Essays and debates on Hungary's economic situation and perspectives

Muraközy László (ed.): Fecseg a felszín és hallgat a mély. Tudatok és tudatalattik a gazdaságpolitikában. ["Chattering surface – silent depths. Varieties for the conscious and the subconscious in the economic policy of Hungary".]
Akadémiai Kiadó, 2007

Merre tovább a magyarországi reformokkal? ["How to go on with Hungary's reforms?"]
Pénzügykutató Zrt., 2007

Versenyképességi Évkönyv 2007 ["Yearbook of competitiveness 2007"]
GKI Gazdaságkutató Zrt., 2007

In recent years, the growth and development of Hungary's economy has spectacularly fallen behind those of its neighbours, that is, countries in a similar situation. Meanwhile, the political fragmentation of the country has intensified, public opinion on political institutions has become increasingly negative, the government's credibility has been damaged in Hungary and abroad alike, the necessary structural changes have not been carried out for years, and public debt has increased. In summer 2006, external factors forced the government to act: the EU Convergence Programme outlined a new path of economic policy.

Many of us felt that in the period when an inadequate path was being followed, the eminent and influential representatives of the economic and social sciences seemed to fail to voice their opinion effectively in the matter of mistakes and delays which had already been clearly visible at that time. However, the new period of economic policy did have a stimulating effect on debates over economic policy. Several publications, research reports and conference volumes have made efforts, on the one hand, to understand the situation and examine the path that has lead there, and, on the other hand, to try and find way outs. Within the framework of the present review, I will present a selection of the publications issued last year.

■ First, let me mention the collection of studies edited by *László Muraközy,* which contains the conference lectures of *László Antal, Dóra Győrffy,* László Muraközy, *Ádám Török, Lajos Bokros* and *László Csaba.* The editor's aim is to answer the question as to why Hungary, a top-ranking country in the 1990s, is now lagging behind its peers. "Economic growth is decelerating, there is a chronic budget deficit coupled with a twin deficit, public finances are highly centralised, major distribution systems suffer from functional disorders and financial problems, public debt is increasing, there is a growing disillusionment, accession to the euro zone is becoming an ever more remote possibility, and there is a lack of trust inside and outside the country alike. All this is indicative of the existence of serious and long-standing problems which cannot be attributed solely to one or two chance events or inadequate decisions of economic policy." (p. 9.) The aim of the editor and the authors is to help readers understand today's situation through an analysis of the apparent similarities, continuities and recurring events of the last six decades. Let me point out my opinion as a reader that the studies – albeit they contain a lot of interesting details – fail to offer a convincing answer to the question: how could the country slide back within a short period of time while the external circumstances were basically favourable?

Although the emphasis on the continuity of economic policy provides certain explanations for today's problems, it does not answer the question why Hungary was in a better position in the 1990s. Beside discussing underlying tendencies, it would have been useful giving a critical analysis of the reasons and motives of inadequate economic political decisions, since it was due to the decisions of actual persons and governments that in 2002 and 2006 Hungary's budget deficit increased to an unprecedented degree, and it was analysable measures that resulted in the country's slump back into indebtedness. Without a critical take on decisions, an exaggerated significance may be attributed to fate, and this may provide an excuse for the actual mistakes of the recent past and, what is more important, for mistakes that will possibly be made later on in future.

Let me give an overview of the past, as its lessons help us see present and future in a context. The reader may not be surprised to hear my argument that individuals have memories which are at least as different as their notions of the present or the future. Muraközy goes back to the democratic transition and points out that the majority of economists had quickly realised that capitalism was the only way, yet, "when we remember" we see that almost nobody (not even the political advocates of change) voiced this opinion, while notions of "a third way" were highly wide-spread. He illustrates such unrealistic notions using the following example: "the first independently elected government made an unrealistic promise of a 'social market economy' as a substitute for 'market-based socialism'." (p. 37) Thus, the author feels, Hungary did not make a distinct division between past and future: "The soft democratic transition, which followed an era of soft communism, even among democratic circumstances, preserved a preference of personal consumption as an instrument of political legitimation, along with all its harmful consequences." (ibid.)

It is hard to believe that Hungarian economists are not familiar with the notion of a social market economy – a notion included in the European draft constitution, as well as in the Polish and Hungarian constitutions (in the latter, in the first sentence of the preamble). Exactly why was it unrealistic? As we know from the works of *Wilhelm Röpke* and *Eucken* and from *Adenauer's* chancellorship, the term "social" does not denote the same concept as in "social worker". Quite the contrary, it denotes a system based on the dynamism of small and medium pro-competition enterprises that counteract monopolies and expect prosperity from employment and not from a fatherly state and expensive public welfare systems.

