the paper is to deliver a weak test of existing theories of policy change applied for a large scale policy change scenario. The underlying explanatory powers of the particular policy change theories are examined in the special case of large scale policy change under the circumstances of external constraints. The paper intends to carry out an analysis whether the stipulations of the theories are supported by the case or not. Therefore the paper intends to contribute to the emerging stream of public administration applied research agendas on public sector reform by making visible and understandable the main contexts and the interacting processes those shaping public policymaking with the use of the findings of the case study those potentially add and enrich the existing theories. Such an insight could improve our

[66] See “A quiet tax revolution in Hungary?” (Pesuth, 2015).

[67] OECD stands for Organization for Economic Co-operation and Development – grouping together 36 industrialized countries.

[68] Apart from some MNB working papers, there are references to it in various regular OECD and European Commission publications.

understanding of the factors hindering and the factors facilitating public policy change to happen.

The paper is structured as follows. First, the analytical framework of study, the relevant policy change theories are presented (Section 2). Afterwards, the research design is set, the methodology is presented, the research question and hypothesis are elaborated (Section 3.). Then the variables offered by policy change theories are operationalized (Section 4.) and the case study's empirical body of work is presented (Section 5.). Finally, the paper concludes with evaluating the role of independent variables in explaining the causal mechanisms of policy change (Section 6.).

4.2. Policy change theories – literature review

The topic of large scale tax policy change is located at the intersections of policy studies, political economy, political science, public administration studies and tax theory writings. Policy change refers both to incremental refinements in existing structures and the introduction of new and innovative policies replacing existing ones. Accordingly, it posits a change in attitude or in principle of the decision-makers (Hogwood and Peters, 1983; Polsby, 1984; Bennett and Howlett, 1992; Cerna, 2013). The term "policy reform" generally refers to a major change that goes beyond day-to-day policy management, potentially involving structural changes (Alesina et al, 2006), a "deliberate attempt (…) to change the system as a whole" (Fullan, 2009).

Reform is inherently political as it represents a selection of values, a particular view of society and is has distributional consequences vis-à-vis the allocation of benefits and costs (Reich, 1995). However, it is not easy to accomplish policy reforms. Large-scale change is considered as "not the norm" by scholars, (Wilsford, 1994:251), even "difficult, if not impossible" (Birkland, 2005:41). Why policies change and when, is indeed a tricky question and a "rather poorly understood phenomena" (Rodrik, 1996). Many policies - even dysfunctional ones – are going through long periods of stability before they change.

How can change eventually come at all? What are the circumstances those allow and what are the factors those facilitate policy change to happen? The axiom that "policy change can and does happen under the proper conditions" (Birkland, 2005: 41) gives little practical help in answering the question. A better understanding on these "proper conditions" is offered by the policy theories elaborated by scholars in the past decades. In the following section the paper gives a brief overview of the various policy theories with a special focus on their policy change explanations.

Public policy theories are centred around to uncover the ways how the policy agenda is constituted and to find those factors – or rather the interaction of multiple factors - from where the change of those policies emerge. In their quest, scholars looked at the role of new ideas and arguments in the above processes. Policy change does not come easily, though. The theory of path dependency (Wilsford, 1994; Pierson, 2000; Mahoney, 2000) departs from the postulate that "history matters, and it matters a great deal" (Wilsford, 1994: 279). According to the theory, the policy process within an existing institutional framework is dominated by the decentralized interaction of policy actors. That can lead to the lengthy survival of certain - even suboptimal - policy outcomes. As such, public policies and formal institutions are difficult to change by design: decisions made in the past encourage policy continuity. Because institutions are sticky and actors protect existing models, it is difficult to change policies (Pierson, 2000; Greener 2002). Still, under certain conditions, a big change that departs from the historical path can be possible. The theory of path dependency helps to explain why policy continuity is more likely than policy change, but it also reveals that "critical junctures" facilitate policy change to occur (Cerna, 2013).

The interplay of individual agents, ideas, institutions and external factors (i.e. multiple streams) is looked at by Kingdon in his seminal book "Agendas, Alternatives, and Public Policies" (Kingdon, 1984). The multiple streams (MS) approach was a major step in understanding policy formation. Policy formation is seen by Kingdon, as the joint combination of the streams of problems, policies and politics. The particular circumstances where they congregate and result in policy change decisions is labelled by Kingdon as the policy window. Kingdon argues for continual change and adaptation of public policies as opposed to the stability of decision-making in policy communities. Other scholars enriched the window of opportunity theory, such as Wilsford and Capoccia. “By developing the interplay of structure with conjuncture, the occasional accomplishment of big change can be systematically understood.” (Wilsford, 1994: 253). To introduce a major change policy makers have to wait for a critical juncture (Capoccia and Kelemen, 2007) or a window of exceptional opportunity called conjuncture (Wilsford 1994).

A critical juncture (Capoccia and Kelemen 2007) or a window of exceptional opportunity called conjuncture (Wilsford 1994) is identified by the literature as an independent variable facilitating policy change. The window of opportunity is provided most notably by a crisis situation ‘since it delegitimizes long-standing policies underpinning the status quo’ (Kickert and Randma-Liiv, 2017: 91). Economic crises by nature deliver welfare losses. A deep economic crisis may deliver policy reforms because the perceived political costs of not reforming (i.e. policy continuity scenario) is larger than the costs of the reform scenario (Drazen and Grilli, 1990). The hypothesis that crises lead to fiscal consolidation and public sector reforms has become part of the “conventional wisdom” (Tommasi and Velasco, 1996). Accordingly, both the path dependency (PD) and the multiple streams (MS) approach identify the window of exceptional opportunity manifested by an economic crises as an independent variable that facilitate policy change.

In a typical policy sector, there are long periods of stability followed by major (fast - and sometimes dramatic) policy changes. Therefore scholarly attention need to be focused on both change and stability. Baumgartner and Jones are particularly interested in the rapidity of the change between longer periods of equilibrium. Hence the idea that stable periods of policy making are punctuated by policy activism. Punctuated equilibrium (PE) theory describes the pattern of cyclical changes of policy. According to the theory, once an idea gets attention, it will expand rapidly and become unstoppable (Baumgartner and Jones, 1991; Baumgartner and Jones, 1993). Punctuated equilibrium is the process of interaction of beliefs and values concerning particular policy (termed policy images) with the existing set of political institutions or venues of policy action. (Christensen, Aaron and Clark 2003, Christensen et al. 2006). Punctuated equilibrium model connects together in a dynamic framework the various elements to decision-making. Institutions are important as they encircle a set of political participants into the policy process (while exclude others). Ideas, are vital as they are the rudimentary building blocks of the various policy agendas. According to the punctuated equilibrium theory, policy-makers' perceptions and the institutional framework determine the way policy problems are defined.

Changes in the main aspects of a policy usually result from shifts in external factors such as macro-economic conditions or the rise of a new systemic governing coalition, i.e. the "Advocacy Coalition Framework" (ACF) (Sabatier 1988, Sabatier and Jenkins-Smith 1993). Similar to PET, Sabatier and Jenkins-Smith also put the role of ideas in the centre in theorizing over policy change. They synthesized many insights from earlier accounts of public policy in the formulation of public policies framework. According to their findings, the advocacy coalition is an alliance of bodies holding the same ideas and interests. Moreover, according to the ACF, changes in economy and society feed into public opinion - this in turn affects the policy positions of political parties and interest groups and henceforward, the ideas and preferences of policy makers.

Policy change can be understood through the examination of political subsystems (advocacy coalitions) those seek to influence governmental decisions. The theory recognizes that there are various competing sets of core ideas about causation and value in public policy. Coalitions form around these core idea sets because certain interests are linked to them. The members of advocacy coalitions are coming from a variety of positions (elected and agency officials, interest group leaders, researchers etc.) and they shape the particular belief system - a set of basic values, causal assumptions and problem perceptions (Sabatier, 1988; Sabatier and Jenkins-Smith, 1991). Policy options are therefore the function of the position of the particular advocacy coalition vis-à-vis the elite political decision makers: shifts in the government have an impact on the advocacy coalition.

The role of beliefs in shaping policy ideas is a key concept for both the advocacy coalition framework (ACF) and the punctuated equilibrium theory (PET), both takes into account the theoretical relevance of discursive factors in policy change. Additionally, the ACF approach claims that there is a tendency for policy actors to exaggerate both the power and maliciousness of their policy opponents – this is referred to as the devil shift (Sabatier et al., 1987). At the same time PET argues that reframing plays a key role in changing the policy image (Baumgartner, 2013; Princen, 2013).

The form of political executive (i.e. advocacy coalition) affects – among other things – reform ownership (Pollitt and Bouckaert, 2011). Top-down reforms driven by elite decision making – influenced by ideas and pressures from elsewhere – constitute the core of the reform process. Shifts in the locus of authority is a critical component of the policy change process (Hall, 1993). A public sector reform is more likely to happen if one political group (or advocacy coalition) becomes a dominant player (Alesina, 2006). This political group is understood as being mainly domestic – however in some cases external players (mainly supranational institutions) play also an important role.

Though the academic field of political economy (PE) may lie somewhat offside the scholarly tradition of public administration studies, still for the policy change topic it is considered highly relevant. Political economy researchers find that fiscal consolidation and broad reforms are more likely to occur when new governments take office (i.e. when elections are a long time away); when governments are politically strong (strong mandate, strong state, narrow coalition, strong leadership); and when the executive branch faces fewer institutional constraints (Reich, 1995; Alesina, 2006). Large scale policy shifts are more likely to occur immediately after an election, presumably when the new government enjoys a mandate and when new elections are a long time away (Alesina, 2006). The form of the political system influences also the decision-making patterns: one-party governments in majoritarian systems are able to implement quick and resolute fiscal cutbacks, while coalition governments in consensual democracies will engage in protracted negotiations (Kickert, Randma-Liiv and Savi, 2015). Broad reforms are possible when there is sufficient political will and when changes are designed and implemented by capable planners and managers with strong vision. The larger the number of institutional constraints on the executive, the more delayed and less successful policy reforms become (Hamann and Prati, 2002).

How ideas can be transmitted from one place to another is the topic of the policy learning stream of thought, that terms "policy-oriented learning" or "diffusion" as a major determinant of policy innovation and change (Cairney, 2015). Policy learning emphasises the importance of policy diffusion and policy transfer in the policy change processes (Rose, 1991; Dolowitz and Marsh, 1994). Policy diffusion is a process in which policy innovations spread from one government to another (Shipan and Volden 2008). In its most generic form, policy diffusion is defined as one government's policy choices being influenced by the choices of other governments. In other words, the "knowledge about policies, administrative arrangements, institutions in one time and/or place is used in the development of policies, administrative arrangements and institutions in another time and/or place" (Dolowitz and Marsh 1996: 344). Policy makers rely on examples and insights from those who have already experimented with concerning policies (Shipan and Volden 2008; Shipan and Volden, 2012). Policy diffusion and its role in public policy formation can take various forms (i.e. political leaming, government leaming, policy-oriented leaming, lesson drawing and social leaming). These concepts are used to describe the process by which programs and policies developed in one country are emulated by, and diffused to others (Rose, 1991; Cerna, 2013).

This can take the form of a transfer process of policies, administrative arrangements, institutions, and ideas from one entity to another (Dolowitz and Marsh, 1996). It can come in a voluntary or in a coercive way, where coercion is the use of force, threats, or incentives by one government to affect the policy decisions of another. Coercive policy transfer is also termed as facilitated unilateralism or hierarchical policy transfer. This occurs via the transnational or supranational authority when a state is obliged to adopt policy as a condition of financial assistance (Bulmer and Padgett 2014). Nevertheless, the perceived influence of the external pressure on domestic policy making varies.

Some scholars argue that foreign pressure in reality has only a weak or moderate effect on domestic policy making (Alesina 2006, Mahon 2004). Some argue that IMF-supported programs' conditionalities are critical to fiscal consolidation, however the eventual success of a program rests on individual governments that are responsible for policy choices, design and implementation (Crivelli and Gupta, 2014). Other scholars stipulate that external pressure in a form of conditionality related to financial assistance (i.e. IMF bail-out program) is the final source of forced implementation of swift and radical policy change (Christensen and Laegreid, 2017; Randma-Liiv and Kickert, 2018). While quantitative revenue conditionality is a regular phenomenon of IMF programs, this can also be related to tax policy or tax administration reform (Crivelli and Gupta, 2014).

The quality of the coercive policy transfer and its outcome depend on variables such as the degree of authority accrued by supranational institutions and the density of rules and the availability of sanctions/incentives (Bulmer and Padgett, 2014). Concerning policy transfer capabilities of governments under the circumstances of coercive policy transfer, Bulmer and Padgett (2014) distinguish muddling through and problem solving type of attitudes of the political executives whereas the muddling through approach leads to weaker forms of policy transfer while problem solving attitude results in stronger policy transfer outcomes.

Isomorphism models argue that policy diffusion occurs between states when one is adopting a new policy from others that are similar (i.e. peers), as these states provide the best information about the usefulness of the given policy and also about the potential implications of adopting it (Brooks, 2005). A certain degree of regional diffusion is therefore a consequence of the above mechanisms, as neighbouring countries tend to be similar in a variety of ways. But states share similarities with states that are not geographically. In their seminal paper, (1983): "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields" DiMaggio and Powell claim that the concept that captures the process of organizations getting more similar (i.e. homogenization) is isomorphism. They conclude that isomorphism has two types (competitive and institutional) and they identify three mechanism of institutional isomorphic change (coercive, mimetic and normative). Policy diffusion can be based on a wide range of political, demographic and budgetary similarities across states. (Volden, 2006) or channels of cultural commonality and historic connection among nations (Weyland, 2004). , p. 256). A special type of isomorphism is constituted by the process of Europeanization (Radaelli 2000 and

Radaelli 2003). Pressures for changing public policies could also emanate from supranational institutions in the form of coercive policy diffusion (Christensen and Laegreid, 2017).

The above theories provided justifications of policy change versus policy stability. They are interested in the role of existing routines and interests in periods of change, they analyse the influence of ideas, institutions and interests. They offer explanations of the complex interactions between these multiple factors by looking at the range of causal inferences. Theorizing also delivers simplifications over the key aspects of the complex policies. As an outcome, public policy scholars introduced novel concepts to represent these influences, such as the policy window, punctuated equilibrium, policy diffusion, advocacy coalition, etc.. Table 4.1. summarizes the main findings of the various policy change theories. Both path dependency and multiple streams theory identifies the window of opportunity (labelled as critical juncture, conjuncture policy window) often coming in a sudden change of the socio-economic setting. This become manifest most typically in the form of an economic crisis, and this is considered as an independent variable that facilitates policy change to happen.

The political factors shaping policies come along with the conceptualisation of ACF and PET in the form of underlying beliefs of policy preferences, frames and reframing of policies - as well as with PE scholars (through the reform ownership of elite decision makers). Ideas and perceptions of the elite decision makers play a crucial role in these theories. Policy change may come when the policy ideas turn around, most likely through the change within the composition (i.e. a government change) and the quality (i.e. strong mandate and leadership, narrow coalition, fewer institutional constraints etc.) of the decision making authority. These factors facilitating policy change are synthetized by the paper as domestic cleavage structures – the term is encompassing the most relevant concepts offered by PET, ACF and PE.

Nevertheless, alongside the domestic cleavage structures, PE recognizes another relevant change with regards to the decision making body, that is the shift in the locus of authority (that results in changing policy formulation by influencing policy ideas, and often exerting pressures to change). External influence is therefore recognized as a factor facilitating policy change. The scholars of the policy learning stream of thoughts had the same findings. According to the conceptualization of the policy learning stream, external influence plays a key role in policy learning. It can take the form of a voluntary and coercive form. Voluntary policy learning comes with policy diffusion and isomorphism. External pressure emanates from the coercive policy transfer processes. External influence in the form of coercive policy transfer is typically delivered in form of policy conditionality. This can be manifest in IMF bail-out cases.

The above approach presented by the theories is going to be applied by the paper with regards to the analysis of the Hungarian tax reform. This categorization echoes Mahon's findings whereby he suggested that in reforming the tax system in Latin America, there were three areas of focus — economic crises, international influence, and domestic politics (Mahon, 2004).

