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After the economic crisis – In a state of exception?

REPORT BY

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After the economic crisis – In a state of exception?

The topic of the conference is the role of constitutional courts in economic crisis. In this report, I give an overview on how Hungary has been handling the economic crisis. The case of Hungary is special, since the conservative/rightist party elected in 2010 (and again in 2014) has a two-thirds majority, which enables the party to amend the constitution or adopt a new one. The report will focus on the constitutional provisions adopted in response to the crisis, and its impact on the Hungarian constitutional system.

The 2008 economic crisis hit Hungary hard, endangering both state insolvency and the collapse of the national currency. Since the outbreak of the crisis, Hungary has followed a strict fiscal policy. However, there is a huge difference between the crisis management of Hungary, and other European states. For more than four years, the Hungarian government has been giving its crisis management policy a constitutional rank. In addition, the government follows an economic strategy called '*unorthodox economic policy*'. The policy has two main pillars: The first is trying to reduce budget deficit mainly through the cuts in unemployment and social benefits (Szikra forthcoming), the second is the involvement of unorthodox income sources in the state budget (Hegedűs 2014: 6). Unorthodox income sources include taxes levied retroactively (e.g. 98 per cent tax on severance payments), nationalisation of private property (e.g. private pension funds), sector-specific 'supertaxes' imposed on sectors (bank, energy, retail, telecommunication, and media) chosen in an arbitrary way, and the introduction of these taxes in such a way as to affect foreign-owned large companies. Jan-Werner Müller called this policy 'economic nationalism' (Müller 2011: 8). Nouriel Roubini mentioned Hungary as an example of 'state capitalism tendencies in Central and Eastern Europe, where the role of the state increases to the detriment of market-oriented reforms' (Roubini 2014).

In what follows, I give you examples of how the government applies its unorthodox economic policy using the constitution as an instrument of ordinary politics. First, I write about the retroactively levied 98 per cent tax. The tax was declared unconstitutional, and the Constitutional Court was consequently deprived of its competence concerning financial issues. In 2011, the ruling majority adopted a new constitution, called the Fundamental Law. One of its aspirations was to introduce a stringent constitutional debt ceiling, thereby requiring fiscal discipline. Let me give you an illustration of the sometimes unconstitutional methods chosen to achieve this ultimate aim.

1. As a first step in 2010, a new constitutional amendment was adopted, which allowed for the Parliament to *retroactively tax incomes* received from public funds (from pensions to extra bonuses of former high-ranking government officials) if the income was given contrary to 'good morals' by state organisations.[1] The aim of the new amendment was to create an exception to the constitutional limits of financial and tax measures, as well as the settled case law of the Constitutional Court.[2] Based upon this constitutional provision, an Act was adopted which imposed a retroactive 98 per cent punitive tax mainly on individuals worked for the previous liberal/leftist governments and removed from office.[3]

[1] The first version of Article 70/I(2) of the Constitution read as follows: 'In case of incomes received from public funds serving as a contribution to public revenues statute may retroactively as of the beginning of the given tax year introduce special taxes if the income was given contrary to good morals by organisations managing state property or by organisations owned mostly by the state or governed by the state.'

[2] The Constitutional Court has been very active in reviewing financial measures. In 1995 the Court invalidated portions of the government's austerity program (Decision 43-45/1995). See (Scheppele 2004, Sajó 1996: 31) Recently the Constitutional Court reviewed several tax measures. The Court annulled the regulation on the expected corporate tax base (Decision 8/2007). Later the Court decided that 'quasi taxation' of family allowance was against the Constitution (Decision 127/2009) and it also found the property tax unconstitutional (Decision 8/2010).

[3] The Act imposed a 98 per cent tax on public sector severance pay above HUF 2 million (approximately EUR 70.000). It was to be applied on the pay public sector employees leaving their jobs after 1 January 2010 received.

The Act was challenged before the Constitutional Court, which declared the Act unconstitutional, and annulled it *ex tunc*. The Court did not examine in an explicit manner the constitutionality of the constitutional amendment itself, but has taken this for granted by applying it in the current case. According to the Court, the constitutional amendment made an exception to the prohibition of retroactive legislation only in cases of incomes paid *contra bono mores*. Despite this, under the challenged Act, the 98 per cent tax was applied to legally received severance pays, in accordance with 'good morals'. The 98 per cent tax was aimed not only at incomes that the government considered were against 'good morals' (e.g. excessive public sector bonuses), but also at the wages and salaries of public sector workers (e.g. civil servants, public sector employees, doctors, teachers) that had been perfectly legal until then. In the Court's view, payments received according to former statutory regulations could not be seen as incomes *contra bono mores*. Therefore, they could not be taxed retroactively, even under the new constitutional amendment. In addition, although the constitutional amendment paved the way for the legislature to introduce special taxes on certain incomes, for the Court, 98 per cent seemed to be confiscatory. Therefore, it was contrary even to the newly enacted constitutional provision.[4]