This was easy to understand even at that time. The policy-making speech given by *József Antall* on 22 May 1990, made it evident that the country faced a serious situation, that economic change was necessary and that market economy would come. "It is of common knowledge that the rate of inflation is over 20% per year. It is also well-known that Hungary's debt is over 21 billion dollars – this means the highest amount per capita in Central and Eastern Europe. Feigned employment and hidden unemployment make up for a significant part of labour force. The infrastructure is underdeveloped, and this is one of the major hindrances to Hungary's opening towards the market. The condition of health care is catastrophic; our schools are worn and poor", said the prime minister elect. (Antall József Országgyűlési Beszédei ["József Antall's Speeches in the Parliament"], 1990–1993, Athenaeum Nyomda Rt., Budapest, 1994, p. 15)

The detailed programme of Antall's government ("The Programme of National Renewal") expressly clarifies the system the coalition was heading towards. The first paragraph of the programme is as follows: "A fundamental and comprehensive aim of the government's economic policy is to effectuate *an economic transition.* As such, the aim of the program is to create the foundations of a new, viable market economy system to replace the practically paralysed economy which has evolved in the past 40 years and basically relies on state guidance and isolation from external factors. The aim is to attain these objectives in conformity with Hungary's conditions while relying on the experience of successful Western European countries. This new system is a modern European *social market economy* that forms an integral part of the world market and is based on the primacy of private property." (A nemzeti megújulás programja, A köztársaság első három éve ["The Programme of National Renewal, The First Three Years of the Republic"] Miniszterelnöki Hivatal [Prime Minister's Office], Budapest, September 1990, p. 13 with italics in the original).

It would be quite different if the author had said that the majority of the society had been unwilling to face the situation, had cherished illusions concerning the transition, had not heard or had not really understood the essence of the new model. Most probably, this is true to a considerable degree. Yet the fact that politicians did not use the term "capitalism" is hardly an argument for their support to a third way. Even today, for various reasons, the term "capitalism" is rarely used in Hungary.

■ Having pointed out my opinion concerning a certain moment of the past, let me quote another one, a reference that keeps recurring throughout the volume. As Muraközy interprets it, the Bokros package was a rare "relatively lucid moment" of Hungary's economic history, which, he says, averted the crisis that was imminent in 1994/95 (pp. 39 and 81). *László Antal* also cites the 1995 package as a positive example, that is, as a radical adjustment that was regarded exemplary even by international institutions. The Bokros package, whenever referred to in the volume, appears as an unquestionably positive factor in Hungary's past otherwise characterised by mistakes and negligence.

I do not wish to analyse the 1995 adjustment within the framework of a review; also, in my opinion, the activity carried out by the government and coalition in question from the summer of 1994 (when it entered into power) to March 1995 is clearly set apart from the issue of the radical (Bokros–Surányi) package. Yet I must make two points. This event of Hungarian politics has been much debated by the economic and sociological professions, but those authors who make reference to it in the volume do not even mention or quote any authors who criticised it. Yet there is another aspect that is closely related to the topic of the volume: quite possibly, it was the consequence of the package that many citizens who until then had supported or at least accepted the democratic transition and respected its values turned away from the reforms and moved towards populism, which the volume condemns. In this respect, it is irrelevant whether the package was regarded as exemplary by international institutions or not.

It would have been useful giving an unbiased re-assessment of the tools of the package (surprise inflation, laying the blame on personal overconsumption, a presumptuous style, inadequate preparation and the resulting series of constitutionality-related mistakes); rather than just its impacts on the real economy, or at least examining the hypothesis that Hungary may have paid an excessive price in terms of system legitimation in exchange for the package's balancing effect. According to a poll by Medián, 1995 was a turning point in the process of the collapse of the positive perception of market economy values. I discussed the issue in Péter Ákos Bod: Államháztartási hiány és társadalmi deficit ["Budget Deficit and Social Deficit"] (In: Granasztói – Kodolányi (ed): Magyarország ma és holnap, ["Hungary Today and Tomorrow"] Magyar Szemle Könyvek, 2007). To illustrate the fact that my doubts concerning the benefits of the package are shared by others, let me quote *Csaba Gombár's* opinion from another volume of essays and studies reviewed here: "Some say that the Bokros package was a positive reform measure. [...] in terms of politics, as a reform measure, it was clearly a failure. It was not accepted by the governing party – or, as it later turned out, by the government itself –, let alone the society. Yet a reform is a series of political acts: it is impossible to operate solely with the abstract rationality of professionals." (Merre tovább a magyarországi reformokkal? Pénzügykutató Zrt., 2007, p. 250).