Table 4.1. Policy change theories: key concepts and independent variables facilitating policy change

<table>
<tr><th></th><th>Path dependency</th><th>Multiple streams</th><th>PET</th><th>ACF</th><th>PE</th><th>Policy learning</th></tr>
<tr><td rowspan="2">Key concepts facilitating policy formulation</td><td>decentralized interaction of policy actors</td><td>interplay of individual agents, ideas, institutions and external factors</td><td>process of interaction of beliefs and values</td><td>the advocacy coalition</td><td>form of political executive</td><td>policy diffusion
policy transfer
isomorphism</td></tr>
<tr><td>policy continuity
and
institutional stickiness</td><td>the joint combination of the streams of problems, policies and politics</td><td>institutions
ideas
perceptions</td><td>ideas
interests
belief system</td><td>reform ownership
capable managers</td><td>political leaming
government leaming
policy-oriented leaming
lesson drawing
social leaming</td></tr>
<tr><td rowspan="2">Key concepts facilitating policy change</td><td>critical junctures</td><td>policy window</td><td>reframing</td><td>changes in public opinion affect policy positions</td><td>shift in the locus of authority (ideas, pressures)</td><td>coercive or voluntary policy transfer</td></tr>
<tr><td>sudden change in the socio-economic environment</td><td>change in the macro conditions</td><td>new elite decision makers</td><td>shifts in the government
(devil shift)</td><td>new governments
strong mandate
narrow coalition
strong leadership
fewer institutional constraints</td><td>policy conditionality</td></tr>
<tr><td>Independent variables facilitating policy change</td><td colspan="2">economic crisis</td><td colspan="3">domestic cleavage structures</td><td>external influence</td></tr>
</table>

Source: Author

4.3. Research question, research design and case selection

The paper is interested in identifying the combination of factors facilitating large-scale policy changes. The dependent variable of the article is the outcome of tax policy change in Hungary in 2009-2018. The research question (RQ) of the paper is the following one:

What combination of independent factors facilitated the Hungarian tax reform in the 2009-2018 period?

Derived from the exhibited scholarly literature and utilizing Mahon's propositions (Mahon, 2004) the following factors are operationalized as independent explanatory variables:

1. Domestic cleavage structures which define reform ownership through the political capabilities of elite decision makers and the belief system of the advocacy coalitions.

2. The window of opportunity in the form of economic crisis as it delegitimizes previous long-serving policies and undermines the status quo.

3. External influence that makes policy learning, policy diffusion and policy transfer happen either in voluntary or in coercive form.

The hypothesis of the paper is (H) the following one: The co-existence of all the three factors stipulated by policy change theories, i.e. domestic cleavage structures allowing high level of reform ownership, the window of opportunity in the form of economic crises and the influence of international agents in the form of policy transfer facilitated the Hungarian tax reform in the 2009-2018 period.

The research focuses on the Hungarian tax reform that took place in the past decade (from 2009 until 2018). In order to achieve better contextualization of the topic, the study looks at the previous history of tax policy changes in Hungary (i.e. the 2004-2008 period), and examines the tax policy developments in other (mainly EU and OECD) countries as well. The time period under investigation is segmented into four episodes of the four consecutive governments. Governments are considered to have the democratic mandate to deliver their political programs therefore they are considered by the paper as the units of the analysis.

A large scale tax policy change occurred in the given time period (2009-2018) and in the given place (Hungary)[69] – these changes were unprecedented in an international comparison, therefore it is an extreme case. At the same time, macroeconomic conditions, the intensity of external influence, the political orientation and the political support of domestic elite decision makers were qualitatively different throughout the observed time-period. There is one auxiliary reason of the case selection and this is the familiarity of case: i.e. as an economist, I have analysed the developments of the Hungarian economy and contacted the various members of the prevailing advocacy coalitions from a macroeconomic point of view by profession[70].

The analytical work is based on macroeconomic datasets (Eurostat; OECD, Worldbank; KSH, MNB, Hungarian Government), official government documents, official and working papers of international organizations (IMF, OECD, European Commission), advocacy coalition policy papers, and other documents as well as semi-structured interviews with members of various advocacy coalitions[71]. Case studies are considered to be a powerful method for locating causal mechanism and explaining single outcomes (Coppedge, 2007; Gerring 2007). Accordingly, the research is designed as an embedded case study purporting within-case analysis.

---

[69] The share of income tax in total tax revenues dropped from 26% to 18% while the share of taxes on goods and services increased from 37% to 44% - OECD database: https://stats.oecd.org/OECDStat_Metadata/ShowMetadata.ashx

[70] I am the Head of Research of Raiffeisen Bank Hungary from 1997 on – the primary coverage of the macroeconomic developments, including public finances is my job.

[71] Interviews were conducted between 2015 and 2017 with representatives of National Bank of Hungary, the Fiscal Council, the IMF Resident Representative Office, Ministry of Finance, Ministry of National Economy, European Commission.

It is not the purpose of this study though to evaluate the effects of the changes of tax system on the economy and on the society. Tax policy is looked at by taking the big picture: the tax revenue changes of the main tax types are in focus, a more refined analysis is not carried out. Taxes imposed at the local level are not in the scope of the study.

In the next section the paper further elaborates the three factors identified by policy change theories from the perspective of their impact on tax reform with the underlying ambitions to find out how they interplay in the causal mechanisms of tax policy change.

4.4. Contextualization of the independent variables facilitating tax policy change

4.4.1. Domestic cleavage structure

"Taxation is deeply redistributive, therefore profoundly political. National tax structures reflect both national preferences and histories" (Wyplosz, 2015:15). Tax policy design and its implementation are outcomes of the political process, i.e. the choices on taxation made by public decision makers are always influenced by political considerations (Woolley, 1984; Hettich and Winer, 1999). These choices are influenced by the given institutional context and the various advocacy coalitions, however political factors have a more explicit role as elected politicians typically use the tax system (i.e. tax bases, rate structures, exemptions and provisions as a set of related policy instruments) to favour particular interest groups in order to increase their chances of re-election (Hettich and Winer, 1999; Brys, 2011).

Perceptions and ideas of the elite decision makers on tax policy design is shaped by their belief system according to the PET and ACF. Advocacy coalitions on the political left are typically in favour of generally high redistribution ratio (measured in total tax revenue as a percentage of GDP) and also in relatively high and progressive income taxes. On the other hand, advocacy coalitions on the political right argue for lower general tax burden, and particularly for lower income tax. Nevertheless, there is rather a continuum with regards to the ideal tax policies rather than polarized views whereby the general perception of the voters (i.e. the given society) about fairness plays an essential role.

Politicians have an incentive to implement tax reforms that benefit large numbers of voters, especially "swing voters"[72] (Profeta, 2003). Tax reform is shaped by efficiency, by questions of horizontal and vertical equity (fairness), by tax evasion considerations and by revenue potential (Brys, 2011). The various political cleavage structures have other important influences on tax reforms: governments new in office, strong leadership, partisan dominance favours tax reform (Mahon, 2004; Bird, 2004; Brys, 2011).

In order to formulate the opinion for a need of a tax reform, first, ideas on the necessary tax design have to be reframed by the elite decision makers. Alongside the stipulations of the policy change theories (PET, ACF, PE) it can come by the change of the public opinion that feeds into policy perceptions of the elite decision makers and allows the reframing of the tax policy, or the change of the dominant advocacy coalitions through the arrival of a new government (that preferably enjoys strong mandate, a narrow coalition, and fewer institutional constraints) or the change of the locus of authority through the emergence of external pressure via policy conditionality. Tax reform often takes place when the International Monetary Fund (IMF) makes it a performance condition for its loans. (Mahon, 2004). Governments sometimes face a situation where burden shifting across groups is perceived politically unviable. In these cases the reliance of national governments on international constraints, such as those

[72] "Swing voters" are likely to change their votes in response to a reform that is beneficial for them (Profeta, 2003).

coming from the International Monetary Fund (IMF) or the European Commission are helpful in implementing tax reforms (Brys, 2011).

The empirical section will scrutinize the above qualities of the domestic cleavage structures of the consecutive governments (i.e. the units of analysis) from the viewpoint of whether they were supportive or unsupportive for facilitating large scale policy change. These will include the level of reform ownership of the elite decision makers, the belief system of the dominant advocacy coalitions (ideal policy design versus existing policies – i.e. the role of ideas, and the existence of the devil shift), and the investigation on the actual locus of authority (internal versus external).

4.4.2. The Window of Opportunity in the form of economic crisis

According to the path dependency theory, policy continuity is the norm, because decentralized interaction of policy actors argue for institutional stickiness. Multiple streams theory emphasises the interplay of individual agents, ideas, institutions and external factors and identifies the policy process as the joint combination of the streams of problems, policies and politics. Policy change therefore allowed if the problems, policies and policies twist to such an extent that existing policy solutions become obsolete in the perception of the policy makers. Such a situation (conjuncture, window of opportunity, policy window) comes when there is a major shift in the socio-economic environment: i.e. an economic crises.

The political economy obstacles to reform are easier to overcome during a crisis situation as they undermine the power of vested interests and convinces policy makers that fundamental tax reforms are necessary. As such crisis facilitates to create a sense of urgency, to overcome the coalition of political opposition and administrative inertia that normally blocks significant change and therefore to open a “window of opportunity” for fundamental tax reform that otherwise would not come (Bird, 1992; Olofsgard, 2003; Brys, 2011; Brys, Matthews and Owen, 2011).

There are various types of economic crises, such as inflation, exchange rates, debt, banking, real estate, real economy etc. These crises seldom come alone, there are typical interlinkages between some of them (i.e. inflation and exchange rate crisis or real estate and banking crisis usually come together etc.). Financial crisis is constituted by a situation when there are perceived public sector problems on financing the payment obligations. At its most extreme case it is a sovereign debt crisis that involves either outright default on debt-refinancing, the restructuring of debt (Reinhardt and Rogoff 2011) or requiring the assistance of an international lender of last resort to mitigate debt-refinancing difficulties. Tax policy changes are often driven by adverse macroeconomic conditions, with the purpose to mitigate the impact of the financial crisis: i.e. crisis increases the pressure to raise more tax revenue in order to restore public finances.

In order to contextualize the independent factor facilitating policy change in the form of an economic crisis, the severity and the magnitude of the 2008-2009 financial crisis and the subsequent sovereign-debt crisis is briefly introduced here. The economic impact of the crisis is represented by Appendix 2 (GDP change over the previous year in EU member-states between 2004-2014). The crisis brought about a massive decrease of the employment rate and increased the poverty rate in most European Union member-states (see Appendix 11. Employment in EU memberstates, 2007-2014 and Appendix 12. People at risk of poverty or social exclusion in EU memberstates, 2007-2014).[73]

Several countries – including a number of EU member states - got into severe financial distress as a consequence of the financial and economic crises (see Appendix 5. IMF program countries in 2009 by program types). The 2009 financial crises was followed by the sovereign debt crisis in the European Union manifest in a steep

---

[73] In the 2010-2012 period the people at risk of poverty or social exclusion increased by almost 10 million in the EU. The most severe deterioration of the social conditions were registered in Ireland, Greece, Spain, Italy, and Hungary countries most affected by the financial crises. The EU lost nearly 1.5 million jobs in 2010 alone.

increase of public budget deficit and public debt in several member states (see Appendix 3. Public budget balance in EU member-states between 2004-2014 in GDP percentage and Appendix 4. General Government Debt in EU member-states between 2004-2014 in GDP percentage). Due to its dramatic social costs it turned around both national and international politics and stemmed new mechanisms in the governance within the European Union (Alesina, 2012; Blöchliger at al 2012, De Grauwe, 2013, Sutherland et al 2012; Ongaro 2014). Clearly the 2008-2009 economic crisis can be well considered as an appropriate window of opportunity for policy change.

The empirical research will shed light on how the presence versus the lack of the window of opportunity manifested in the form of an economic crises influenced the consecutive Hungarian governments' willingness to reform tax policy.

4.4.3. External influence: tax theories and policy recommendations

The rudimentary building block of the policy learning stream of thought is that ideation for a policy change emanates from external sources through the process of the adaptation - in one way or in other – the policy practices already applied in another jurisdiction. Policy diffusion can take various forms ranging from policy emulations, isomorphism to coercive policy transfer.

In order to contextualize how international influence facilitate tax policy change, this section first presents the theoretical foundations of taxation. Then a synopsis of policy recommendations stemming from the theories is offered followed by an overview of how policy recommendations changed taxation practices over the recent decades especially in OECD and EU member states. Then other sources of international influence are identified and explained.

Three major normative taxation theories emerged influencing policy decisions in recent decades: (1) equitable taxation, the prevalent theory in the 1950s and 1960s; (2) the theory of optimal taxation developed in the 1970's , and (3) the revival and reformulation of the fiscal exchange (Hettich and Winer, 1999). These theories provide guidelines on the preferred tax design and the importance of the individual elements within the tax system as a whole. The theory of equitable taxation is rooted in classical liberalism (emphasizing individual liberty as the primary value, together with equality as next in importance). The theory advocates the minimization of political interference in the life of economic agents and therefore calls for institutions and policies designed accordingly. At the same time, due to its equality principle, the theory also claims that the tax system has to have the function to create greater equality through redistribution. Taxation is therefore imposed in accordance with the ability to pay – so the main focus is on horizontal equity (i.e. same rate for same comprehensive income). The theory assumes broad and single base. It also implies equal treatment of income from any source, including capital. Equitable taxation has exercised an impact on tax reform and design in the Anglo-Saxon countries (mainly in the 1965-1985 period)[74].

Optimal tax theory argues that as the efficiency costs of taxation are potentially large[75], it is worthwhile to focus attention on how to minimize them (Slemrod, 1989). Optimal taxation theory assumes competitive markets in a general equilibrium whereby justice in taxation requires each taxpayer to suffer an equal sacrifice. Equity and efficiency goals are integrated into a single welfare function (Mirrlees, 1971; Diamond and Mirrlees, 1971). According to the theory a key goal for tax design is to reduce the deadweight loss of the system as a whole as far as possible[76]. Optimal taxation theory argues for single and inelastic tax base and calls for broad personal consumption tax. At the same time it advocates shifting the emphasis away from

---

[74] I.e. Report of the Royal Commission on Taxation (1966) that proposed extensive revisions in the tax system of Canada; U.S. Department of the Treasury's Blueprints for Basic Tax Reform (1977) and Tax Reform for Fairness, Simplicity and Economic Growth (1984). The latter report led to the Tax Reform Act of 1986.

[75] Modern welfare economics interprets sacrifice as loss of utility that need to be minimized in the aggregate level. Taxation is viewed as contributing to the loss of utility, and the theory defines sacrifice as a reduction of social welfare.

[76] The size of the deadweight loss is related to the elasticities of demand and supply for the item subject to being taxed (i.e. the extent to which demand and supply respond to changes in price). The more elastic is the demand for a product with respect to its price, the more a given tax increase will reduce demand for it. High elasticities equal to higher deadweight losses (Mirrlees, 2010).

capital taxation (Mankiw, Weinzierl and Yagan, 2009). Optimal taxation theory has influenced policy blueprint from the 1990's onwards (i.e. income tax with a broadly defined base; a renewed emphasis on consumption and expenditure taxation; lower tax rates on the returns from capital assets).

The fiscal exchange approach to taxation derives from the central problem of how to design institutions of government responsive to the electorate and at the same time ensure that electoral processes do not lead to exploitation by organized interest groups (Buchanan, 1976). Its central question is to what extent the government's power to tax should be limited and how? The theory recommends narrow multiple and elastic tax base and reduced emphasis on taxation of capital, non-regressive tax structure with rules limiting tax discrimination. Table 4.2. summarizes the major theoretical considerations and policy recommendations of the three theories.

Although, policymakers have been selective in adopting theories' recommendations, overall, tax policy moved in directions suggested along several aspects (Slemrod, 1989; Mankiw, Weinzierl and Yagan, 2009).

Based on tax theory suggestions, academic literature developed a ranking of taxes according to their negative consequences on economic growth, which was internalized by international and supranational institutions (i.e. the OECD, the IMF and the European Commission). Accordingly, in terms of reducing GDP potential of a given country recurrent taxes on immovable property are considered as being the least distortive tax instrument, followed by consumption taxes, taxes on labour and capital income (Prammer, 2011; Mirrlees, 2010; OECD, 2010; Csomós-P.Kiss, 2014; Garnier et al, 2014, Mathe, Nicodeme and Rua, 2015; Szoboszlai et al, 2018). It is assumed that switching from 'origin-based' taxes (income tax) to 'destination-based' taxes (consumption tax) could improve competitiveness (LeBlanc, Matthews and Mellbye, 2013). This ranking has been influential for recommending to shift tax burden away from labour. Originating from tax theories' policy prescription a common intellectual framework has developed claiming that the combination of broad tax bases and low rates are the best way to collect revenues while ensuring that taxes distort business and household decisions as little as possible (Brys, Matthews and Owen, 2011; Mathe, Nicodeme and Rua, 2015). Fiscal devaluations – cuts in labour taxes financed by increases in VAT – are a particular form of tax shifts (Puglisi, 2014).

The European Commission has been recommending Member States to reduce taxes on labour and increase revenues from other tax bases (i.e. consumption taxes) since the early 1990's (Mathe, Nicodeme, and Rua; 2015). The role of international organisations is important, both in coercive policy transfer (i.e. IMF conditionalities) and in voluntary policy learning as they play an important role in creating a forum where countries can share information and views about tax issues (Brys, 2011).

