A cooler climate for investors

The government's decision to let the holders of Swiss franc-based credits repay their loans early at a far below market rate of exchange sent a shock through the banking system. While the early reactions predicting the collapse of the entire banking system were over the top (and the government also provided some relief by tightening requirements for debtors and consequently softening them for banks), the plan itself, the lacking consultation about it and the vehement rejection of any criticism shows a pattern that is probably disquieting for potential investors. On occasion, the government shows scant concern for legal certainty and the rule of law, thus encumbering long-term calculations of returns on investment with the looming possibility of arbitrary taxes or other explicitly or effectively punitive action.

Traditionally, when the average person was afraid that the government plans to take his money away, he would hide it under the mattress. Nowadays he will take it to Switzerland when a lot of money is involved, or to Austria when the funds are less significant. And this is not only true metaphorically. Some folks are really taking their money abroad.

But what's a multinational or a large Hungarian corporation to do when the government deems itself the arbiter of the appropriate level of profit it should earn? Well, as long as his profits remain high enough, he'll stay, having already made significant investments that are themselves expensive to move. Only once he considers that enough has been taken will he leave or fold.

Government matters

It takes a lot to reach such a breaking point, however, which is why former PM Ferenc Gyurcsány famously told employers who bemoaned his tax increases "Feel free to leave Hungary!" Yet even when leaving may not be worth to bother, coming may be an entirely different matter.

The question that the Orbán government is facing is whether its string of unexpected and at times radical and punitive policies are scaring off potential investors. Unlike the gloating announcements of new investors arriving in Hungary, the negative decisions that investors make usually does not become public record. All else being equal, however, it is reasonable to assume that what the government does or fails to do figures intensely in these decisions.

Bold and unpredictable = risky

And two aspects weigh heavily against the Orbán government. First, it clearly has no qualms demanding massive financial sacrifices from the corporate sector when its political priorities or budgetary quandary so require. Second, many of its policies come out of the blue, making long-term strategic planning difficult.

While corporations can and should put up with increased burdens from time to time, uncertainty and unpredictability – combined with stubbornness and an unwillingness to concede mistakes – pose a major risk element for investors. High taxes are one thing, but high taxes or other effectively punitive measures that emerge as unexpectedly as the rabbit did when it first came out of the wizard's hat (i.e. before it become a cliché) are an entirely different matter.

Welcome, moral hazard

The government's most recent surprise for the banking sector is to let people get out of their Swiss franc denominated loans if they can pay back the entire loan at a rate of 180 Forints per CHF – a significantly lower exchange rate than is applicable in the market today. The banks will have to swallow the losses stemming from the difference between the government mandated exchange rate and the real world rate.

PM Viktor Orbán made it clear already a little while ago that the banks would have to pay part of the costs of the foreign currency loan crisis that has engulfed hundreds of thousands of private households and, politically speaking, the government as well. In fairness, the banks have collected extensive profits on loans taken out in Swiss francs in the form of relatively high interest rates – high compared to Swiss franc-based loans generally, low as compared to forint loans – and exaggerated fees.

Who benefits?

But the government's imposition of this low exchange rate would lead to massive losses for the affected banks without clearly addressing the major issue of overburdened household debtors: those that can scrape together sufficient money to repay their loans (at an exchange rate that is still higher than the rate most of them borrowed against) in a lump sum are presumably not those most under pressure from the current situation and thus in need of relief.

While there are other programmes in place that may or may not help those in need, this particular plan seems primarily designed to help those who are well-off at the expense of the banking sector. Of course, in light of the government's tax policies a bit of upper-class welfare is hardly surprising.

And to be fair, since the initial announcement the government has made some sensible concessions – which is in and of itself unusual. Thus, for instance, the maximum forint value of credits that can be repaid at the lower exchange rate will be 10 million, which means those high earners who took out huge loans to finance more expensive houses or apartments will not benefit.

This will also limit the exposure of the banks, which are seething, anonymous sources tell the newspapers. Of course, the same has happened before.

Harbinger of worse to come: crisis taxes

Facing the perennial budget squeeze in 2010, the government immediately moved to massively involve large corporations – many of them foreign owned – in this process by levying a crisis tax that sought to take a huge chunk of what the government termed their windfall profits. On the face of it, the so-called crisis tax was not altogether unreasonable. The affected corporations had money to spare.

There were two problems. First, the tax was arguably too steep, generally exceeding the rates imposed in other countries that Fidesz cited as examples. Second, the tax was designed ingeniously to burden Hungarian corporations, notably OTP and CBA (whose owners' politics also leans towards Fidesz), less. Indeed, though that was not its primary purpose, the crisis tax was probably one of the deftest moves to exploit the loopholes in EU anti-protection policies.

While there was some back and forth regarding how long the extra tax would actually be levied – the government's bid is currently at three years – at least it was clear that it was a temporary measure. The government is no longer credible, however, when it claims that no new punitive measures will be imposed.

Nationalisation, nationalisation, nationalisation

In addition to the taxes that were levied and especially to the way they were imposed, foreign investors also had the opportunity to see other worrying signs concerning the government's relation to business – at least those businesses that do not belong to its own clientele.

Indicative of the governing party's overall attitude was for instance the sudden unilateral takeover of the water works company in Pécs from the French Suez corporation, and the quick assumption of control over the company that was responsible for the red sludge disaster last year, MAL Zrt. In neither case is the issue that the decision is necessarily wrong.

What is troublesome is that the government shows scant respect for private property and same is at the obviously willing to change laws quickly, without much deliberation and room for objections, to increase government control over private enterprises. When its real or perceived interests so dictate, the government easily adapts the current legal environment even if that leads to a feeling of insecurity and uncertainty in the business community.

While laws often need to be changed either because they were bad to be begin with or because they need to be adapted to changing circumstances, normally the process should be cautious and reflect strategic thought rather than the immediate needs or preferences of those in power.

Limited effect: rule of law is toothless

In response to the Swiss franc issue the Austrian government – which saw many of its domestic banks suffer already from last year's crisis tax – first protested bitterly and has now turned to the European Court of Justice for an injunction. Domestic commentators, too, have indicated that the government's decision would run afoul either of the Constitutional Court or the European Court of Human Rights. The logic displays a lacking understanding of Fidesz.

In matters small and large, Fidesz politicians have made clear that the rule of law matters less to them than what the people demand, which always fortuitously coincides with whatever controversial act Fidesz is planning to push through at the moment.

It is of course possible that one or the other extreme measure will be stalled or even nixed by a court. After all, the 98% special retroactive tax on severance payments in the public service was also significantly amended before it ultimately entered into effect. But in return, for a trifle in fiscal terms, the government got a pretext (law is in the way of justice) for neutering the Constitutional Court and retained the tax as well– a classic example of keeping one's cake and eating it, too.

In other words, if it really wants something, Fidesz will find a way to realise it and no court will stop it.

Methods matter

Not all of the government's controversial acts were wrong. The heavy-handed way in which they were imposed, however, the lacking consultation and unwillingness to compromise, and above all the unpredictability, combine to create an image that could net Hungary higher losses in forfeited investments than what it stands to gain from these measures.

If Fidesz continues to instil the notion into foreigners' (and of course Hungarians') mind that the ruling majority is puissant enough to push through a scheme no matter how radical or ill-advised it may be, and that even blatant breaches of the law will or cannot be stopped by the judiciary, then the message will also be received by those who are probably not its intended audience: potential future investors. And they may well decide to heed it – pre-emptively.