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Hungary Premier Credits His 'Unorthodox' Course for Economic Rebound

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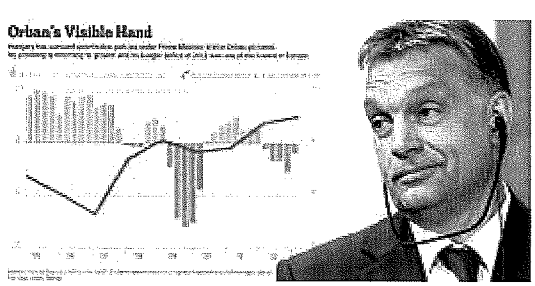
BUDAPEST—Hungary's provocative premier Viktor Orban credits his government's unconventional policies for driving the recent rebound in the country's economic performance and plans to stick to measures like selectively taxing banks and other sectors that are largely dominated by foreign companies.

Hungary is pulling out of recession, with economic output expanding in the first three months of the year after contracting in 2012. The budget deficit is among the smallest in Europe, and it is one of the few countries on the Continent where public debt levels are declining, though from a high level.

"When you are in trouble, when your neighbors are also hit with crisis, just following standard, generalized economic policies doesn't work," Mr. Orban said in an interview. "You need to take targeted action. People say such policies are unorthodox. If you have a more positive view, they are innovative. But they are targeted."

Since coming to power in 2010, Mr. Orban has taken steps, such as slapping special taxes on banks and a few other businesses, that have riled those caught in the cross hairs and drawn criticism from the European Union and the International Monetary Fund, which rescued the country from the brink of insolvency in 2008.

Other measures, including the diversion of privately managed pension money into state coffers, cutting electricity rates and partially bailing out households saddled with foreign-currency loans, have raised questions among investors and economists.



The prime minister made it clear that he doesn't plan to change his "targeted tax system" soon. He said that until public debt outstanding is reduced to below 50% of annual gross domestic product (it is now nearly 80%), "we basically cannot change" the way the government raises revenue. That could take a decade, he said.

In June, EU finance ministers voted to end the strict surveillance of Hungary's budget after the country slashed its deficit to 1.9% of GDP last year and Brussels forecast the gap would remain below the EU-mandated limit of 3% in 2013 and 2014.

This week, Hungary's central-bank governor, a close ally of Mr. Orban's, also asked the IMF to close its office in Budapest. Hungary is due to complete repayments of the money it borrowed from the IMF next year. The IMF said it would oblige by not naming a successor to its current representative in the country, whose term expires in August.

Both were political victories for Mr. Orban, who has cast himself as a defender of Hungarian sovereignty against what he and his allies term the meddling of the EU and IMF—and is facing re-election next year.

"Hungary's recovery is partly due to good fortune. The euro-zone crisis never flared up to the extent we feared," said Neil Shearing, London-based chief emerging-markets economist for Capital Economics. "Part of it is also due to a genuine fiscal-tightening policy becoming less restrictive and some of it to measures that have received an awful lot of criticism."

For example, Mr. Shearing said, government programs to convert foreign-currency loans into local-currency debt have hit the profits of foreign banks operating in Hungary, but also have helped to reduce the country's external exposure as Western European banks have deleveraged.

During his tenure, Mr. Orban has stoked controversy beyond the realm of economic policy as well. He has come under fire from human-rights groups and European officials for moves that his critics say threaten to undermine democracy by, among other things, infringing on judicial independence and media freedom.

In July, the European Parliament urged Hungary to ensure protection of "checks and balances, and fundamental rights, including freedom of expression, the media and religion or belief, protection of minorities, action to combat discrimination and the right to property."

Liberal domestic opponents say Mr. Orban and his right-leaning Fidesz party have turned Hungary into "Orbanistan" by writing Christianity and a restrictive definition of family into the country's new constitution and promoting nationalism.

Mr. Orban is unapologetic, and condemned the European Parliament vote as very dangerous. "Mainstream European political thinking is that we should abandon our roots," he said. "We are probably in a minority in the European arena at the moment. But the values and traditions we are defending are European ones."

Public support for Mr. Orban and Fidesz remains relatively strong despite last

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Hungarian Prime Minister Viktor Orban

year's recession, something Mr. Orban attributes to a focus on the middle class. "If you look beyond the numbers, the impact of our economic policy has been clearly a strengthening of the middle class," he said "If you don't want an economic crisis to become a political crisis, you need to defend the middle class."

To avoid directly raising the tax burden on households, Mr. Orban resorted to taxing banks, telecommunications and energy firms and large retail chains—sectors dominated by foreign companies. Critics say that by doing so, he is putting the economy's future growth prospects in jeopardy by creating an environment that discourages investment.

"The frequently changed regulatory environment, the ad hoc measures, new tax burdens and the extremely short deadlines for compliance make it impossible" for companies "to plan, and hamper operating here," said Michael Nixon, managing director of Nestlé Hungaria, on behalf of the Hungarian European Business Council, an industry group.

Another risk, economists said, is that Mr. Orban's government will spend more in the run-up to next year's elections to goose the economy and win votes. A turn in investors' risk appetite—either from a worsening of conditions in the euro zone or a scaling back of central bank easy money policies globally, could also weaken the Hungarian forint.

"We are doing better, we are improving," Mr. Orban said. "People criticize the government. But no one is saying Hungary lacks leadership. In crisis times, that is important."

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