2. As the Court declared the 98 per cent tax unconstitutional, the governing majority responded immediately by initiating a constitutional amendment *restricting the competencies of the Constitutional Court* so that the Court cannot review the constitutionality of certain financial measures. This means that, only if the petition refers exclusively to the right to life and dignity; the right to protect personal data; the right to freedom of thought, conscience, and religion; and the right connected to Hungarian citizenship, the Court may examine the constitutionality of Acts on state budget, taxes, contributions, and customs. However, the Court may not assess these acts with regard to the principles of non-discrimination, rule of law, proportionality of burden-sharing, and the prevalence of the right to property. Hungarian case law reflects that the Constitutional Court has annulled tax and other financial measures, by referring to those rights and principles, which are missing from the list. Government officials made it clear that they saw no choice but to limit the power of the Constitutional Court.[5] Otherwise, the so-called 'supertaxes' and the nationalisation of private pension funds might be deemed unconstitutional.

However, even if it was clear that the government's definite aim was to curb the power of

[4] Decision 184/2010 [HUN-2010-3-009]. Soon after the decision, the government launched a new version of the constitutional amendment under which any income from public funds could be taxed retroactively up to five years. The only constitutional hurdle of taxing was not to revoke the totality of the income. The new version of Article 70/I (2) of the Constitution read as follows: 'In case of incomes received from public funds serving as a contribution to public revenues statute may retroactively as of the beginning of the fifth tax year before the given tax year introduce special tax that shall not reach the amount of the income was given by organisations managing state property or by organisations owned mostly by the state or governed by the state.' Beside the constitutional provision the Parliament voted again for the extra tax on certain incomes. The new Act stated that, from 2005 on, public sector employees are obliged to pay extra taxes on severance payments that are above the HUF 3,5 million (approximately EUR 12.500) threshold. There was a HUF 2 million cap for managers of state-owned enterprises, companies owned by local governments and senior officials in the public sector, including municipalities. The Constitutional Court annulled again in its decision 37/2011 the retroactive effect of the 98 per cent tax. Two days after delivering the decision, Parliament approved a new law under which a 98 per cent tax can be levied on severance payments made after 1 January 2010. After this move the European Court of Human Rights had declared in its decisions R. Sz. v. Hungary, N. K. M. v. Hungary and Gáll v. Hungary that the 98 per cent tax on severance pay was contrary to Article 1 of the Convention. In its recent decision 6/2014 the Constitutional Court did not find any reason to differ from the content of the decisions of the European Court of Human Rights regarding the 98 per cent tax on severance pay. Hence, the Constitutional Court held that the Act XC of 2010 – which contains the provision of the 98 per cent tax – was contrary to international treaty, namely to the European Convention of Human Rights and it prohibited the application of the concerned regulation in the pending cases.

[5] The vice president of the governing party, Lajos Kósa indicated in June 2010 that in a crisis situation 'economic constitutionality can be suspended'
<http://www.portfolio.hu/gazdasag/kosa_szuk_eselyunk_van_arra_hogy_elkeruljuk_gorogorszag_helyzetet.134056.html>

the Constitutional Court, a dilemma remained whether the Court had any room left to review cases involving budgetary and tax issues. Taking into consideration only the original intent of the legislators, upon the basis of the new rules on competence, the Constitutional Court did not have the power to deliver a decision on the merit in financial matters. Despite that, the Court delivered at least one decision on tax issues after the constitutional amendment. On the basis of its competence to protect human dignity, the Court argued in the second 98 per cent tax case that the retroactive effect of the 98 per cent tax was an affront to human dignity. It followed from the decision that the non-discrimination principle could be applied relating only to natural persons under the right to human dignity.[6] Hence, although other financial measures (provisions on nationalising private pension funds, provisions on 'supertaxes') were also challenged before the Constitutional Court, the Court did not use its competence to protect human dignity in order to deliver decisions on these issues.

3. The economic nationalisation strategy continued in 2011 with a *wholesale constitutional review*. One of the reasons given by the government to adopt a whole new constitution, was to address some budgetary issues, like public holding of strategic elements of national wealth and checks on excessive indebtedness. (Mádl 2011: 12-13)

The Fundamental Law gives constitutional rank to several financial issues (the budgetary procedure, provisions on national assets), but it first and foremost introduces a debt ceiling and regulates the basic requirements (stability, transparency, and sustainability) of fiscal policy (Varju 2012: 310). In achieving the required public debt ratio and fiscal discipline, the primary responsibility rests on Parliament and the Government. But in a very uncommon way, the Fundamental Law obliges the functioning of the Constitutional Court, the judiciary, and other state bodies to observe these principles.[7] When evaluating this provision, the Venice Commission rightly pointed out that financial reasons can bear on the interpretation and application of norms, but they are not sufficient to overcome constitutional barriers and guarantees. They must not in any way hamper the responsibility of the Court to scrutinise an act of state, and to declare it invalid if it violates the Constitution. (Opinion 2011: para 51)

In addition, the previous limitation of the Constitutional Court's competencies, connected with financial matters, is confirmed by the Fundamental Law. It is not improved by the proviso, that the rule remains in force until the public debt in Hungary will be reduced to 50 per cent of the Gross Domestic Product, since the debt ratio presently stands at around 80 per cent. Therefore, competence concerning every kind of *ex post* constitutional review is restricted in such a way that the Court has the power to overview budgetary and tax measures only in special circumstances, and with regard to a limited part of the Constitution.