Let me point out again: I do not expect others to share my opinions about the past. I only expect an analyst of the past to have at least a flicker of doubt: it may be possible that the Bokros package was not one of the very rare lucid moments but yet another application of a campaign-like adjustment which, by that time, had been carried out several times, the difference being that the Bokros package was introduced among democratic circumstances. Surely, the majority of the analysts who published their works in the volume may remember similarly structured adjustment packages introduced in 1979 and 1986 (devaluation, the reduction of state expenses, putting a brake on wages, the increase of officially set prices and the artificial inflation of incomes). As far as I am concerned, the representatives of the Hungarian mainstream may regard the 1995 adjustment as a break with the Kádár era; still, they should reflect on the reform packages introduced then and later (including those of the autumn of 2006), which, not unlike in the Kádár era, are applied by enlightened authorities under external pressure against a reluctant and uncomprehending population.

On the other hand, it is strange indeed that in Hungary the stages of economic policy related to political cycles follow each other with remarkable regularity. Previously, the years of party congresses had brought loosening and an improvement of the public mood which then had quickly been followed by austerity adjustments. As László Antal puts it, reform stagnations and reform waves alternated with one another. Now the budget runs out of control in the year of general elections, then the new government, condemning the previous one, embarks upon mid-term adjustment; consequently, the budget deficit is at its lowest in mid-term, between two elections. After that, as general elections are approaching, the government starts spending either covertly or openly, and thus a new cycle of indebtedness is launched.

▫ The year of 1990 is a exception – it is good to know that such years do exist. In 1990, the Antall government closed the year with a balanced budget, what is more, with a small surplus. However, I was shocked to read the comment on this fact: "The year of the political transition was peculiar: as a result of the austerity measures forced by (among others) the

World Bank, the Németh government handed over public finances with practically no deficit. Formally speaking, democratic governments started their activity from a zero deficit." (Muraközy, p. 86.) This is simply not true. During the weeks before the first free general elections Hungary got very close to state bankruptcy, not the least because at the end of 1989 it turned out that there had been a misreporting (an internationally accepted term for data forgery related to the figures reported to the International Monetary Fund. The IMF (obviously not the World Bank!) terminated the valid loan contract and was willing to grant loans only under new, stricter conditions, that is, it made Hungary accept further liberalisation and a budget deficit not higher than ten billion forints. The outgoing government signed the contract on 14 May 1990; the first round of the general elections was held on 25 March. The caretaker government waited for the inauguration of the new government with the introduction of the approved package of energy price rises. The package raised the price of fuel and all other kinds of energy in the summer and – among the well-known tense events – in October of the same year.

The democratically elected new government did not inherit a balanced budget; instead, it faced the situation described above and the contract with the IMF. In addition, foreign-currency reserves had been drained away almost completely by that time: in 1989, during the misguided "Gorenje campaign" and within the framework of "measures taken to improve public mood", the Németh government allotted the remaining international reserves of the Central Bank to an increased tourist allowance. Taking into consideration these facts, it would be very strange to conclude that democracy in Hungary started with a zero deficit.

In the chapter on the heritage of the communist regime, Dóra Győrffy presents a plausible overview of the mental changes that occurred in the Hungarian (Central Eastern European) society. It shows that people had an unrealistic (i.e. overestimated) notion of the reform communist regime left behind, coupled with exaggerated expectations concerning the state. After 1990, this inevitably led to disillusionment which was contributed to by uncitizenlike attitudes toward the state: tax evasion, norm violation and playing tricks. As a consequence of dissatisfaction, political populism started to rise. The behavioural patterns of rule evasion, ingrained during the period of state socialism re-emerged. "If leaders are socialised into the idea that rules can be violated, then promises will not be restrained by budgetary limits. The leaders will play tricks to evade such limitations, and citizens will do so too when it comes to paying taxes." (p. 152.) This situation leads directly to a budget deficit, which, in turn, results in the slowdown of economic growth and a justifiable disillusionment with the system. It is to be concluded that as long as the communist traditions of paternalism and rule-evading behaviour linger on, budget deficit cannot be considered an exceptional event but a normal situation in the new democracy. The author argues that in the region this trend can be counterbalanced solely by external factors, as in the case of the Baltic states or Bulgaria.