Table 4.2. Tax theories - theoretical considerations and policy prescriptions

	Equitable Taxation	**Optimal taxation**	**Fiscal Exchange**
Theoretical considerations	greater equality through redistribution minimal interference through taxes ability to pay (horizontal equity)	competitive markets in general equilibrium taxation is a reduction of aggregate welfare (i.e. deadweight loss) deadweight loss need to be minimized	limit tax discrimination responsiveness to the electorate
Tax policy prescriptions	broad and single base equal treatment of income	single inelastic base broad consumption tax lower tax on capital hump-shaped rate structure	narrow multiple elastic base lower tax on capital non-regressive tax structure

Source: Author

The generally witnessed trend toward reduced taxation of capital income, tax systems with flatter tax rates and the growing importance of value-added taxes are consistent with theory prescriptions. In OECD countries, top marginal rates have declined, marginal income tax structures have flattened, and commodity taxes have become more uniform (Mankiw, Weinzierl and Yagan, 2009)[77]. Out of the 36 OECD countries, 33 experienced massive decrease of the personal income tax (measures in percentage of overall tax revenues – see also Appendix 8. Personal income tax percentage share of total tax revenue in OECD countries and Appendix 9. Personal income tax percentage share of total tax revenue OECD average and Hungary) and Appendix 8.). Altogether there were 57 periods of sizeable decrease of the personal income in total revenue, out of which 46 periods when the share of personal income in total tax revenue fell by more than 3%[78].

These tax cuts were accompanied by broadening the tax base: "fairness" arguments reinforced economic efficiency arguments for broadening tax bases by phasing out tax breaks favouring particular groups. (Brys, Matthews and Owen, 2011; Slemrod, 1989)[79]. The individual jurisdictions' tax structures moved toward flatter rates and the marginal tax rate on high earners fell in most countries (in the OECD countries, but also outside over the past three decades (Hines and Summers, 2009)

Globalization[80] is considered to be also a factor of international influence facilitating tax policy change as it enhances "tax optimization" behaviour i.e. multinational corporations use internal prices to locate profits where taxation is lowest, therefore it generates tax competition (Brys, Matthews and Owen, 2011). Globalization also implies the increasing use of consumption taxes as the associated activities are relatively easy to localize (as opposed to incomes), which in turn reduces the potential for international tax avoidance. Smaller and more open economies rely

[77] The top marginal income tax rate has fallen in nearly every OECD country over the past decades, in many cases quite substantially: i.e. the marginal tax rate on the highest income in the U.S. was reduced from 70 percent (in the early 1970's) to below 30 percent (by late 1980's).

[78] Source: OECD tax database - https://data.oecd.org/tax

[79] The principle is that the tax base should be broad and marginal tax rates should be moderate formed the basis of the 1986 reform of the US income tax reform (Williamson 1990).

[80] I.e. the liberalization and integration of markets that made capital internationally mobile and increased cross-border ownership of business.

less on personal and corporate income taxes, and more on expenditure and trade taxes than other governments do (Hines and Summers, 2009).

The paper will examine in the following section (4.5.) the strength of external influence coming in the form of ideation, policy recommendations, coercive external pressure, economic rationality (i.e. the challenge of globalization) on the consecutive Hungarian governments, with the purpose to uncover the relation of this independent variable (i.e. external influence) on the dependent variable (i.e. large scale tax policy change).

4.5. Empirical body of work

4.5.1. Case selection rationale

In the following section the paper analyses the previously identified three factors' role in the causal mechanism of tax policy change both in a general setting and in a particular context provided by the case under investigation.

The main elements in all tax systems are tax bases, rate structures, and special provisions such as exemptions, credits, and deductions. Tax regimes are complex systems, with typically 50-80 different types of taxes employed, often with different tax rates and numerous exemptions applied to various economic agents or economic activities. In any tax system, these elements are all determined jointly. One needs to examine the process by which tax structure is determined in order to understand taxation. "Tax systems can be viewed as the outcome of optimizing political and economic behaviour in a competitive political system" (Hettich and Winer, 1999:59). Tax revenues constitute the large majority of governments' income – it is an essential question how tax burden is distributed: i.e. what actors on what type of activities pay how much taxes. From the perspective of the current study, this is the most rudimentary characteristic of any given tax system.

When one aims to evaluate the changes in the tax policy, there are several possible ways to measure them. One way would be to examine the particular tax rates imposed, exemptions applied, and the changes along these dimensions. Nevertheless, such an approach would prove to be rather insufficient in grabbing the underlying issue of how tax burden is distributed in the society. Another approach would be to measure the various types of tax revenues in nominal terms, or discounting the impact of inflation and economic growth, rather in relation to GDP. However, there still remains the noise of the sometimes drastic cyclical and/or structural changes of the economy and fiscal consolidation needs. Therefore, the most reliable measure of a given tax system is the share of the various economic actors and activities within the pool of total tax revenue. This is the chosen measurement technique of this study where the big picture is in the focus.

The big picture has the following segmentation[81]: (1) taxes on income, profits and capital gains; (2) social security contributions; (3) taxes on payroll and workforce; (4) taxes on property; (5) taxes on goods and services. Tax policy changes are examined by the paper on the dimension of the changes in the share of the overall tax revenues of the above categories. What would be the criteria of a significant tax policy change? There is no agreed definition for this question, therefore there is a need to develop it here.

The assumption is that a significant tax policy shift occurs when the burden share within the total tax revenue mix of at least two types of taxes (i.e. out of the large tax categories) changes by more than 5 percentage points. While the criteria of the 5 percentage point change can be labelled as arbitrary, and one can argue that a smaller (i.e. 2-3 percentage point) change should also be classified as a significant tax policy change, the counterargument is that such fluctuations may be produced by abrupt changes in the macroeconomic environment as well without intentional policy measures, therefore by lifting the criteria threshold to meaningfully higher levels as proposed, such caveats could be avoided. A 5 percentage point change of a major element within the tax structure on the other hand is a measure that reflects a significant

[81] This classification of taxes is used by the Worldbank, the IMF, and the OECD.

reconsideration of the tax policy concerning the weights of certain taxable activities and actors.

The argument for the other criteria, i.e. that tax changes should comprise at least two types of taxes is based on the intention to avoid cases of more incremental tax policy changes and grab the cases of deliberate policy reforms. Nevertheless, tax policy reforms normally take considerable amount of time to deliver intended outcomes. Starting from the point in time, when the idea of a tax reform is born in advocacy coalitions, typically it takes years to get the results, as ideas need to go through fiscal feasibility studies and legislative procedures before implementation, time is needed to get the tax-payers ready to accustom to the new requirements, and finally the revenues to come alongside the expected structure.

It is advisable to examine multiyear periods' tax revenues before and after tax reforms versus those of single years, as that would give a more balanced picture preferably cleared from one-off effects producing undesired biases in the time series. Therefore, the following research will analyse 3-year averages in order to conclude whether a significant tax reform occurred.

A major tax reform therefore was identified in any case when 5% percentage point change happened of at least two major tax elements with regards to their share in the overall tax revenues in examining three-year period averages. Having analysed the Eurostat and OECD databases, eventually there are two such cases detected: Hungary and Lithuania (see Table 4.3.). Nevertheless, in Lithuania the overall tax burden shift is less fundamental as it can be considered as a rebalancing of the different types of tax on labor, whereas the Hungarian case exemplifies a major policy turnaround with the weight of the tax burden moved from income to consumption (see Table 4.4. and also Appendix 10. Hungary's tax revenues structure by tax types' share of total tax revenue, 1991-2017). Therefore, Hungary arguably constitutes the case of a significant tax policy change.

Table 4.3. The change of share of the tax types in total tax revenue (in %) 2006-2008 average versus 2012-2014 average

	consumption tax	income tax	property tax	social security tax
Hungary	**6,3**	**-7,2**	1,2	-0,8
Lithuania	2,7	**-12,5**	0,1	**9,7**

Source: OECD Database / Author

Table 4.4. The changes in Hungary's tax revenue structure (3-year averages)

	2006-2008	2009-2011	2012-2014	2015-2017
Taxes on income, profits and capital gains	25,1%	20,7%	17,9%	18,6%
Social security contributions	33,4%	32,6%	32,6%	33,1%
Taxes on payroll and workforce	0,8%	1,1%	1,4%	1,7%
Taxes on property	2,1%	2,8%	3,3%	3,0%
Taxes on goods and services	37,6%	42,0%	43,9%	42,9%
Other taxes	0,9%	0,8%	0,8%	0,7%

Source: OECD Database / Author

4.5.2. Case research

The analysis covers the three consecutive governments' tax policy changes (i.e. Bajnai 2009-2010; Orbán 2010-2014; Orbán 2014-2018), however, it also gives an account of the previous time period (2004-2008) in order to better contextualize the case.

Hungary joined the EU in May 2004 and almost immediately the EU's Excessive Deficit Procedure[82] was launched (in early summer 2004). The Hungarian government needed to submit a detailed plan how it planned to reduce the deficit. Internal conflicts within the government resulted in a change of the prime minister[83] in August 2004. The incoming Prime Minister Gyurcsány was eyeing to the 2006 parliamentary elections, therefore the government refrained from employing unpopular fiscal consolidation measures. However, in order to formally comply with the EDP, the Ministry of Finance prepared a national program in autumn 2004 – without consulting fellow ministries, the central bank, or economic think-tanks[84]. While fiscal consolidation program and structural reform proposals were aligned with the EU recommendations – implementation was fully missing[85]. This changed after the 2006 elections. The lack of a strong political coalition weakened the political leaders' capacity to implement comprehensive reforms though. Political consent was secured by party-politicking through behind-the-scenes deals among the coalition parties. Interest groups were only minimally involved in policy formulation and eventually all decisions were made by the prime minister.[86] Corporatist institutions, such as the National Interest Reconciliation Council[87], were side-lined (Sárközy, 2012; Hajnal, 2012). Fiscal consolidation focused on the revenue side. The government

[82] The EDP is an action initiated by the European Commission (EC) against those member states whose public budget deficit runs above 3% of GDP (the rule was changed in the aftermath of the severe 2009 crisis).

[83] Prime Minister Medgyessy resigned in August 2004 – Gyurcsány (former Minister of Youth Affairs and Sports) became prime minister in September 2004. Early elections were not held; the coalition government continued.

[84] Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary).

[85] Interview with analyst at the European Commission Directorate-General for Communication, Representation in Hungary, 24 February 2017 (Budapest, Hungary); Interview with former high level political representative of Hungary in the European Commission, 20 September 2016 (Szentendre, Hungary).

[86] Interview with former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary).

[87] A tripartite council dealing with labour market and general economic policy issues involving the government, the trade unions, and the various employer groups.

increased personal and corporate income taxes, social security contributions and introduced a sector tax on the energy and banking sectors.

The domestic cleavage structures were unhelpful in achieving a meaningful tax reform as the political support of the government was weak (no dominant player emerged) and the government was not considering international recommendations on how to create a more growth enhancing tax regime, but was rather focussing on keeping its voter base relatively immune against tax increases[88]. Reform ownership (i.e. tax reforms recommended by the international institutions) was weak.

In this time period (2004-2008) the window of opportunity in the form of economic crisis was absent. Global and European economic conditions were favourable. The Hungarian economy had an average annual GDP growth rate of 4.4% (versus 2.4% in the Euro-area – see also Appendix 2.) in 2004-2006, The revenue-side-centred-measures resulted in punishingly high taxes intimidating investment and employment while they also led to flourishing tax avoidance practices; economic growth practically disappeared in 2007-2008 (average annual GDP growth was 0.7% in Hungary versus 1.8% in the Euro-area and 6% in the East Central European[89] region).

Despite the EDP, international influence on domestic policy making was weak. According to the EU rules of those times, in case of such an incident, the member state under the EDP was obliged to submit corrective programs in order to eliminate the excessive deficit. The usual method was that the European Commission (EC), more specifically the Directorate General for Economic and Financial Affairs (DGEcFin) gave an opinion on the member state's fiscal consolidation program. The content of the program was solely the responsibility of the member state's government. DGEcFin

[88] Interviews with high ranked government officials and background conversations with top level political decision makers (undisclosed).

[89] East Central European region is understood here as the ex-Communist countries without ex-Sovietunion

also had the task to audit the development of the program, but the programs content and its implementation was fully the responsibility of the member state (Török, 2019).

As the global financial crisis escalated in autumn 2008, due to the weak financial position of Hungary[90], there came a complete freeze on the government's primary bond market. Elite political decision makers called for financial assistance in order to avoid the country defaulting on its debt servicing. In late October 2008, the government signed a stand-by arrangement (SBA) with the IMF, supplemented by a loan contract signed with the EU and another one with the World Bank[91]. The EU was involved in the bailout program under the terms of the EU Treaty[92]. The IMF's SBA included detailed policy prescriptions with quantitative targets in the form of policy measures with numerical objectives and qualitative targets in the form of public sector reforms. The implementation of both the quantitative and the qualitative policy targets was strictly monitored – i.e. the program had firm conditionality criteria. Under the IMF bailout program (2008–2010), the perceived task of the central government was crisis management, with the underlying objective of implementing the agreed (i.e. prescribed) fiscal consolidation measures and the public sector reforms.

Prime Minister Gyurcsány resigned in March 2009, and the incoming caretaker government was headed by Bajnai, until the next elections (scheduled for one year later). Bajnai's caretaker government acted as the agent of the IMF and the EC, without a high level of domestic support or political legitimacy (Török, 2019). The IMF-prescribed fiscal consolidation program contained the correction of the Hungarian tax system among others (i.e. short-term efficiency-enhancing measures with prompt expenditure cuts and long-term structural reforms). The program prescribed tax cuts (social security contributions, personal and corporate income taxes) with a broadening of the tax base and tax increases (consumption taxes). Domestic decision-making authority was severely curtailed. The emergency situation paralysed the domestic

[90] I.e. Hungary had excessively high level of short maturity external debt.

[91] The size of the SBA loan was EUR 12.5bn, the EU loan was EUR 6bn, the World Bank loan was EUR 1bn.

[92] According to article 119, before a non-Euro-area member state seeks financial assistance from an outside source, it has to consult with the EC and the Economic and Financial Committee.

political elite and reduced domestic resistance, that is, it opened the window of opportunity for public sector reforms. The shift in the locus of authority (from domestic elite decision makers to the IMF) was present in the form of coercive policy transfer (i.e. the SBA conditionalities). New policy images were adopted. In this process domestic advocacy coalitions were also supporting the policy change: "Reformszövetség"[93] was delivering policy proposals echoing the mainstream propositions in tax policy change (aligned to the taxation theories). It advocated flat rate tax system as lower marginal tax rate was expected to increase the labour supply, and therefore deliver the widening of the tax base. Lower tax rates were also expected to lower the propensity for tax avoiding behaviour (i.e. whitening the economy) and simplify the tax system (therefore reducing administrative costs). Eventually, a key member of Reformszövetség became the Finance Minister of the Bajnai government.

The care-taker government had NPM-like managerial approach in delivering policy changes[94]. The sense of urgency also decreased the institutional constraints and resulted in a relatively high level of reform ownership.

At the 2010 parliamentary elections, opposition Fidesz, campaigning with tax-cut promises, won a two-thirds parliamentary super-majority. The new government led by Prime Minister Orbán faced the challenge of pleasing voters (i.e. deliver tax cuts, refrain from further austerity measures), while also continuing with fiscal consolidation and public sector reforms according to the IMF program?. Moreover, in the post-crisis period, the EC took more seriously its role in preventing macro

[93] Reformszövetség (i.e. Reform-alliance) formally existing between November 2008 and April 2009 was formed by various interest groups (employers' associations, trade unions, business groups and scientists, economists). It proposed an economic program which was largely resembling the IMF prescribed measures focussing on macro-stability and competitiveness, public sector and tax reforms (Source: Reformszövetség).

[94] Interviews with former representative of the Fiscal Council, former employee of the IMF Resident Representative Office, former official at the Ministry of Finance, former high level decision maker at Ministry of National Economy.

instability and excessive deficits with the introduction of strengthened mechanism[95]. First, the government introduced a banking tax – without any consultation with the IMF or the EC[96]. This was a violation of the program. Given the confrontational stance of Prime Minister Orbán, the relationship between the new government and the IMF/EC soured rapidly. Finally, the IMF and the EC decided to terminate the bailout program prematurely in summer 2010[97]. The EDP was still in place though, and therefore fiscal consolidation had to continue.