The Fundamental Law, instead of giving the Constitutional Court full scope of control over the constitutionality of the budget and tax legislation, gives a special power of intervention in this domain to the newly created Budget Council (Opinion 2011: para 98). The prior consent of the Budget Council is needed for the Parliament to approve the national budget. However, the Budget Council is not an elected, parliamentary body; it consists of members mostly appointed by the ruling majority. In a related development, the Fundamental Law defines the Hungarian Forint as 'the official currency of Hungary,' and it requires that the so-called cardinal laws regulate taxation and pension policy.[8] With these constitutional provisions, the Fundamental Law enshrines the current parliamentary majority's political preferences concerning economic policy issues, makes political alteration difficult, and puts a heavy burden on future parliamentary majorities by constraining them in realising their own economic policy.

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[6] Decision 37/2011 [HUN-2011-2-005]. More on this, see note 4.

[7] Article N of the Fundamental Law

[8] Articles K, L, 40 of the Fundamental Law. Based upon this Parliament adopted the Economic Stability Act (Act CXCIV of 2011), which defines the basic principles of taxation (introduces the universal flat tax) and the structure of the pension system. Any change to these provisions requires a subsequent two-thirds vote in Parliament. (Bánkúti-Halmai-Scheppele 2012: 267)

4. The *justification* given by the government for specifying the desirable level of public debt (50 per cent of the GDP), and the obligations and prohibitions that prevail in situations where this is not achieved (competence cut of the Constitutional Court and the prior consent of the Budget Council), was the financial problems of the state. The argument went that, after the 2008 economic crisis, the Hungarian government needed a greater room for manoeuvre, not limited by constitutional constraints, in order to manage the crisis. This argument presupposes that, as a result of the 2008 economic crisis, Hungary has ended up in a state of emergency, when constitutional guarantees had to be limited or suspended; and the normal constitutionally ordained power sharing had to give way to concentration of all essential powers in the hands of the prime minister, until the crisis was overcome.

There are several problems with this argument. First, I do not contest that economic collapses might warrant temporary suspensions of constitutional guarantees, in such cases where the very survival of the constitutional democracy is at stake (Dorsen 2010: 1511). However, the situation was different when the economic crisis hit in 2008. At that time, Hungary was seriously in debt and politically polarised; therefore, the financial crisis was followed by an even deeper political crisis. It was also an important feature of this period, that the quality of democratic institutions and rule of law were never questioned (Hegedűs 2014: 6). Under such circumstances, the very condition for introducing the state of emergency, the impossibility of constitutionalism, was missing (Dyzenhaus 2012: 443).

Second, the Fundamental Law contains a detailed set of prescriptions for the state authorities to respond to an emergency. It provides for special emergency powers, in case of an imminent danger of war and external armed attack, and in the event of a natural or industrial disaster.[9] In the latter case, it is for the government to decide on how to respond to the emergency. However, the Fundamental Law does not provide for suspension of constitutional rights in times of financial crisis. The Fundamental Law admits, that in times of financial crisis, keeping constitutional rules is not impossible.

Third, even if we accept that the Fundamental Law as a whole is the constitution of an abnormal situation, we should take into account that crisis management constitutions have special mission to complete. Such a crisis management constitution could only be an interim constitution, and its only role should be to facilitate the circumstances needed in order to return back to the normal constitutional system as soon as possible. There is no sign in the constitutional text that the Fundamental Law was assumed to be such an interim constitution.

To conclude, an economic collapse might serve as adequate reason for the constitution-maker to include economic crisis as one of the possible grounds for introducing a state of emergency. The 2008 financial crisis did not have such an impact on Hungary. Therefore, the recent economic crisis did not provide an adequate justification for the authorisation of the government to derogate from the principles and fundamental rights guaranteed by the Constitution, by taxing arbitrarily and retroactively, by nationalising private property, and by terminating legal checks on governmental power.

Not only were principled reasons missing to substantiate the allegation concerning the need to apply the above measures, but also they were not suitable to reach the ultimate aim: 50 per cent ratio of public debt to the GDP. The numbers show that the trend of Hungary's public debt is not exactly sharply descending, its public debt reached 84.6 per cent of GDP by the end of the first quarter of 2014.[10] Therefore, the constitutional provisions, that were adopted in response to the crisis, were not adequately justified, and they subsequently proved to be ineffective.

[9] Articles 48-54 of the Fundamental Law.
[10] 'Hungary public debt rises close to all-time high'
<http://www.portfolio.hu/en/economy/hungary_public_debt_rises_close_to_all-time_high.27786.html>

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