Eastern Europe Faces Financial Risks and Social Tension

Final quarter statistics confirm that post-Communist Central and Eastern Europe will face a 2012 riddled with stagnation or recession. Though many analysts remain optimistic, underlining the resilience and adaptability of populations accustomed to flexibility and sacrifices, the second phase of the European recession that began in 2008 has hit the region hard. The main change from previous years is that financial instability and austerity programs, and the resulting social crisis, are undermining the region's political stability.

Derelict **Belarus** would already be bankrupt were it not for assistance from Moscow. The situation in **Hungary** is also particularly worrisome. The country's center-right government, led by Viktor Orban, which was elected in April 2010 landslide, has proved unable to cope with the economic disaster inherited from the previous administration and has lost most of its trust as a result. Hungary differs from **Greece** and other European Mediterranean states in that its financial woes don't accurately reflect the actual state of the economy, which while poor is hardly catastrophic (in 2011 growth stood at 1.5 percent, inflation four percent, the deficit slightly above three percent, foreign currency reserves at record high, exceeding €38 billion, and the balance of payments registered a surplus).

The real problem in Hungary is growing perception that the government unreliable, if not dysfunctional. It has not only undertaken unorthodox economic measures but also accompanied them with strong verbal hostility towards international monetary institutions. The tone has heightened tension and cut into the country's financial stability. Drastic spending cuts and higher tax rates approved for the calendar year 2012 have only added to the volume of foreign and domestic criticism.

The country's new constitution, which greatly increased the power of the executive and judicial branches in the economic, has a triggered a series of nationwide demonstrations. Although Orban enjoys a huge parliamentary majority (his party controls more than two thirds of the body's seats), his support has declined rapidly. At the same time, neither the radical right nor the left, which is divided into three parties and whose leaders are largely discredited leaders, have been unable to profit from the instability.

But cracks are beginning to appear. Controversial Finance Minister György Matolcs may well lose his job if negotiations with the International Monetary Fund for a €20 billion loan fall through. The fall saw the resignation of several undersecretaries, while Economic Development Minister Tamás Fellegi, considered among the most competent members of the Hungarian executive, stepped down in December.

The edgy relationship between Hungary and the IMF symbolizes the blind alley in which the center-right government finds itself. In November, Budapest went against 18 months of anti-global economic policy in asking for IMF assistance to help the country avoid default. In the course of the year, Hungary will be called on to renew €4 billion worth of maturing bonds.

But Hungary's IMF overture, which ended a cycle of ugly rhetoric, still wasn't enough to reassure investors and major international rating agencies, which downgraded Hungarian government bonds to junk status. The decision has increased the uncertainty surrounding Hungarian National Bank, whose governor, Andras Simor, has long been at odds with a government that has done all its power to weaken his position. Some analysts say that if the country can no longer borrow against the market (state bonds now yield in excess of 10 percent), the government could dip into its reserves to pay off its debt, a step that the European Central Bank and the EU wouldn't tolerate.

In Budapest, Orbán, so far deaf to European calls and disliked Western governments, especially Washington, Paris and Berlin, is seen as potentially surrendering executive power in the coming months to a more moderate member of his party (Mihály Varga, the country's finance ministry undersecretary has been mentioned) or a technocrat figure (the latter solution would come on the heels of what's already occurred in Greece and Italy.) Even **Slovakia** and the **Czech Republic** find themselves in troubled waters.

The Slovak executive, a heterogeneous coalition of liberal and conservative, lost an October confidence vote based on the controversial question of membership of the European rescue fund. The elections of 2012 may well produce an overturning of the political landscape, with Robert Fico's center-left SMER (which has nationalist sympathies) seen as a likely winner. Fico ran the government from 2006 to 2010. Though Slovakia's finances are generally in order and its public debt reduced, the possibility of a German recession threatens an economy based largely on mechanical and exports.

Czech Republic faces similar woes. Its government, backed by President Vaclav Klaus, sympathized with Britain's refusal to endorse the majority agreement reached in December calling for additional fiscal and financial integration among European economies.

Moving on to southeast Europe, crisis and corruption scandals led to the electoral collapse of governing parties in both **Slovenia** and **Croatia**. In Slovenia, the popular mayor of Ljubljana, atop a civic part, took over power at the expense of the right, while in Croatia voters punished the conservative party, despite its success in bringing the country closer to EU entry.

Changes also lie in wait for **Serbia** and **Romania**. In Belgrade, the latest (and irresponsible) postponement EU entry negotiations, driven by the results of the December summit, have vastly reduced the electoral hopes of the pro-European coalition led by Boris Tadic, with national voting set for March 2012. Increased tensions in northern **Kosovo** weighed heavily on the postponement. Brussels is inclined to see the stubbornness of the Serbian political class as dictated by matters of domestic prestige. Whoever admits to the debacle in the former Albanian province, which declared independence in 2008, would no doubt face the ire of a population frustrated by nearly two decades of wars and defeats. Serbia remains the only regional state that refused to recognize Kosovo as an independent entity.

In Bucharest, the Democratic Liberal Party government of Prime Minister Emil Boc is slowly coming to an end. The economic crisis has hit hard, producing mass public sector layoffs and spending cuts. Romania is still a poor country a quarter of whose workforce is employed elsewhere, particularly in **Spain** and **Italy**. Local conditions in their new nations have forced these workers to reduce the number of remittances they send back to family members. National elections scheduled in the fall of 2012 are likely to lead to a victory by the nationalist-populist Social Democratic (PSD) headed by Victor Ponta.

The only European country that seems to have retained a certain economic dynamism is **Poland**. But behind Poland's virtuosity (which trumpets economic growth and political stability), Prime Minister Donald Tusk's Civic Platform (PO) faces anything but smooth going. Though Tusk won October elections, the result was a much a result of the chronic weakness of the Polish left, which was unable to promote an alternative to Tusk, and the specter of a return to power of the conservative and nationalist Law and Justice Party headed by former Prime Minister Jaroslaw Kaczynski.

In recent years Poland has been able to finance its growth based largely on demands of the German manufacturing industry and bolstered by the European Development Fund, which is set to lose considerable financial clout. The Tusk years have witnessed alarming increases in public debt and budget deficits. The strengthening of domestic infrastructure been limited to on-paper project, few of them followed through with in fact. Unemployment is up among the youth population despite the growth and mass migration. This in turn is contributing a deepening of the country's already abysmal urban-rural and east-west divides.

Despite initial ambitions, the Polish presidency of the EU, now coming to end, has turned out to be little more than ceremonial. The country now faces a true trial-by-fire in the shape of the 2012 European Football Championship, organized together with **Ukraine**. An era of dreams is about to come to an end. The Polish leadership, which lack capital and fresh idea, will soon be forced to face the more prosaic reality of being part of a Europe mired in a deep crisis. ●