The government introduced sector taxes on selected industries (bank, retail, energy, and telecoms). Otherwise, the Orbán government's tax policy was consistent vis-à-vis the philosophy of putting the weight of taxation from income related taxes to consumption related ones (as a consequence, the normal VAT bracket was raised to 27% in Hungary, the highest in the EU and in the OECD) and broadened the tax base[98] – this strategy was advocated by the OECD and by the IMF. The tax system was further modified by introducing various consumption and turnover-related taxes (unhealthy food tax, financial transactions levy, telephone usage tax, advertisement tax, and so forth). The source of these ideas were typically other countries' taxation practices[99] in the form of voluntary policy learning. Income taxes (both personal and corporate) were cut[100]. In the post-IMF program period the Orbán government aimed to reduce coercive external influence as much as possible. The locus of authority shifted again, this time back to the domestic decision making elite. The National Interest Reconciliation Council and other consultative, tripartite arrangements aimed at

[95] Introduction of the European Semester, the Six pack and the Two pack, the Macroeconomic Imbalance Procedure and the strengthening the Stability and Growth Pact.

[96] After the government change, it turned out that the public deficit was running above plan; therefore, the measure was implemented in order to fix the fiscal problem quickly.

[97] The officially set end date for the program was October 2010.

[98] Several tax exemptions were abolished, including minimum wage earners'.

[99] The government made thorough analysis of the global taxation regimes and adopted several elements from various countries to the Hungarian circumstances – Interview with a former high level decision maker at Ministry of National Economy

[100] The personal income tax system was transformed from a progressive rate structure to flat tax, while SME's corporate tax rate was cut.

collective bargaining, as well as sectoral level consultative forums, were either abolished or replaced by new institutions with limited authority (Hajnal, 2016).

The government had very strong political support: a single-party government with a parliamentary supermajority and a continuously high popular approval rate. Strong reform ownership and capable managers were present (i.e. not constrained by internal political forces, such a coalition partner or strong opposition). The belief system of the elite political decision makers was resembling the mainstream tax policy theories rooted in the school of neo-liberal economic policy. The advocacy coalition of the Orbán government proclaimed similar ideas on tax policy as the previous Reformszövetség and as the recommendations of international institutions: broadening the tax base, reducing tax on income and a fundamental tax philosophy change (Cséfalvay and Matolcsy, 2009). However, while under the IMF SBA program, policy diffusion occurred among the circumstances of a coercive policy transfer and in the post-IMF program period policy learning was voluntary. The source of tax policy ideas was diverse: some were coming from the OECD, some from the European Union, and some from other sources. The window of opportunity in the form of economic crisis prevailed, although it was not as severe as in the previous period. Due to the European debt crisis in 2012 (followed by the 2008 financial and 2009 real economy crisis), the lack of available IMF credit line, Hungary's financial position got under renewed pressure. Fiscal consolidation was also a necessity due to the ongoing EDP.

The government was able to secure its re-election at the 2014 parliamentary elections with 2/3 majority once again, i.e. the locus of authority did not change. This period was qualitatively different from the previous four years, given the economic setting. Hungary was released from the EDP in 2013. Sustainable and relatively fast economic growth returned from 2013 onwards both in Hungary and in the Euro-area. The window of opportunity in the form of economic crises has disappeared. As far as the tax policy is concerned, this period brought about mixed results. The tax base was (minimally) narrowed as certain product groups (i.e. meat and milk) were reclassified from the normal 27% VAT bracket to lower ones. However, at the same time, both corporate and personal income taxes were further cut, and the cost of labour (the social security tax paid by the employer) has been decided to get reduced in a multiyear program through cutting social security tax – it is still ongoing. Employers' paid social security tax on gross wages was 27% in 2016, when a multiyear program was decided to cut it – in line with international institutions' recommendation to cut tax burden on labour – and therefore to gain competitive advantage in globalization. Social security tax on gross wages was lowered in 2017, 2018 and in 2019 (currently it is 17.5%) while further cuts are scheduled with the target of reaching 11.5% in 2022. The impact on tax revenues is rather neutral so far, given the fast wage an employment growth in 2017-2018 so far. Therefore, eventually the 2014-2018 government period did not delivered a large-scale tax policy change.

As it is exhibited in Table 4.5., the large policy shifts were the characteristics of the Bajnai and the Orbán I. governments (cutting tax burden on income and increase the tax burden on consumption – i.e. a policy shift defined as fiscal devaluation by the scholarly literature – see Puglisi, 2014).

Table 4.5. The change of the tax types in total tax revenues*

	Gyurcsány	**Bajnai**	**Orbán I.**	**Orbán II.**
Taxes on income, profits and capital gains	1,4%	-2,9%	-4,9%	0,3%
Social security contributions (SSC)	0,7%	-1,6%	1,5%	-0,8%
Taxes on payroll and workforce	-0,1%	0,2%	0,3%	0,1%
Taxes on property	-0,2%	0,5%	0,6%	0,2%
Taxes on goods and services	-1,6%	3,9%	2,6%	0,1%
Other taxes	-0,2%	0,0%	-0,1%	0,1%

*Source: OECD Database / Author; *measured in consecutive periods (before and after the tax changes)*

4.6. Discussion

The paper was looking for the answer to the question: What combination of independent factors facilitated the Hungarian tax reform in the 2009-2018 period?

The paper is embedded in the various policy change theories and utilized the explanations theories provide for the phenomenon of policy change as opposed to policy continuity. Multiple streams and path dependency argue that while policy change (especially large scale reform) is not the norm, still, under extraordinary ciscrumstances labelled as policy windows, or window of opportunities, conjunctures do exist under which policy change finds it way through the interplay of individual agents, ideas, institutions and external factors (multiple streams) or through the decentralized interaction of policy actors (path dependency). Such extraordinary circumstances are provided by the 2008-2009 financial and economic crisis and the following 2011-2012 souvereign debt crisis in most EU memberstates. The magnitude of the crisis was particuclary significant in the case of Hungary. That affected both the society and the political actors to a large extent. The paper has found that in those cases (whereby the unit of analysis is a government's tenure) when the independent explanatory variable of economic crisis was present (i.e. 2008-2010 and 2010-2014) large scale tax policy change happened as opposed to the cases (i.e. 2004-2008 and 2014-2018) when both economic crisis and tax reform was missing.

Punctuated equilibrium theory (PET) and advocacy coalition framework (ACF) suggest that ideas and the political executives' belief systems play a key role in policy formulation. These can change either upon the arrival of new elite decision makers (in the form of a new government involving the devil shift, or by large modifications in the composition of the advocacy coalition) or upon elite decision makers' reflection on dramatic shifts in the public opinon concerning the relevant policy field. Political economy (PE) scholars accentuate the importance of reform ownership of the political executive that is determinded by a set of various factors (i.e. strong mandate; narrow or no coalition; intstitutional contraints etc.). The above factors altogether are synthetized by the paper in the term of domestic cleavage structure. According to the stipulations of PET, ACF and PE, high level of reform ownership and the devil shift can be considered as appropriate facilitating factors for policy reform. The empirical evidence echoes well the stipulations of the theories: domestic cleavage strucutres were supportive for tax policy reform in the case of both the 2008-2010 (i.e. changes in the advocacy coalition, shift in the belief system of the political executives), and 2010-20104 governments (strong mandate, one-party government etc.) while unsupportive in the case of the 2004-2008 and the 2014-2018 governments.

Policy learning theories find that external influence plays a key role in policy diffusion and in policy transfer processes. Policy transfer may be voluntary or coercive. Coercive policy transfer typically involves some form of conditionality. In the case of the 2004-2008 government, external influence was weak, through the mild (pre-crisis) form of policy recommendations derived from the Excessive Deficit Procedure. Large scale tax policy reform was not enacted by the government then. The 2008-2010 period brought about a dramatic change with IMF policy conditionality. In this period, tax reform measures were taken by the government. While the 210-2014 government started with the pre-mature stepping out from the IMF bail-out program, elevated level of external pressure was derived from the strict post-crisis form of the EDP. Major tax reform was enacted, largely influenced by mainstream (i.e. European Commission, IMF and particularly OECD) tax policy recommendations. As EDP was lifted in 2013, the 2014-2018 government did not face high level external influence any longer. No major tax reform was enacted by this period’s government.

The hypothesis was that the co-existence of the three factors stipulated by policy change theories, i.e. domestic cleavage structures allowing high level of reform ownership, the window of opportunity in the form of economic crises and the influence of international agents in the form of policy transfer facilitated the reform of the Hungarian tax system in the 2009-2018 period. This hypothesis was proved - as Table 4.6. exhibits. Eventually, the expenditure level is being determined simultaneously with the structure of taxation (Hettich and Winer, 1999).

Table 4.6. Unfolding the case - independent factors facilitating tax policy change Hungary 2004-2018

		2004-2008	2008-2010	2010-2014	2014-2018
Independent / explanatory variables	**economic crisis**	not present *favourable economic and financial conditions*	present *major financial and real economy crisis*	present *protracted financial and real economy crisis*	not present *favourable economic and financial conditions*
	international influence	weak *in the form of pre-crisis EDP*	strong *coercive policy transfer (IMF SBA)*	strong *in the form voluntary policy learning and post-crisis EDP*	weak *in the form of globalization*
	reform ownership	weak *weak government thriving for political survival* *advocacy coalition not supporting tax reform*	strong *locus of authority shifted to IMF* *advocacy coalition supporting tax reform*	strong *new single party government, strong mandate* *advocacy coalition supporting tax reform*	strong *single party government, strong mandate* *advocacy coalition supporting tax reform*
Dependent variable	**tax policy change**	small	large	large	small

Source: Author

Policy change is truly difficult to happen and only does when the "proper conditions" are available (Birkland). We argued to have a more refined knowledge on the factors facilitating policy change to happen. The finding of the paper is that the coexistence of all the various identified independent factors were necessary for major policy change or policy reform - that goes beyond day-to-day policy management and involves structural changes. It is that the theories of path dependency, punctuated equilibrium, policy learning and advocacy coalition framework have already developed individually the elements of the big puzzle of policy change. The paper proposes to bring on a common platform of the existing streams of thoughts to develop the framework for a policy reform theory. In order to facilitate such an enterprise, the paper suggests continuing to study the causal mechanism of large scale policy shifts in other cases.

CHAPTER 5.

CONCLUDING REMARKS

Public policy change is the broad enquiry of the dissertation. The narrower research area under coverage is large scale policy change or policy reform of the central government. The underlying aim of the dissertation was to gain a better understanding on the factors those facilitate policy change. The research looked at the circumstances under which the need for policy change articulates; the sources of the newly set policy directions; and the evolution of the policy change process.

As a macroeconomic analyst I learned that the content and the quality of economic policy making largely determines the overall performance of a country. Therefore, in my professional work I had paid a special attention on public policies affecting the macro-level beyond fiscal policy in general, such areas as tax policy, education policy, health care policy, industrial policy etc.

The 2008-2009 financial crisis and the subsequent sovereign-debt crisis brought about distinctive break vis-à-vis the previously accepted *modus operandi* not only in the realm of the economy and financial markets, but it also generated meaningful repercussions in the field of (both national and international) politics and resulted in new mechanisms in the governance within the European Union (Alesina, 2012; Blöchliger at al 2012, De Grauwe, 2013, Sutherland et al 2012; Ongaro 2014). Several countries – including a number of EU member states - got into severe financial distress as a consequence of the financial and economic crises due to their earlier accumulated imbalances provoked by policy malfunctioning. The previously designed governance structures of the EU proved to be inefficient to prevent and manage the crisis. The influence of external agents (understood here as the European Commission's Directorate-General of Economic and Financial Affairs and the International Monetary Fund) on national policy design substantially increased. Problem-ridden member-states of the EU were requested to cut budget deficit and reduce public debt. Hungary was a definitive basket case for such developments: the country witnessed external influence coming from the EU in the form of the Excessive Deficit Procedure, an IMF-bail-out, land-sliding political changes, deep economic crisis, and a series of fiscal consolidation and public sector reform attempts. The Hungarian case is considered here an apt choice to elucidate large scale policy change and national policy reform under external constraints.

In 2015 an international research project was launched where I was invited to join. The research project - led by Professor Ongaro and Professor Kickert - aimed to investigate the politics of fiscal consolidation, the domestic government's political decision-making about consolidation, and the influence EU (and IMF) on that. The research project was a follow-up of earlier research (COCOPS WP7) that focused on national governments' political decision-making on fiscal consolidation and reform. The ultimate ambition of the research project was to analyse how the external agents affected public sector reforms in countries under conditions of fiscal crisis and consolidation. The research work developed in two streams. One with a relative focus on the effects of EU (and IMF) on public sector and administrative reforms and another with a relative focus on the influence of EU (and IMF) on consolidation. I participated in both streams and covered the Hungarian case. The ultimate contribution from my side to the research project was two articles published in renowned international journals. '*Unintended outcomes effects of the European Union and the International Monetary Fund on Hungary's public sector and administrative reforms*' published in Public Policy and Administration, and '*The politics of fiscal consolidation and reform under external constraints in the European periphery: Comparative study of Hungary and Latvia*' published in Public Management Review co-authored be Aleksanders Cepilovs.

I continued to further study the combination of necessary factors facilitating large scale policy change / policy reform with the broad aim to test and potentially refine existing theories of policy change and to compare their explanatory power. I studied a specific policy area in Hungary with the the target to uncover the various stages of the change process; the rationale behind the choices of national elite decision makers; the influence of external agents; and the interplay between the considerations of fiscal consolidation need and policy reform. The article written on it '*Factors Facilitating Large Scale Policy Change Hungarian Tax Reform 2009*-2018' is published in Political Science Online (2019 December).

This portfolio dissertation compiles the three articles (Chapter 2., Chapter 3. and Chapter 4.) which constitute the main body of the text. The central theme of each of the articles is policy change under the circumstances of external constraints with the focus on the influence of external agents on national policy making. A special focus was put on the domestic fiscal consolidation, the fiscal measures affecting public sector reforms and the influence of external agents on the decisions on particular policy outcomes.

All the three papers are embedded into the terrain of the various policy change theories. They equally share the ambition to test and refine existing theories of policy change and to contribute to the emerging stream of public administration applied research agendas on public sector reform by making visible and understandable the main contexts and the interacting processes shaping public policymaking.

The time frame of all the three article is the financial crisis and the crisis management years (2008-2012), amended with the pre-, and post crisis years, broadly speaking the past 15 years (2004-2018). The selected case of the dissertation is Hungary – all three articles deal with the Hungarian developments. In the same time, other EU and OECD countries are also looked at for comparisons and Latvia is analysed more in-depth in Chapter 3.

Public policy change refers to shifts in existing structures deriving from a change in attitude or in principle (Bennett and Howlett, 1992; Cerna 2013). The dissertation looked at large-scale policy change or policy reform, i.e. a major change that goes beyond day-to-day policy management, potentially involving structural changes (Alesina et al, 2006), the introduction of new and innovative policies replacing existing ones in order to change the system as a whole (Fullan, 2009: 102). Public sector reforms, government-wide in scope and cross-cutting all public services are understood as changes to the structures and processes of public sector organizations, i.e. re-form previously existing arrangements by the attributes of a new structure, form, or process, driven by specific considerations and political actors' interests (Barzelay, 2001; Ongaro, 2009). The dissertation considers the terms 'policy reform' and 'large scale policy shift' interchangeable in line with other scholars (i.e. Cerna, 2013). The dissertation stipulates that policy change does not necessarily equal with improvements with regards to efficiency or quality of the public services or by any other considerations.

There is abundant literature on the policy change topic. Nevertheless, policy change theory is fragmented as it is consisting of a number of streams – not a coherent, all-encompassing policy framework as such exist yet. The scholars identified the most important theories as (1) multiple streams; (2) path dependency; (3) punctuated equilibrium; (4) policy learning – policy diffusion; and (5) the interest group activity centred 'Advocacy Coalition Framework'. While these approaches offer fairly uneven categories, regarding their scholarly ambitions and their actual scopes, each of them has the underlying goal to comprehend the very existence of policy change and to give plausible explanations to the question what factors drive policy change. Therefore the above literature constitutes the theoretical framework of the dissertation.

As a major step in understanding policy formation, Kingdon looked at the interplay of individual agents, ideas, institutions and external factors (i.e. multiple streams). Policy formation is seen by Kingdon, as the joint combination of the streams of problems, policies and politics. The particular circumstances where they congregate and result in policy change decisions is labelled by Kingdon as the policy window. Kingdon argues for continual change and adaptation of public policies as opposed to the stability of decision-making in policy communities.

The theory of path dependency claims that institutions are sticky, decisions made in the past encourage policy continuity and actors protect existing models, therefore public policies and formal institutions are difficult to change (Greener 2002; Wilsford, 1994; Pierson, 2000; Mahoney, 2000). Still, under certain conditions – that is called conjuncture, critical juncture or more commonly, the window of opportunity - a big change that departs from the historical path can be possible (Wilsford 1994; Capoccia and Kelemen, 2007). The window of opportunity - in the form of an economic crisis - delegitimizes previous arrangements and policies (Kickert and

Randma-Liiv, 2017), therefore it is considered by the literature as an independent variable facilitating policy change. When policy change comes, than the historical context – i.e. welfare state, civil society organisations, civil service regulations, unionization - also considered to be factors shaping the process and content of policy change (Christensen and Laegreid, 2017; Randma-Liiv and Kickert, 2018).