Indeed, the fixed exchange rate and the exchange rate table used as an exchange mechanism demand a balanced state budget (or even a surplus). It is a matter of taste to decide to what extent this can be regarded as an external factor: when determining a system based on a strong exchange rate, the political elite of the countries in question consciously decided that the budget would not be allowed to have a deficit. As for Hungary, it is very informative that the majority of former planned economies have had no problems with the budget deficit rate, while others – especially Hungary – do have long-standing budget problems.

■ As for *Ádám Török's* retrospective analysis, it is worth highlighting our present knowledge on privatisation as opposed to the notion prevalent two decades ago. According to the notion widely accepted at that time (qualified as "naive" by Török), fast privatisation and the acceleration of property structure reforms provided the solution for the transition crisis. The "complex" notion, on the other hand, held that consumer protection and the tools of the privatisation of the capital market should be built up, and the norms of competition control and a proper framework of corporate governance should be established. In Hungary, governments were under strong pressure (among others, by external factors) to carry out privatisation as fast as possible; however, the drawbacks of efforts for speed and increased revenue are tangible now: e.g. cost disadvantages or competitive disadvantages resulting from inadequate demonopolisation. At this point, it is worth referring back to the norms of social market economy. If it had been possible indeed to assert the aspects of Sozialmartkwirtschaft which counterbalances the big state and big business, Hungary would have acceded to the European Union with a higher employment rate and a healthier company structure, and, consequently, it would have been able to make more out of the factors of growth stimulation which were prevalent before and after accession.

■ The volume contains an analysis by Lajos Bokros on the origins of the distortion of the state structure. As opposed to several recent views, Bokros has a well-grounded opinion of the actual performance (or rather the lack of performance) of the reformed version of planned economy (also called "goulash communism"). Most probably, it was the Yugoslav communist system that came closest to a market economy: in their case, the lack of performance became manifest in the inflation rate. The Polish and Hungarian versions did not permit either a chronic deficit (of a degree similar to that of Romania) or a relatively long-lasting high inflation curve. Consequently, in these countries the lack of performance emerged in the form of dramatic external indebtedness. "Deficit and inflation are clearly visible and can be experienced every day to an extremely high degree. Deficit and inflation mean instant compensation for loss: it is the consumers who suffer the negative consequences of the inefficiency and lack of productivity of the system. The degree of external indebtedness, on the other hand, is an uninteresting piece of macroeconomic data, not easy to classify. [...] This is a type of loss compensation, yet it is carried out primarily at the expense of future generations" (p. 238). As far as the debt is concerned, the state and the society cheat on each other in order to maintain a momentary and relative prosperity. As Bokros concludes: "Basically, the severe distortion of the Hungarian state and society of the intermediate post-transition period – the effects of the distortion are tangible even today – is rooted in this fact." (ibid.)

■ László Csaba's study is an interesting discussion of the fact that long-term path dependence explains more about the present-day divergent development of former communist states than the established political order and the ideological scale of values applied by their government. It is also apparent that poverty, emerging in the course of the transition, has two major aspects: labour market and education. As for the former, it can be improved by deregulation and fast growth; however, growth cannot remedy the tensions resulting from a lack of adequate education. In my interpretation, path dependence exercises its influence through a lasting existence of underlying factors related to culture and social structure. Yet nations do have choices when it comes to successful or unsuccessful political periods and taking advantage of (or missing) opportunities.

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A whole series of conferences have dealt with the issue of the convergence programme –

timed to be introduced after the 2006 general elections – and related measures. I have already cited *Merre tovább a magyarországi reformokkal?* published by Pénzügykutató Zrt. The series of debates organised by the research institute discussed pension reforms, health care reforms, regional development and local government reforms, as well as reforms in education. Another interesting conference was organised to discuss the constitutional order of the republic. The fundamental issue of the future of the taxation system was also dealt with. As several speakers and numerous participants voiced their opinions during the conferences, the message of the publication is more difficult to sum up than that of a volume of studies and essays. Certain subject matters have become outdated; for example, there is a considerable gap between the health care reform plans of October 2006 and today's situation.