In a typical policy sector, there are long periods of stability followed by major (fast - and sometimes dramatic) policy changes. Therefore scholarly attention need to be focused on both change and stability. Punctuated equilibrium theory looks at the pattern of cyclical changes of policies when long periods of stability are followed by major policy changes. According to the theory, once an idea gets attention, it will expand rapidly and become unstoppable (Baumgartner and Jones, 1991; Baumgartner and Jones, 1993). Punctuated equilibrium is the process of interaction of beliefs and values concerning particular policy (termed policy images) with the existing set of political institutions or venues of policy action (Christensen, Aaron and Clark 2003, Christensen et al. 2006). According to the theory, policy-makers' perceptions and the institutional framework determine the way policy problems are defined.

Policy learning deals with the question how ideas can be transmitted from one place to another (Rose, 1991; Dolowitz and Marsh, 1994; Shipan and Volden 2008). Policy transfer refers to the process whereby actors borrow policies, administrative arrangements, and institutions developed in one setting to make them work within another setting (Dolowitz and Marsh, 1996). Policy transfer occurs on a continuum between 'purely voluntary' policy transfer and 'purely coercive' policy transfer (Bennett and Howlett, 1992; Heclo, 1974; Rose, 1991). Coercive policy transfer – also termed as facilitated unilateralism or hierarchical policy transfer - occurs via the exercise of transnational or supranational authority; when a state is obliged to adopt policy as a condition of financial assistance (Bulmer and Padgett 2014).

The quality of the coercive policy transfer and its eventual outcome depends on variables such as the degree of authority accrued by supranational institutions and the density of rules and the availability of sanctions on the one hand, and on the reform ownership of elite decision makers on the other hand. Reform ownership in turn rests upon 'advocacy coalitions'. The change of the systemic governing coalition and the surrounding political subsystems (i.e. the form of political executive) with new policy concepts, is another independent variable of policy change. Top-down reforms driven by elite decision making – influenced by ideas and pressures from elsewhere – constitute the core of the reform process. Accordingly, public sector reform is more likely to happen if one political group (or advocacy coalition) becomes a dominant player (Alesina, 2006).

Policy change can be understood through the examination of political subsystems (advocacy coalitions) those seek to influence governmental decisions. The adcovacy coalition theory recognizes that there are various competing sets of core ideas about causation and value in public policy. Coalitions form around these core idea sets because certain interests are linked to them. The members of advocacy coalitions are coming from a variety of positions (elected and agency officials, interest group leaders, researchers etc.) and they shape the particular belief system - a set of basic values, causal assumptions and problem perceptions (Sabatier, 1988; Sabatier and Jenkins-Smith, 1991). Policy options are therefore the function of the position of the particular advocacy coalition vis-à-vis the elite political decision makers: shifts in the government have an impact on the advocacy coalition. The role of beliefs in shaping policy ideas is a key concept for both the advocacy coalition framework and the punctuated equilibrium theory - both takes into account the theoretical relevance of discursive factors in policy change.

The dissertation uncovers the politics of fiscal consolidation under the circumstances of economic crises, studies the external inducement in making policy reform at the national level in the wider area of the public sector and in the narrower case of tax policy in Hungary. The dependent variable is ultimately the policy outcome of the policy change procedure. There are a series of independent variables identified stemming from the postulates of the various policy change theory literature, such as the influence of the EU and the IMF; economic crises; reform ownership of elite decision makers etc.

In order to establish causal relations (Bennett 2004; George and Bennett 2005) four data sources were consulted during the empirical research. First, extensive desk research was conducted, analysing publicly available official reports issued by the national institutions Second, semi-structured interviews were conducted with key policy makers. Third, relevant media sources were consulted. Fourth, statistical and financial market data were collected and analysed. The research chapters apply the process-tracing method for within-case analysis in order to establish causal relations (Bennett and George, 2005; Beach and Pedersen, 2013) incorporated into within-case analysis (Chapter 2. and Chapter 4.), and the most similar system design in a two-country comparative case study methodology (Chapter 3.). The dependent variable is ultimately the policy outcome of the policy change procedure. The independent variables are: (1) Domestic cleavage structures which define reform ownership through the political capabilities of elite decision makers and the belief system of the advocacy coalitions. (2) The window of opportunity in the form of economic crisis as it delegitimizes previous long-serving policies and undermines the status quo. (3) International influence that makes policy learning, policy diffusion and policy transfer happen either in voluntary or in coercive form.

The articles asked the following questions: How applicable are existing policy change theories for interpreting the empirical puzzle embodied in the Hungarian case? How did the international institutions affect fiscal consolidation and reforms? Why were the outcomes of the crisis so different despite the seemingly similar initial conditions (Hungary vs. Latvia)? What combination of independent factors facilitated the Hungarian tax reform in the 2009-2018 period?

The main findings of the dissertation chapters are the following: (1) Public sector reform content is aligned to the dominant elite decision makers' agenda (Hungary: 2004-2013). (2) Socio-economic structures and key political decision makers' reform ownership is crucial in the policy reform trajectories (Hungary; Latvia, 2009-2013). (3) The coexistence of all the various identified independent by the policy change theories (that of path dependency, punctuated equilibrium, policy learning and advocacy coalition framework factors were necessary for major policy change or policy reform) were present and facilitated large scale tax policy change in Hungary.

The dissertation proposes the refinement of existing policy change theories with the findings on the role of socioeconomic factors, key political decision makers' reform ownership and their dominant political agenda. Moreover the dissertation suggests that shcolars of the policy change area could put additional efforts and endeavour to synthetize existing policy change theories, in order to collect them onto a common platform and develop the framework for a ‘Grand Policy Reform Theory’. In order to facilitate such an enterprise, the paper suggests continuing to study the causal mechanism of large scale policy shifts expanded into a broader set of cases in order to gain more evidence and insight into the necessary factors facilitating large scale policy changes.

References:

Alesina A., Ardagna S., Trebbi, F. (2006): Who Adjusts and When? The Political Economy of Reforms, Vol. 53, Special Issue, International Monetary Fund 1-29.

Ágh, A., (2011): Anticipatory and adaptive Europeanization of Hungary, Budapest: Kossuth Kiadó.

Alesina A., Ardagna S., Trebbi, F., (2006): Who Adjusts and When? The Political Economy of Reforms, Vol. 53, Special Issue, International Monetary Fund 1-29

Alesina, A. and Ardagna, S. (2010) Large changes in fiscal policy: Taxes versus spending, in Brown, J.R. (ed) Tax Policy and the Economy, University of Chicago Press: 35-68.

Alesina, A. (2012): "Fiscal Policy after the Great Recession." Atlantic Economic Journal 40: 429–435. doi:10.1007/s11293-012-9337-z.

Alesina, A., Favero, C. and Giavazzi, F. (2014) The output effects of fiscal stabilization plans, NBER working papers No. 18336.

Åslund, A. and Dombrovskis, V., (2011): How Latvia came through the financial crisis. Washington, DC: Peterson Institute.

Auers, D., (2011): Election Briefing No 66 Europe and the Early Latvian Election of September 17 2011.

Auers, D., (2015): Comparative Politics and Government of the Baltic States: Estonia, Latvia and Lithuania in the 21st Century. Basingstoke: Palgrave Macmillan.

Auers, D. and Kasekamp, A., (2013): Comparing radical-right populism in Estonia and Latvia. Right-Wing Populism in Europe. Politics and Discourse. London & New York: Bloomsbury Academic, pp.235-248.

Barzelay, M. (2001): The New Public Management: Improving Research and Policy Dialogue. Berkeley, CA: University of California Press.

Baumgartner, F., Jones, B. (1991): Agenda dynamics and policy sub-systems, Journal of Politics 53(4), 1044-1074.

Baumgartner, F., Jones, B. (1993): Agendas and Instability in American Politics. Chicago, IL: University of Chicago Press.

Baumgartner, F., (2013): Ideas and policy change. Governance, 26(2), 239-258.

Beach, D., Pedersen, R. (2013): Process-Tracing Methods – Foundations and Guidelines. Ann Arbor: University of Michigan Press.

Bennett, A., (2004): Case study methods: Design, use, and comparative advantages. In D.F.Sprinz and Y. Wolinsky-Nahmias (Eds.) Models, numbers, and cases: Methods for studying international relations, Ann Arbor: The University of Michigan Press. pp.19-55.

Bennett, A., George, A., (2005): Case Studies and Theory Development in the Social Sciences. Cambridge, MA: MIT Press.

Bennett, C., Howlett, M. (1992): The lessons of learning: Reconciling theories of policy learning and policy change. Policy Sciences 25(3): 275–294.

Bird, R., (1992): Tax Reform in Latin America: A Review of Some Recent Experiences. Latin American Research Review 27, no. 1: 7–36.

Bird, R. (2004): Managing Tax Reform, International Bureau of Fiscal Documentation Bulletin, February.

Birkland, T. (2005): An introduction to the policy process: theories, concepts, and models of public policy making, 2nd edition, M.E.Sharpe, Armonk, New York

Blanchard, O.J., Griffiths, M., Gruss, B., (2013): Boom, bust, recovery: forensics of the Latvia crisis. Brookings Papers on Economic Activity 2013, 325–388.

Blöchliger, H., D. H. Song, and D. Sutherland. (2012): “Fiscal Consolidation: Part 4. Case Studies of Large Fiscal Consolidation Episodes.” OECD Economic Department Working Papers, No. 935. doi:10.1094/PDIS-11-11-0999-PDN.

Blyth, M., (2013): Austerity: The history of a dangerous idea. New York: Oxford University Press.

Bohle, D., (2016): East Central Europe in the European Union. In A.Cafruny, Talani L.S., and Martin, G.P. (Eds.) The Palgrave Handbook of Critical International Political Economy. Palgrave Macmillan UK, pp.369-389.

Bohle, D., (2017): European Integration, Capitalist Diversity and Crises Trajectories on Europe’s Eastern Periphery. New Political Economy, DOI:10.1080/13563467.2017.1370448.

Bohle, D. and Jacoby, W., (2017): Lean, Special, or Consensual? Vulnerability and External Buffering in the Small States of East-Central Europe. Comparative Politics, 49(2), pp.191-212.

Borio, C. E. V., Disyatat, P. (2011). Global Imbalances and the Financial Crisis: Link or No Link? BIS Working Paper No. 346

Brooks, S. (2005): Interdependent and Domestic Foundations of Policy Change: The Diffusion of Pension Privatization around the World. International Studies Quarterly 49, pp. 273–294.

Bruszt, L. (2007): Multi-level Governance – The Eastern Version Emerging Patterns of Regional Developmental Governance in the New Member States. EUI Working Papers SPS 2007/13. http://hdl.handle.net/1814/7672 (last accessed 18 December 2017).

Brys, B., S. Matthews and J. Owens (2011): Tax Reform Trends in OECD Countries, OECD Taxation Working Papers, No. 1, OECD Publishing, Paris. http://dx.doi.org/10.1787/5kg3h0xxmz8t-en

Brys, B. (2011): Making Fundamental Tax Reform Happen, OECD Taxation Working Papers, No. 3, OECD Publishing, Paris. http://dx.doi.org/10.1787/5kg3h0v54g34-en

Brys, B. et al. (2016): Tax Design for Inclusive Economic Growth, OECD Taxation Working Papers, No. 26, OECD Publishing, Paris. http://dx.doi.org/10.1787/5jlv74ggk0g7-en

Buchanan, J. (1976): Taxation in Fiscal Exchange, Journal of Public Economics 6: 17-29.

Bulmer, S. and Padgett, S., (2004): Policy Transfer in the European Union: An Institutionalist Perspective B.J.Pol.S. 35, 103–126, Cambridge University Press

Cairney, P. (2015): Paul A. Sabatier: An Advocacy Coalition Framework of Policy Change and the Role of Policy-Oriented Learning Therein, The Oxford Handbook of Classics in Public Policy and Administration (Edited by Martin Lodge, Edward C. Page, and Steven J. Balla)

Capoccia, G. and Kelemen, D., (2007): The study of critical junctures: theory, narrative and counterfactuals in historical institutionalism, World Politics 59(3): 341-369.

Cerna, L. (2013): The Nature of Policy Change and Implementation: A review of Different Theoretical Approaches OECD Working Papers

Christensen, C., Aaron, S. and Clark, W. (2003): Disruption in education, Educause Review. Available at: http://net.educause.edu/ir/library/pdf/ffpiu013.pdf

Christensen, C., Baumann, H., Ruggles, R. and Sadtler, T. (2006): Disruptive innovation for social change, Harvard Business Review 84: 1-8.

Christensen, T., Laegreid, P. (2017): A transformative perspective. In: Van de Walle, S., Groeneveld, S. (eds.) Theory and Practice of Administrative Reform. London: Routledge, pp. 27–43.

Collignon, S., Esposito P., Lierse, H. (2011). European Sovereign Bailouts, Political Risk and the Economic Consequences of Mrs Merkel. ARENA working paper, Download from: www.stefancollignon.eu Download 22.05.2016.

Coppedge, M. (2007): Case Studies are for Intensive Testing and Theory Development, Not Extensive Testing, in Symposium John Gerring Case Study Research Principle and Practive 2007, Qualitative methods, Fall 2007 p 2-3

Crivelli, E. and Gupta, S., (2014): Does conditionality in IMF-supported programs promote revenue reform? IMF Working Paper, Fiscal Affairs Department

Crouch, C., (2009): Privatised Keynesianism: An unacknowledged policy regime. The British Journal of Politics & International Relations, 11(3), pp.382-399.

Csáky, Gy. (2009): IMF hitelek Magyarországnak jellemzői, Pénzügyi Szemle [Main characteristics IMF loans provided for Hungary, Public Finance Quarterly 2013(1): 94–108.

Cséfalvay, Z., Matolcsy, Gy. (2009): Jövőkép – Megújított szabadelvű és szociális piacgazdaság Magyarországon, Magyar Gazdaságfejlesztési Intézet (policy paper):

Csomós, B., P. Kiss G. (2014): Az adószerkezet átalakulása magyarországon 2010-től Különszám az adópolitikáról Köz-Gazdaság 2014/4

De Grauwe, P. 2013. "Panic-Driven Austerity in the Eurozone and Its Implications." VoxEU, February 21. https://voxeu.org/article/panic-driven-austerity-eurozone-and-its-implications

De Vries, M., Nemec, J. (2013): Public sector reform: An overview of recent literature and research on NPM and alternative paths. International Journal of Public Sector Management 26(1): 4–16.

Diamond, P., Mirrlees, J. (1971): Optimal Taxation and Public Production I—II, American Economic Review 61: 8-27, 261-78.

DiMaggio, P., Powell, W. (1983): The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields. American Sociological Review Vol. 48. no. 2. pp. 147-160. DOI: 10.2307/2095101

Dolowitz, D., Marsh, D. (1996): Who learns from whom: A review of the policy transfer literature. Political Studies XLIV: 343–357.

Drazen, A., Grilli, V. (1990): The benefits of crises for economic reforms (No. w3527). National Bureau of Economic Research.

Eversheds B. (2011): Analysis of possibilities and suggestions for delegation of public sector functions. State Chancellery, Riga.

Eihmanis, E., (2018): Cherry-picking external constraints: Latvia and EU economic governance, 2008–2014. Journal of European Public Policy, 25(2), pp.231-249.

European Commission (2010): Economic governance: the EU gets tough, http://ec.europa.eu/economy_finance/een/019/article_88106_en.htm. Download 25.05.2016.

European Commission (2012a): First Alert Mechanism Report On Macroeconomic Imbalances in member states, Published on eGov monitor. http://www.egovmonitor.com/node/46725. Download 25.05.2016.

European Commission (2012b): Alert Mechanism Report, COM (2012) 68 final, Brussels, Download 25.05.2016.

European Commission (2010): Strengthening Economic Governance in the EU Report of the Task Force to the European, Brussels, Download 26.05.2016.

Fullan, M. (2009): Large-scale reform comes of age, Journal of Educational Change 10: 101-113

Garnier, G., Gyorgy, E., Heineken, K., Mathe, M., Puglisi, L., Rua, S., Skonieczna, A., Van Mierlo, A. et al (2014): A wind of change? Reforms of Tax Systems since the launch of Europe 2020, European Commission Taxation Papers, Working Paper 49

Gerring, J. (2004): What is a Case Study and What is it Good For?, American Political Science Review 98(2), 341–54.

Gerring, J. (2007): Case Study Research. Cambridge: Cambridge University Press

Gerring, J., Seawright, J. (2008): Case Selection Techniques in Case Study Research - A Menu of Qualitative and Quantitative Options, Political Research Quaterly 2008, 62, 294

George, A. L. and Bennett, A. (2005): Case studies and theory development in the social sciences. Cambridge, Mass: MIT Press.

Greener, I. (2002): Understanding NHS reform: the policy-transfer, social learning and path-dependency perspectives, Governance 15(2), 161-183

Griffiths, M., (2013): Latvia: The Domino That Did Not Fall, in: Bakker, B.B., Klingen, C. (Eds.), How Emerging Europe Came Through the 2008/09 Crisis. An Account by the Staff of the IMF's European Department. Washington, DC: International Monetary Fund, pp. 113–124.

Gros, D. (2012): Macroeconomic Imbalances in the Euro Area: Symptom or Cause of the Crisis? Centre for European Policy Studies, Brussels; 2012 CEPS Policy Brief No. 266

Hajnal, Gy. (2012): Hungary. In: Koen Verhoest, Sandra Van Thiel, Geert Bouckaert, Per Laegreid (2012): (eds): Government Agencies Practices and Lessons from 30 Countries, Basingstoke: Palgrave, pp. 288-299

Hajnal, Gy. (2013): Public Sector Reform in Hungary: View and Experiences from Senior Executives (Country report as part of the COCOPS Research Project), http://www.cocops.eu/wp-content/uploads/2013/10/Hungary-WP3.pdf (last accessed 20 November 2017).

Hajnal, Gy. (2014): April. Unorthodoxy at work: An assessment of Hungary's post-2010 governance reforms. Paper presented at IRSPM XVIII Annual Conference, Ottawa, Canada.

Hajnal, Gy. and Kovács, É. (2015): Hungary's central state administration 1990-2014. In: Hajnal, Gy, van Dooren, W., Vakkuri, J. and Aristovnik, A. (eds.) Towards Meaningful Measurement: Performance Management at the Crossroads of Internal Efficiency and Social Impact. Special issue of the NISPAcee Journal of Public Administration and Policy 8(2) Bratislava: NISPAcee.

Hajnal, Gy. (2016): New wine in new bottles? Assessing Hungary's post-2010 public administration reforms, In: Hammerschmid, Gerhard, Steven van de Walle, Rhys Andrews and Philippe Bezes (2016): (ed.): Public Administration Reforms in Europe. The View from the Top, Chaltenham, UK: Edward Elgar pp. 96-105

Hall, P. (1993): Policy paradigms, social learning and the state: the case of economic policy-making in Britain, Comparative Politics 25: 275-296

Hamann, J., Prati, A. (2002): Why Do Many Disinflations Fail? The Importance of Luck, Timing, and Political Institution, IMF Working Paper 02/228 (Washington: International Monetary Fund).

Heclo, H. (1974): Social Policy in Britain and Sweden. New Haven, CT: Yale University Press.

Hettich, W., Winer, S. (1999): Democratic choice and taxation: a theoretical and empirical analysis, Cambridge University Press

Hiden, J., Salmon, P., (1994): The Baltic nations and Europe: Estonia, Latvia and Lithuania in the twentieth century. London: Longman.

Hines J., Summers, L (2009): How Globalization Affects Tax Design, in Tax Policy and the Economy, Volume 23 Brown J. and Poterba J. eds University of Chicago Press (123 – 157): URL: http://www.nber.org/chapters/c10573

Hirschman, A.O., (1970): Exit, voice, and loyalty: Responses to decline in firms, organizations, and states (Vol. 25). Cambridge, MA: Harvard university press.

Hood, C., Wright, M. (1981): From decrementalism to quantum cuts? In: Hood C. and Wright M. (eds) Big Governments in Hard Times. Oxford: Martin Robertson, pp. 199–227.

Hughes, J, Sasse, G., Gordon, C. (2004): Conditionality and compliance in the EU's eastward enlargement: Regional policy and the reform of sub-national government. Journal of Common Market Studies 43(3): 523–551.

Hogwood, B., Peters, G. (1983): Policy Dynamics. Brighton: Wheatsheaf Books.

Greskovits, B. (2015): The hollowing and backsliding of democracy in East Central Europe. Global Policy 6: 28–37. http://doi.org/10.1111/1758-5899.12225

Griffiths, M., (2013): Latvia: The domino that did not fall, in: Bakker, B.B., Klingen, C. (Eds.), How emerging Europe came through the 2008/09 crisis (pp. 113–124). An Account by the Staff of the IMF's European Department. Washington, DC: International Monetary Fund.

IMF (2010): Strategies for fiscal consolidation in the post-crisis world, IMF policy paper, January 2010.

IMF (2011): Hungary: ex-post evaluation of exceptional access under the 2008 Stand-by Arrangement, Washington: IMF country report no. 11/145, June 2011.

IMF (2012): 2011 Review of Conditionality: Background Paper: Content and Application of Conditionality. Washington, DC: International Monetary Fund.

IMF (2013): Latvia: Ex-Post Evaluation of Exceptional Access under the 2008 Stand-By Arrangement [IMF Country Report No. 13/30]. Washington, DC: International Monetary Fund.

Josifidis, K., Allegret, J.P. and Pucar, E.B., (2013): Adjustment mechanisms and exchange rate regimes in 2004 new EU members during the financial crisis. Post-Communist Economies, 25(1), pp.1-17.

Kattel, R. and Raudla, R., (2013): The Baltic Republics and the crisis of 2008–2011. Europe-Asia Studies, 65(3), pp.426-449.

Kickert, W. (2011): Distinctiveness of administrative reform in Greece, Italy, Portugal and Spain: Common characteristics of context, administrations and reforms. Public Administration 89(3): 801–818.

Kickert, W.J., Randma-Liiv, T. and Savi, R. (2015): Politics of fiscal consolidation in Europe: a comparative analysis. International Review of Administrative Sciences, 81(3), pp.562-584.

Kickert, W. and Randma-Liiv, T. (2015): Europe managing the crisis: The politics of fiscal consolidation. London: Routledge.

Kickert, W., Randma-Liiv T. (2017): The impact of fiscal crisis on public administration reforms in Europe. Journal of Comparative Policy Analysis: Research and Practice 19(2): 91–99. DOI: 10.1080/13876988.2017.1286781

Kickert, W., Ongaro, E. (2019) Influence of the EU (and the IMF) on domestic cutback management: a nine-country comparative analysis, Public Management Review, 21:9, 1348-1367, DOI: 10.1080/14719037.2019.1618383

Kingdon, J. (1984): Agendas, Alternatives, and Public Policies. Boston: Little, Brown.

Kovács, O. (2016): The Hungarian agony over Eurozone accession. In José M. Magone, Laffan, B., Schweiger, C. (Eds.) Core-periphery Relations in the European Union: Power and Conflict in a Dualist Political Economy, pp.231-250. London: Routledge.

Kornai, J. (2015): Hungary's U-turn. Capitalism and Society 10(1): Article 2.

Körössényi, A. (1999): Democratic transition and political patronage: Relation between spheres of politics government and public administration. Hungary in a comparative perspective. Research Support Scheme, Open Society Institute. http://rss.archives.ceu.hu/archive/00001024/01/25.pdf

LeBlanc, P., S. Matthews and K. Mellbye (2013): The Tax Policy Landscape Five Years after the Crisis, OECD Taxation Working Papers, No. 17, OECD Publishing, Paris. http://dx.doi.org/10.1787/5k40l4dxk0hk-en

Levine, C. H. (1979): More on cutback management: Hard questions for hard times. Public Administration Review 39(2): 179–183.

Levine, C. H. (1985): Police management in the (1980s): From decrementalism to strategic thinking. Public Administration Review 45: 691–700.

Lütz, S., Kranke, M. (2014): The European rescue of the Washington Consensus? EU and IMF lending to Central and Eastern European countries. Review of International Political Economy 21, 310–338.

Mahon, J. (2004): Causes of Tax Reform In Latin America, 1977–1995 Latin American R esearch Review, Vol. 39, No. 1, February 2004, University of Texas Press

Mahoney, J. (2000): Path Dependence in Historical Sociology. Theory and Society. 29 (4), 507−548.

Mankiw, N. G., Weinzierl, M., Yagan, D. (2009): Optimal taxation in theory and practice. The Journal of Economic Perspectives, 23(4), 147-174.

Mathe, M., Nicodeme, G., Rua; S. (2015): Tax Shifts, European Commission Taxation Papers, Working Paper 59

McBeth, M., Shanahan, E., Arnell, R., Hathaway, P. (2007): The Intersection of Narrative Policy Analysis and Policy Change Theory, The Policy Studies Journal, Vol. 35, No. 1, 2007

MacIntyre, A. (2001): Institutions and investors: The politics of the economic crisis in Southeast Asia, International Organization, Vol. 55. No. 1., 81-122.

Mirrlees, J. (1971): An Exploration in the Theory of Optimum Income Taxation," Review of Economic Studies 38: 175-208.

Mirrlees, J., Adam, S., Besley, T., Blundell, R., Bond, S., Chote, R., Gammie, M., Johnson, P., Myles, G., Poterba, J. (eds.) (2010): Dimensions of Tax Design: the Mirrlees Review. Oxford: Oxford University Press

Mirrlees, J., Adam, S. (2011): Tax by design: The Mirrlees review (Vol. 2):. Oxford University Press.

Nier, E. W., Merrouche O. (2010): What Caused the Global Financial Crisis? Evidence on the Drivers of Financial Imbalances 1999-2007, IMF Working Paper No. 10/265

Nunberg, B. (2000): Ready for Europe Public Administration Reform and European Union Accession in Central and Eastern Europe. World Bank Technical Paper, No. 456. Washington, DC: World Bank.

Obstfeld, M - Rogoff K. S. (2009). Global Imbalances and the Financial Crisis: Products of Common Causes (Paper prepared for the Federal Reserve Bank of San Francisco Asia Economic Policy Conference, Santa Barbara, CA, October 18-20, 2009.)

OECD (2001): Sources and Methods of the OECD Economic Outlook. http://www.oecd.org/eco/outlook/sources-and-methods.htm

OECD (2008): Tax and Economic Growth, Economicd Department Working Paper No.620 http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?doclanguage=en&cote=eco/wkp%282008%2928

OECD (2010): Tax Policy Reform and Economic Growth, OECD Tax Policy Studies 20. Paris: OECD Publishing

OECD (2012): Restoring Public Finances, 2012 Update, Paris: OECD.

Olofsgard, A. (2003): The Political Economy of Reform: Institutional Change as a Tool for Political Credibility, background paper to the World Bank's 2005 World Development Report.

Ongaro, E. (2008): Introduction: The reform of public management in France, Greece, Italy, Portugal and Spain. International Journal of Public Sector Management 21(2): 101–117. https://doi.org/10.1108/09513550810855618

Ongaro, E. (2009): Public Management Reform and Modernization – Trajectories of Administrative Change in Italy, France, Greece, Portugal and Spain. Cheltenham: Edward Elgar.

Ongaro, E. (2014): The relationship between the new European governance emerging from the fiscal crisis and administrative reforms: Qualitatively different, quantitatively different, or nothing new? A plea for a research agenda. Administrative Culture 15(1): 10–20.

Ongaro, E., Mele, V. (2014): Public sector reform in a context of political instability: Italy 1992–2007. International Public Management Journal 17(1): 111–142.

Ost, D. (2006): The defeat of solidarity: Anger and politics in postcommunist Europe. Ithaca: Cornell University Press.

Pesuth, T. (2015): A quiet tax revolution in Hungary? Interview with Dr. György Matolcsy, governor of the Central Bank, Society and Economy 37 Suppl p 3-10 DOI: 10.1556/204.2015.37.S.2

Pierson, P. (2000): Increasing Returns, Dependence, and the Study of Politics. American Political Science Review 94 (2), 251-67.

Pierson, P., Skocpol, T. (2002): Historical institutionalism in contemporary political science. Political science: The state of the discipline, 3, 693-721.

Pisani-Ferry, J., A. Sapir and G. Wolff (2013), EU-IMF Assistance to the Euro Area Countries: An Early Assessment, Bruegel Blueprint Series 19, Brussels.

Pollitt, C. (2010): Cuts and reforms—Public services as we move into a new era. Society and Economy, 32(1), pp. 17-31.

Pollitt, C., Bouckaert, G. (2011): Public Management Reform - A Comparative Analysis – New Public Management, Governance, and the Neo-Weberian State. Oxford: Oxford University Press.

Polsby, Nelson W. (1984): Political Innovation in America: The Politics of Policy Initiation. New Haven: Yale University Press.

Profeta, P. (2003): Political Support and Tax Reforms with an Application to Italy, Public Choice 131, 141-155.

Prammer, D. (2011): Quality Of Taxation And The Crisis: Tax Shifts From A Growth Perspective European Commission Taxation Papers, Working Paper 29

Princen, S. (2013): Punctuated equilibrium theory and the European Union. Journal of European Public Policy, 20(6), 854-870.

Puglisi, L. (2014): Fiscal Devaluations on the Euro Area: What has been done since the Crisis?, Taxation Papers, 47.

Radaelli, C.M. (2000): Whither Europeanization? Concept Stretching and Substantive Change, European Integration online Papers (EIoP), Vol. 4, No. 8.

Radaelli, C.M., (2003): The Europeanization of Public Policy, in The Politics of Europeanization (Featherstone, K. and Radaelli C. M. eds) Oxford University Press, pp. 27-56.

Radelet S., Sachs J. (1998): The onset of the East Asian financial Crisis, NBER Working Paper series Working Paper 6680

Randma-Liiv, T. and Kickert, W. (2018): The impact of fiscal crisis on public administration reforms in Europe. In E.Ongaro and S. van Thiel (Eds.), The Palgrave Handbook of Public Administration and Management in Europe. Basingstoke: Palgrave Macmillan.

Raudla, R., Savi, R. and Randma-Liiv, T. (2015): Cutback management literature in the 1970s and 1980s: taking stock. International Review of Administrative Sciences, 81(3), pp.433-456.

Reformszövetség (2008): A gazdaság növekedési és versenyképességének javítása az adórendszer átalakításával; Policy Paper

Reich, M. (1995): 'The politics of health sector reform in developing countries: three cases of pharmaceutical policy', Health Policy 32: 47-77.

Reinhart, C. M., Rogoff K. S. (2010): Is the 2007 U.S. sub-prime financial crisis so different? An international Historical comparison, NBER Working Paper series Working Paper 13761

Reinhart, C., Rogoff, K. (2011): From Financial Crash to Debt Crisis American Economic Review 101 (August 2011), 1676–1706 http://www.aeaweb.org/articles.php?doi=10.1257/aer.101.5.16761676

Robertson, D. B., Waltman, J. L. (1992): The politics of policy borrowing. In: Finegold, D., McFarland, L., and Richardson, W. (eds.) Something Borrowed, Something Blue. Oxford Studies in Comparative Education. Wallingford, UK: Triangle, pp. 25–48.

Rodrik, D. (1996): Understanding economic policy reform. Journal of economic Literature, 34(1), 9-41.

Rose, R. (1991): What is lesson-drawing? Journal of Public Policy 2(1): 3–30.

Sabatier, P., Hunter, S., & McLaughlin, S. (1987): The devil shift: Perceptions and misperceptions of opponents. Western Political Quarterly, 40(3), 449-476.

Sabatier, P. (1988): An advocacy coalition framework of policy change and the role of policy learning therein, Policy Sciences 21: 128-168.

Sabatier, P., Jenkins-Smith, H. (1993): Policy change and learning: an advocacy coalition approach, Boulder: Westview

Savi, R. and Cepilovs, A. (2017): Central decisions, decentralized solutions: Comparing the implications of central cutback policy for the agency level in Estonia and Latvia. Journal of Comparative Policy Analysis: Research and Practice, 19(2), pp.139-154.

Sárközy, T. (2012): Magyarország kormányzása 1978-2012. [The governing of Hungary, 1978-2012], Budapest: Park Kiadó.

Scheppele, K.L. (2014): Hungary: an election in question. https://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1174&context=schmooze_papers. (last accessed 21 July 2018)

Schimmelfennig, F., Sedelmeier, U. (2004): Governance by conditionality: EU rule transfer to the candidate countries of Central and Eastern Europe. Journal of European Public Policy 11(4): 661–667.

Sebők, M. (2014): Hatalom szabályok nélkül kormány és törvényhozás viszonya pénzügyi válság idején, Budapest, MTA TK PTI

Shipan, C., Volden, C. (2008): The mechanisms of policy diffusion, American Journal of Political Science 52(4), 840-857.

Shipan, C., Volden, C. (2012): Policy Diffusion: Seven Lessons for Scholars and Practitioners, Public Administration Review, Vol. 72, Iss. 6, 788–796

Skocpol, T. (1985): Bringing the State Back In: Strategies of Analysis in Current Research, in P.B. Evans, D. Rueschmeyer and T. Skocpol (eds), Bringing the State Back In (Cambridge: Cambridge University Press), 3-37

Slemrod, J. (1989): Optimal taxation and optimal tax systems (No. w3038):. National Bureau of Economic Research

Solska, M., (2011): Citizenship, collective identity and the international impact on integration policy in Estonia, Latvia and Lithuania. Europe-Asia Studies, 63(6), pp.1089-1108.

Sommers, J., (2014): Austerity, internal devaluation, and social (in)security in Latvia, in: Sommers, J., Woolfson, C. (Eds.) The Contradictions of Austerity: The Socio-Economic Costs of the Neoliberal Baltic Model. Routledge, London, pp. 17–43.

Staehr, K., (2010): The global financial crisis and public finances in the new EU countries in Central and Eastern Europe: Developments and challenges. Public Finance and Management, 10(4), pp.671-712.

Sutherland, D., P. Hoeller, and R. Merola. 2012. “Fiscal Consolidation: How Much, How Fast and by What Means?” OECD Economic Policy Paper No. 1. doi:10.1094/PDIS-11-11-0999-PDN

Szoboszlai, M., Bögöthy, Z., Mosberger, P., Berta, D. (2018): A 2010–2017 közötti adó- és transzferváltozások elemzése mikroszimulációs modellel, MNB-tanulmányok 135.

Tommasi, M., and Velasco A. (1996): “Where Are We in the Political Economy of Reforms?” Journal of Policy Reforms, Vol. 1, pp. 187–238.

Török, Z. (2019): Unintended outcomes effects of the European Union and the International Monetary Fund on Hungary's public sector and administrative reforms, Public Policy and Administration, April 2019, SAGE Publications

Vass, L. (2001): Politicians, bureaucrats and administrative reform in Hungary: Who stops whom? In: Peters, G., Pierre, J. (eds.), Politicians, Bureaucrats and Administrative Reform. London: Routledge, pp. 83-92.

Volden, C. (2006): States as Policy Laboratories: Emulating Success in the Children's Health Insurance Program." American Journal of Political Science 50, pp 294–312.

Weyland, K. eds. (2004): Learning from Foreign Models in Latin American Policy Reform. Washington DC: Woodrow Wilson Center Press.

Williamson, J. (1990): What Washington Means by Policy Reform Chapter 2 in Williamson,.J. edited Latin American Adjustment: How Much Has Happened? Peterson Institute for International Economics

Wilsford, D. (1994): Path dependency, or why history makes it difficult but not impossible to reform health care systems in a big way, Journal of Public Policy 14(3), 251-283.

Woll, C. and Jacquot, S., (2010): Using Europe: Strategic action in multi-level politics. Comparative European Politics, 8(1), pp. 110-126.

Woolfson, C., Sommers, J. (2016): Austerity and the Demise of Social Europe: The Baltic Model versus the European Social Model. Globalizations 13, 78–93.

Woolley, J. (1984): Monetary Politics: The Federal Reserve and the Politics of Monetary Policy. Cambridge: Cambridge: University Press.

World Bank (2010): Latvia. From Exuberance to Prudence. A Public Expenditure Review of Government Administration and the Social Sectors. (No. 56747–LV), http://documents.worldbank.org/curated/en/225041468045881507/Analytical-report (last accessed 10 October 2017).

World Bank (2012): Implementation Completion and Results Report on a Series of Two Loans to the Republic of Latvia for a Safety Net and Social Sector Reform Program. http://documents.worldbank.org/curated/en/731251468266155026/Latvia-Safety-Net-and-Social-Sector-Reform-Program-Project (last accessed 20 September 2017)

Wyplosz, C. (2015): The Centralization-Decentralization Issue, European Commission Directorate-General for Economic and Financial Affairs, Discussion Paper 014, ISSN 2443-8022 (online)

Appendix:

Appendix 1. List of interviews

(1) Interview with a member of parliament, 5 July 2016 (Riga, Latvia)

(2) Interview with a former senior civil servant from the Ministry of Finance, 31 May 2016 (Riga, Latvia)

(3) Interview with two representatives of the Bank of Latvia, 19 August 2014 (Riga, Latvia)

(4) Interview with a former member of parliament, 21 July 2016 (Riga, Latvia)

(5) Interview with a senior civil servant from Ministry of Finance, 17 September 2014 (Riga, Latvia)

(6) Interview with an economist from the Ministry of Finance, 13 October 2015 (Riga, Latvia)

(7) Interview with a senior employee of the Financial and Capital Market Commission, 18 September 2014 (Riga, Latvia)

(8) Interview with a representative of the State Employment Agency, 23 January 2013 (Riga, Latvia)

(9) Interview with a representative of the State Social Insurance Agency, 23 January 2013 (Riga, Latvia)

(10) Interviews with National Bank of Hungary experts, 20 October 2015; 24 May 2016; 4 July 2016 (Budapest, Hungary)

(11) Interview with a former National Bank of Hungary executive director, 8 August 2016 (Balatonfüred, Hungary)

(12) Interview with a former representative of the Fiscal Council, 18 December 2015, (Budapest, Hungary)

(13) Interview with a former member of the Fiscal Council, 12 November 2015 (Budapest, Hungary)

(14) Interview with a former employee of the IMF Resident Representative Office, 14 June 2016 (Budapest, Hungary)

(15) Interview with a former official at the Ministry of Finance, 23 August 2016 (Budapest, Hungary)

(16) Interview with a former high level decision maker at Ministry of National Economy, 12 September 2016 (Budapest, Hungary)

(17) Interview with Directorate General for Economic and Financial Affairs expert, 13 July 2016 (Brussels, Belgium)

(18) Interview with an analyst at the European Commission Directorate-General for Communication, Representation in Hungary, 24 February 2017 (Budapest, Hungary)

(19) Interview with a high level political representative of Hungary in the European Commission, 20 September 2016 (Szentendre, Hungary)

Appendix 2. GDP change over the previous year (real terms) in EU member-states (2004-2014)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Belgium	3,6	2,1	2,5	3,4	0,8	-2,3	2,7	1,8	0,2	0,2	1,3
Bulgaria	6,4	7,1	6,9	7,3	6,0	-3,6	1,3	1,9	0,0	0,5	1,8
Czechia	4,9	6,5	6,9	5,6	2,7	-4,8	2,3	1,8	-0,8	-0,5	2,7
Denmark	2,7	2,3	3,9	0,9	-0,5	-4,9	1,9	1,3	0,2	0,9	1,6
Germany	1,2	0,7	3,8	3,0	1,0	-5,7	4,2	3,9	0,4	0,4	2,2
Estonia	6,3	9,4	10,3	7,7	-5,4	-14,7	2,3	7,6	4,3	1,9	2,9
Ireland	6,7	5,7	5,1	5,3	-4,5	-5,1	1,8	0,3	0,2	1,4	8,6
Greece	5,1	0,6	5,7	3,3	-0,3	-4,3	-5,5	-9,1	-7,3	-3,2	0,7
Spain	3,2	3,7	4,2	3,8	1,1	-3,6	0,0	-1,0	-2,9	-1,7	1,4
France	2,8	1,7	2,4	2,4	0,3	-2,9	1,9	2,2	0,3	0,6	1,0
Croatia	3,9	4,1	4,9	5,3	2,0	-7,3	-1,5	-0,3	-2,3	-0,5	-0,1
Italy	1,6	0,9	2,0	1,5	-1,1	-5,5	1,7	0,6	-2,8	-1,7	0,1
Cyprus	5,0	4,9	4,7	5,1	3,6	-2,0	1,3	0,4	-2,9	-5,8	-1,3
Latvia	8,3	10,7	11,9	10,0	-3,5	-14,4	-3,9	6,4	4,0	2,4	1,9
Lithuania	6,6	7,7	7,4	11,1	2,6	-14,8	1,6	6,0	3,8	3,5	3,5
Luxembourg	3,6	3,2	5,2	8,4	-1,3	-4,4	4,9	2,5	-0,4	3,7	4,3
Hungary	5,0	4,4	3,9	0,4	0,9	-6,6	0,7	1,7	-1,6	2,1	4,2
Malta	0,4	3,8	1,8	4,0	3,3	-2,5	3,5	1,3	2,8	4,6	8,7
Netherlands	2,0	2,1	3,5	3,8	2,2	-3,7	1,3	1,6	-1,0	-0,1	1,4
Austria	2,7	2,2	3,5	3,7	1,5	-3,8	1,8	2,9	0,7	0,0	0,7
Poland	5,1	3,5	6,2	7,0	4,2	2,8	3,6	5,0	1,6	1,4	3,3
Portugal	1,8	0,8	1,6	2,5	0,2	-3,0	1,9	-1,8	-4,0	-1,1	0,9
Romania	10,4	4,7	8,0	7,2	9,3	-5,5	-3,9	2,0	2,1	3,5	3,4
Slovenia	4,4	3,8	5,7	7,0	3,5	-7,5	1,3	0,9	-2,6	-1,0	2,8
Slovakia	5,3	6,8	8,5	10,8	5,6	-5,4	5,0	2,8	1,7	1,5	2,8
Finland	3,9	2,8	4,1	5,2	0,7	-8,3	3,0	2,6	-1,4	-0,8	-0,6
Sweden	4,3	2,8	4,7	3,4	-0,6	-5,2	6,0	2,7	-0,3	1,2	2,6
United Kingdom	2,3	3,1	2,5	2,5	-0,3	-4,2	1,7	1,6	1,4	2,0	2,9

Source: Eurostat

Appendix 3. Public budget balance in EU member-states (2004-2014) in GDP percentage

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Belgium	-0,2	-2,8	0,2	0,1	-1,1	-5,4	-4,0	-4,2	-4,2	-3,1	-3,1
Bulgaria	1,8	1,0	1,8	1,1	1,6	-4,1	-3,1	-2,0	-0,3	-0,4	-5,5
Czechia	-2,4	-3,0	-2,2	-0,7	-2,0	-5,5	-4,2	-2,7	-3,9	-1,2	-2,1
Denmark	2,1	5,0	5,0	5,0	3,2	-2,8	-2,7	-2,1	-3,5	-1,2	1,1
Germany	-3,7	-3,4	-1,7	0,2	-0,2	-3,2	-4,2	-1,0	0,0	-0,1	0,6
Estonia	2,4	1,1	2,9	2,7	-2,7	-2,2	0,2	1,2	-0,3	-0,2	0,7
Ireland	1,3	1,6	2,8	0,3	-7,0	-13,8	-32,1	-12,8	-8,1	-6,2	-3,6
Greece	-8,8	-6,2	-5,9	-6,7	-10,2	-15,1	-11,2	-10,3	-8,9	-13,2	-3,6
Spain	0,0	1,2	2,2	1,9	-4,4	-11,0	-9,4	-9,6	-10,5	-7,0	-6,0
France	-3,6	-3,4	-2,4	-2,6	-3,3	-7,2	-6,9	-5,2	-5,0	-4,1	-3,9
Croatia	-5,2	-3,9	-3,4	-2,4	-2,8	-6,0	-6,3	-7,9	-5,3	-5,3	-5,1
Italy	-3,5	-4,1	-3,5	-1,5	-2,6	-5,2	-4,2	-3,7	-2,9	-2,9	-3,0
Cyprus	-3,7	-2,2	-1,0	3,2	0,9	-5,4	-4,7	-5,7	-5,6	-5,1	-9,0
Latvia	-0,9	-0,4	-0,5	-0,5	-4,2	-9,5	-8,6	-4,3	-1,2	-1,2	-1,4
Lithuania	-1,4	-0,3	-0,3	-0,8	-3,1	-9,1	-6,9	-8,9	-3,1	-2,6	-0,6
Luxembourg	-1,3	0,1	1,9	4,2	3,3	-0,7	-0,7	0,5	0,3	1,0	1,3
Hungary	-6,5	-7,8	-9,3	-5,0	-3,7	-4,5	-4,5	-5,4	-2,4	-2,6	-2,6
Malta	-4,3	-2,6	-2,5	-2,1	-4,2	-3,2	-2,4	-2,4	-3,5	-2,4	-1,7
Netherlands	-1,8	-0,4	0,1	-0,1	0,2	-5,1	-5,2	-4,4	-3,9	-2,9	-2,2
Austria	-4,8	-2,5	-2,5	-1,4	-1,5	-5,3	-4,4	-2,6	-2,2	-2,0	-2,7
Poland	-5,0	-4,0	-3,6	-1,9	-3,6	-7,3	-7,3	-4,8	-3,7	-4,1	-3,7
Portugal	-6,2	-6,2	-4,3	-3,0	-3,8	-9,8	-11,2	-7,4	-5,7	-4,8	-7,2
Romania	-1,1	-0,8	-2,1	-2,7	-5,4	-9,1	-6,9	-5,4	-3,7	-2,2	-1,3
Slovenia	-2,0	-1,3	-1,2	-0,1	-1,4	-5,8	-5,6	-6,7	-4,0	-14,7	-5,5
Slovakia	-2,3	-2,9	-3,6	-1,9	-2,4	-7,8	-7,5	-4,3	-4,3	-2,7	-2,7
Finland	2,2	2,6	3,9	5,1	4,2	-2,5	-2,6	-1,0	-2,2	-2,6	-3,2
Sweden	0,4	1,8	2,2	3,4	1,9	-0,7	0,0	-0,2	-1,0	-1,4	-1,6
United Kingdom	-3,1	-3,1	-2,8	-2,6	-5,2	-10,1	-9,3	-7,5	-8,1	-5,3	-5,3

Source: Eurostat

Appendix 4. General Government Debt in EU member-states (2004-2014) in GDP percentage

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Belgium	96,5	94,7	91,0	87,0	92,5	99,5	99,7	102,6	104,3	105,5	107,5
Bulgaria	36,0	26,8	21,0	16,3	13,0	13,7	15,3	15,2	16,7	17,1	27,1
Czechia	28,5	27,9	27,7	27,5	28,3	33,6	37,4	39,8	44,5	44,9	42,2
Denmark	44,2	37,4	31,5	27,3	33,3	40,2	42,6	46,1	44,9	44,0	44,3
Germany	64,8	67,0	66,5	63,7	65,2	72,6	81,8	79,4	80,7	78,2	75,3
Estonia	5,1	4,5	4,4	3,7	4,5	7,0	6,6	6,1	9,7	10,2	10,5
Ireland	28,2	26,1	23,6	23,9	42,4	61,5	86,0	110,9	119,9	119,7	104,1
Greece	102,9	107,4	103,6	103,1	109,4	126,7	146,2	172,1	159,6	177,4	178,9
Spain	45,3	42,3	38,9	35,6	39,5	52,8	60,1	69,5	85,7	95,5	100,4
France	65,9	67,4	64,6	64,5	68,8	83,0	85,3	87,8	90,6	93,4	94,9
Croatia	40,3	41,2	38,7	37,3	39,0	48,3	57,3	63,9	69,5	80,4	84,0
Italy	100,1	101,9	102,6	99,8	102,4	112,5	115,4	116,5	123,4	129,0	131,8
Cyprus	64,8	63,4	59,3	54,0	45,6	54,3	56,8	66,2	80,1	103,1	108,0
Latvia	14,0	11,4	9,6	8,0	18,2	36,3	47,3	43,1	41,6	39,4	40,9
Lithuania	18,7	17,6	17,2	15,9	14,6	28,0	36,2	37,2	39,8	38,8	40,5
Luxembourg	7,3	7,4	7,8	7,7	14,9	15,7	19,8	18,7	22,0	23,7	22,7
Hungary	58,7	60,5	64,5	65,5	71,6	77,8	80,2	80,5	78,4	77,2	76,7
Malta	71,9	70,0	64,5	62,3	62,6	67,6	67,5	70,2	67,7	68,4	63,4
Netherlands	50,3	49,8	45,2	43,0	54,7	56,8	59,3	61,7	66,2	67,7	67,9
Austria	65,2	68,6	67,3	65,0	68,7	79,9	82,7	82,4	81,9	81,3	84,0
Poland	45,0	46,4	46,9	44,2	46,3	49,4	53,1	54,1	53,7	55,7	50,4
Portugal	62,0	67,4	69,2	68,4	71,7	83,6	96,2	111,4	126,2	129,0	130,6
Romania	18,9	15,9	12,4	12,0	12,4	21,9	29,8	34,2	37,0	37,6	39,2
Slovenia	26,8	26,3	26,0	22,8	21,8	34,6	38,4	46,6	53,8	70,4	80,4
Slovakia	40,6	34,1	31,0	30,1	28,5	36,3	41,2	43,7	52,2	54,7	53,5
Finland	42,7	40,0	38,2	34,0	32,7	41,7	47,1	48,5	53,9	56,5	60,2
Sweden	48,9	49,1	43,9	39,2	37,7	41,3	38,6	37,8	38,1	40,7	45,5
United Kingdom	38,6	39,8	40,7	41,7	49,7	63,7	75,2	80,8	84,1	85,2	87,0

Source: Eurostat

Appendix 5. IMF program countries in 2009 (by program types)

	Poverty Reduction and Growth Facilities	Stand-By Arrangements	Exogenous Shock Facilities
Afghanistan	YES		
Armenia	YES	YES	
Belarus		YES	
Bosnia and Herzegovina		YES	
Burkina Faso	YES		
Burundi	YES		
Central African Republic	YES		
Congo	YES		
Costa Rica		YES	
Côte d'Ivoire	YES		
Djibouti	YES		
El Salvador		YES	
Gabon		YES	
Gambia	YES		
Georgia		YES	
Ghana	YES		
Grenada	YES		
Guatemala		YES	
Haiti	YES		
Hungary		YES	
Iceland		YES	
Kyrgyz Republic			YES
Latvia		YES	
Liberia	YES		
Malawi			YES
Mali	YES		
Mongolia		YES	
Mozambique	YES		
Niger	YES		
Pakistan		YES	
Romania		YES	
São Tomé and Príncipe	YES		
Senegal			YES
Serbia		YES	
Seychelles		YES	
Sierra Leone	YES		
Tajikistan	YES		
Tanzania			YES
Togo	YES		
Ukraine		YES	
Zambia	YES		

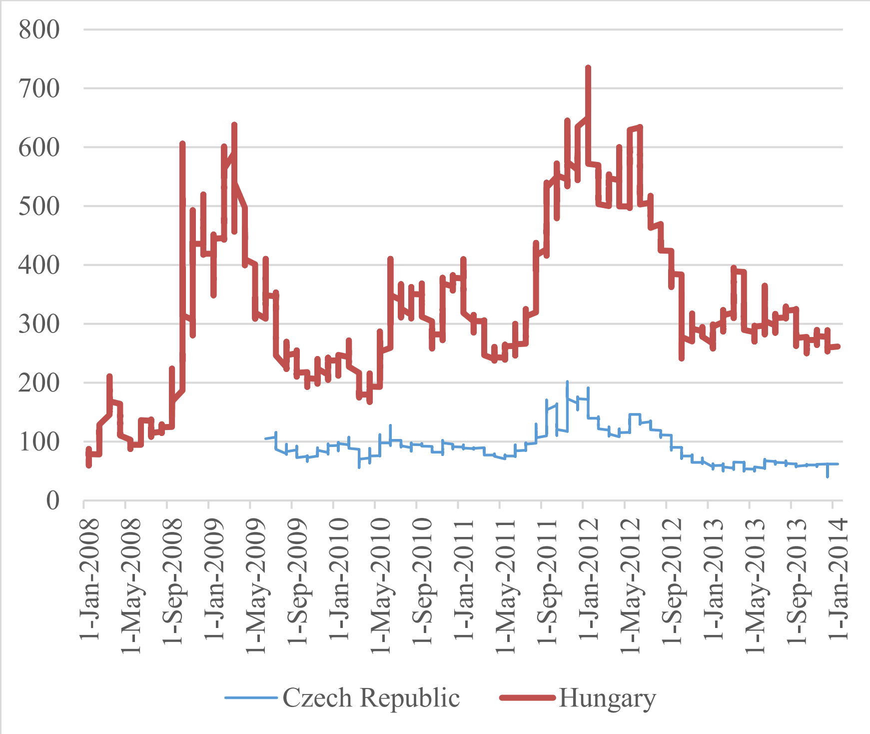
Source: IMF

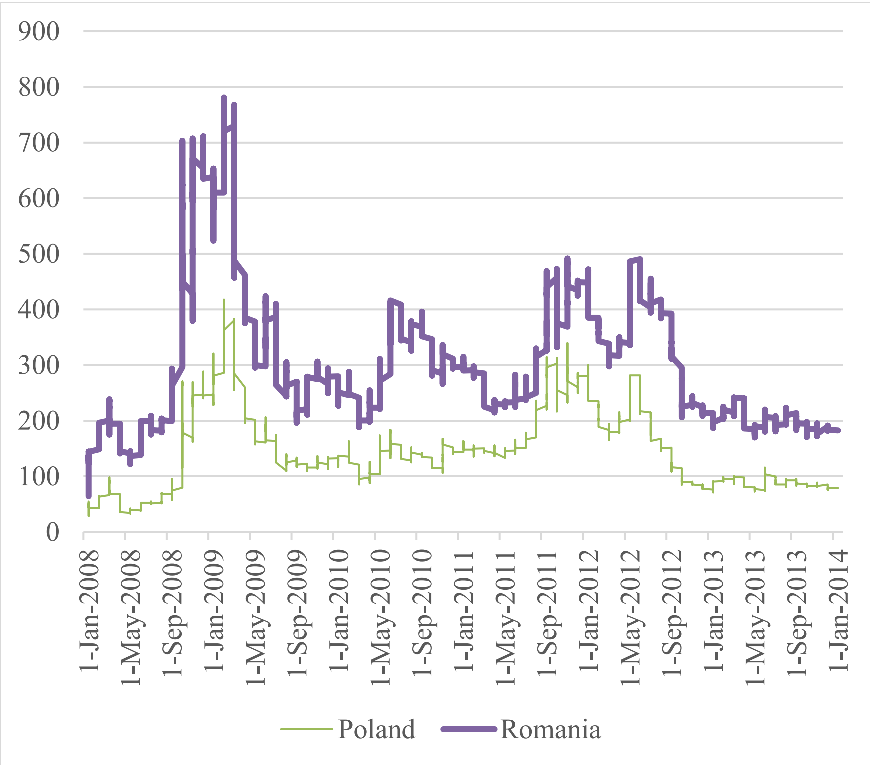
Appendix 6. The benchmark yield of Hungarian Government 3-month Treasury-Bill (in percentage)

05 August 2008	8,7
12 August 2008	8,72
19 August 2008	8,69
26 August 2008	8,73
02 September 2008	8,74
09 September 2008	8,75
16 September 2008	8,89
23 September 2008	8,91
30 September 2008	9,08
07 October 2008	9,22
14 October 2008	10,12
21 October 2008	10,76
28 October 2008	13,29
04 November 2008	12,67
11 November 2008	12,35
18 November 2008	12,16
25 November 2008	11,27

Source: Government Debt Management Agency

Appendix 7. Development of Credit Default Swap (CDS) in selected EU member-states (1 January 2008- 1 January 2014) in basis points





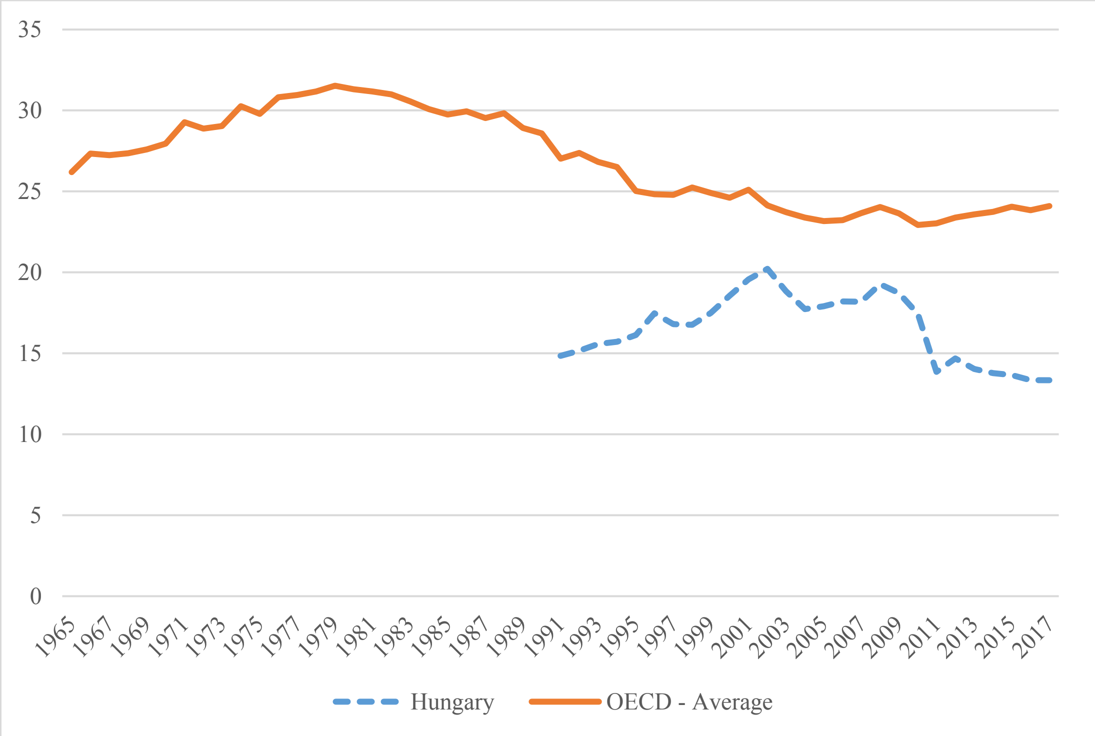
Source: Bloomberg

Appendix 8. Personal income tax percentage share of total tax revenue in OECD countries (period averages)

	2006-2008	2009-2011	2012-2014
Australia	37,22	38,50	39,94
Austria	22,53	22,30	23,02
Belgium	28,10	28,28	28,38
Canada	36,76	35,77	36,30
Chile	4,95	6,95	7,08
Czech Republic	11,30	10,53	10,70
Denmark	52,74	53,27	53,40
Estonia	18,65	15,98	17,04
Finland	30,44	29,94	29,73
France	17,25	17,11	18,44
Germany	25,23	24,74	26,02
Greece	14,89	13,74	17,66
Hungary	18,55	16,67	14,16
Iceland	34,51	37,35	36,88
Ireland	29,95	30,51	32,09
Israel	21,99	18,48	17,99
Italy	25,93	26,55	26,20
Japan	19,30	18,99	18,91
Korea	15,66	14,34	15,54
Latvia	20,41	20,45	20,25
Lithuania	21,77	13,00	13,11
Luxembourg	20,92	21,28	22,59
Mexico	17,80	18,52	20,34
Netherlands	18,22	21,45	18,99
New Zealand	41,15	38,32	37,06
Norway	21,45	23,59	24,53
OECD - Average	23,64	23,20	23,57
Poland	14,72	13,99	14,09
Portugal	16,75	18,18	21,13
Slovak Republic	10,09	9,68	9,82
Slovenia	15,18	15,39	14,47
Spain	20,34	22,10	22,76
Sweden	30,83	28,06	28,34
Switzerland	31,22	31,53	31,04
Turkey	16,35	14,64	14,35
United Kingdom	29,65	29,02	27,45
United States	38,13	35,98	38,84

Source: OECD

Appendix 9. Personal income tax percentage share of total tax revenue OECD average and Hungary



Source: OECD

Appendix 10. Hungary’s tax revenues structure by tax types’ share of total tax revenue (1991-2017)

	Taxes on income, profits and capital gains	Social security contributions (SSC)	Taxes on payroll and workforce	Taxes on propery	Taxes on goods and services
1991	27,6%	35,9%	0,2%	1,2%	33,2%
1992	21,8%	39,0%	0,2%	1,0%	36,0%
1993	20,7%	39,1%	0,2%	0,8%	37,1%
1994	21,0%	38,7%	0,3%	1,0%	37,1%
1995	21,0%	35,6%	0,3%	1,2%	40,6%
1996	22,0%	34,3%	0,3%	1,5%	40,7%
1997	21,7%	33,8%	2,5%	1,5%	39,3%
1998	22,3%	33,5%	2,6%	1,6%	38,9%
1999	23,4%	30,2%	3,6%	1,7%	40,3%
2000	24,3%	29,3%	3,6%	1,7%	40,5%
2001	25,6%	29,7%	3,4%	1,8%	38,7%
2002	26,3%	32,6%	1,1%	1,8%	37,4%
2003	24,6%	32,4%	0,8%	2,1%	39,2%
2004	23,5%	31,7%	0,9%	2,3%	40,7%
2005	23,6%	32,6%	1,0%	2,3%	39,6%
2006	24,5%	33,2%	0,7%	2,2%	38,3%
2007	25,1%	33,6%	0,8%	2,0%	37,6%
2008	25,8%	33,4%	0,8%	2,2%	36,9%
2009	24,4%	32,4%	0,9%	2,1%	39,5%
2010	20,7%	31,4%	1,1%	3,1%	42,9%
2011	17,2%	34,1%	1,3%	3,1%	43,6%
2012	18,0%	32,7%	1,4%	3,2%	44,0%
2013	17,7%	32,6%	1,5%	3,4%	44,0%
2014	18,1%	32,5%	1,5%	3,4%	43,8%
2015	18,3%	32,3%	1,5%	3,3%	43,9%
2016	19,3%	33,2%	1,6%	2,8%	42,4%
2017	18,3%	33,9%	1,9%	2,8%	42,5%

Source: OECD

Appendix 11. Employment in EU memberstates (for aged 20-64, thousand persons, 2007-2014)

	2007	2008	2009	2010	2011	2012	2013	2014
Belgium	4701	4747	4769	4856	4817	4847	4901	4920
Bulgaria	3448	3505	3441	3387	3302	3304	3323	3309
Czechia	5132	5163	5209	5192	5146	5175	5213	5206
Denmark	2869	2859	2845	2822	2811	2788	2767	2777
Germany	40992	41032	41030	40178	40437	40538	40814	40990
Estonia	664	670	666	661	665	658	655	648
Ireland	2293	2312	2260	2206	2182	2174	2192	2199
Greece	4894	4910	4953	4945	4859	4828	4784	4747
Spain	22281	22908	23107	23210	23280	23281	23043	22814
France	28251	28447	28689	28802	28781	28983	29123	29121
Croatia	1884	1890	1886	1871	1841	1825	1811	1868
Italy	23996	24357	24227	24203	24272	24832	24816	25039
Cyprus	383	386	393	409	420	426	425	425
Latvia	1083	1097	1069	1034	1007	1006	986	966
Lithuania	1487	1484	1500	1494	1453	1441	1436	1445
Luxembourg	211	213	227	229	234	246	251	258
Hungary	4184	4144	4135	4171	4190	4265	4300	4413
Malta	165	168	170	172	176	182	190	198
Netherlands	8411	8554	8598	8578	8582	8684	8742	8677
Austria	4064	4100	4132	4147	4176	4222	4261	4278
Poland	16610	16765	17039	16879	16968	17085	17101	17153
Portugal	5196	5203	5161	5166	5138	5087	5010	4976
Romania	9483	9457	9485	8958	8799	8849	8832	8883
Slovenia	1007	1021	1016	1017	998	996	990	991
Slovakia	2646	2679	2680	2696	2668	2695	2703	2707
Finland	2642	2669	2644	2634	2637	2637	2622	2617
Sweden	4750	4797	4799	4827	4887	4909	4963	5005
United Kingdom	30236	30569	30666	30728	30943	31161	31333	31532

Source: Eurostat

Appendix 12. People at risk of poverty or social exclusion in EU memberstates (thousand persons, 2007-2014)

	2007	2008	2009	2010	2011	2012	2013	2014
Belgium	2 261	2 194	2 145	2 235	2 271	2 356	2 286	2 339
Bulgaria	4 663	3 421	3 511	3 719	3 693	3 621	3 493	2 909
Czechia	1 613	1 566	1 448	1 495	1 598	1 580	1 508	1 532
Denmark	905	887	962	1 007	969	965	1 025	1 006
Germany	16 760	16 345	16 217	15 962	16 074	15 909	16 212	16 508
Estonia	293	291	312	289	307	311	313	338
Ireland	1 005	1 050	1 150	1 220	1 319	1 382	1 377	1 279
Greece	3 064	3 046	3 007	3 031	3 403	3 795	3 904	3 885
Spain	10 373	10 786	11 336	12 029	12 363	12 628	12 630	13 402
France	11 382	11 150	11 200	11 712	11 840	11 760	11 245	11 540
Croatia	:	:	:	1 322	1 384	1 384	1 271	1 243
Italy	15 222	15 082	14 799	14 891	16 858	17 975	17 229	17 146
Cyprus	195	181	188	202	207	234	240	234
Latvia	765	740	808	798	821	731	702	645
Lithuania	967	910	943	1 068	1 011	975	917	804
Luxembourg	73	72	85	83	84	95	96	96
Hungary	2 916	2 794	2 924	2 948	3 093	3 272	3 398	3 097
Malta	79	81	82	86	90	94	102	101
Netherlands	2 558	2 432	2 483	2 483	2 598	2 492	2 648	2 751
Austria	1 376	1 699	1 577	1 566	1 593	1 542	1 572	1 609
Poland	12 958	11 491	10 454	10 409	10 196	10 128	9 748	9 337
Portugal	2 653	2 757	2 648	2 693	2 601	2 667	2 879	2 863
Romania	9 940	9 115	8 795	8 425	8 265	8 673	8 392	8 043
Slovenia	335	361	339	366	386	392	410	410
Slovakia	1 152	1 111	1 061	1 118	1 112	1 109	1 070	960
Finland	907	910	886	890	949	916	854	927
Sweden	1 264	1 528	1 641	1 648	1 730	1 679	1 748	1 752
United Kingdom	13 527	14 069	13 389	14 211	14 044	15 099	15 586	15 271

Source: Eurostat