Quite probably, the most interesting topic is the pension scheme. Obviously, actual reforms are needed while there are content-related and substantive debates still going on over fundamental issues. Should everyone be given a basic pension as a civil right so as to avoid a situation where hundreds of thousands go without social insurance and, as a result, risk old-age extreme poverty (Mária Augusztinovics), cf. 21% percent of those not yet pensioned have not acquired the right to even a single day's pension? Or, on the contrary, the fundamental objective of the pension scheme (i.e. providing an extra income for the elderly) should remain based on insurance, since the basic pension, to be financed from general tax revenues, would cost a lot and it would motivate existing and would-be fare dodgers to avoid paying their contribution? (Lajos Bokros)

Quite naturally, the issue of *fare dodging emerges* in the field of health care and other social service systems, as well. Those participating in the debate come up with well-grounded and adequate arguments when discussing policy issues, yet it is impossible to react to their arguments in this review. Still, let me point out a common aspect: the responsibility of the central power, that is, the state. I do not believe that the phenomenon of fare dodging in Hungary (being highly more common than the Western European average) is rooted in general national characteristics. Even path dependence does not offer a totally plausible explanation, as e.g. Slovakian, Estonian and Slovene taxation data show a higher willingness to pay taxes although all these countries also used to belong to the Soviet sphere of influence. Taxes and health care contributions are imposed and collected (if collected), just as tickets are inspected (or not inspected) in public transport – and if there is no inspection, fare dodging becomes an everyday practice. For some time now, there are inspectors working in the public transport of Budapest; since then the frequency of fare dodging has decreased. Instead of laying the blame on the fare dodgers of the major social systems, it is high time to examine the responsibility of those working in the field of social insurance and pension schemes who receive(d) their salaries for, among others, making sure that only deviants evade paying. In my opinion, instead of chiding the public, it would be more useful to ask: why was it that the state – the power of the state – was insufficient for carrying out its task related to essential social and economic issues with adequate efficiency?

I do not say that Hungarian society is all right as it is. The *Versenyképességi Évkönyv (Competitiveness Yearbook)*, published by GKI Gazdaságkutató Zrt offers a comprehensive report on Hungary's position. The recent years' changes in Hungary's indicators which are more tightly or remotely related to business competitiveness, reflect the well-known trend of the country's relative loss of pace; the set of data, however, adds but little to our knowledge, as rarely do abrupt slumps and jumps occur in the structure of industry and in the in- and outflow of capital. The comparison with other countries, on the other hand, contributes to our estimation of Hungary's position with interesting aspects. The data do not verify certain wide-spread superficial opinions of Hungary's position; rather, they support the opinions of those researchers and analysts who, having recognized the fragmented nature of Hungarian society, warn against uniform solutions. For instance, the wide-spread opinion that Hungarian people do not work much is not true. Albeit less people are employed in Hungary than in other countries, those employed work very much (pp. 145–147). Furthermore, factual data and data obtained through business questionnaire surveys contradict the opinion that Hungary spends much on education, especially in terms of subjects and knowledge that are irrelevant from an economic point of view. The rate of public expenditure related to education, if compared to that of other countries (e.g. the Czech Republic, Estonia and Slovenia) is quite moderate; surveys show that Hungary's educational system falls into line with business demands to a higher degree than the European average (pp. 152–157). It is a well-known fact that the Hungarian economy is characterised by a dual structure; nevertheless, the issue of proportions is also essential. If compared to American labour productivity, Hungary is approximately at the level of 50%, yet the functional productivity of big companies in Hungary reaches the German, Austrian and French level, while the efficiency of the SME sector is at or below the Romanian or Bulgarian level (p. 48).

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In a publication entitled *Cikkek a cakkokról – Múltelemzés és jövőkép* [“A Zig-Zag Article – An Analysis of the Past and a Vision of the Future”], edited by *Gábor Karsai* and *András Vértes,* GKI Gazdaságkutató Zrt. published detailed sectoral analyses. The slim volume discusses issues related to the service sector, the real estate market, agriculture, information, communication, issues of the energy sector, and deals with employment and education policy, as well as issues related to settlements. For lack of space, the present review does not offer an overview of such sectoral analyses. Among the articles on issues of general economic policy *Miklós Losoncz's* writing (Csatlakozási [v]álság; [“The Crisis/Disingenuousness of the Accession]”) is noteworthy. In spite of the elaborate title, the article gives a factual and optimistic (in certain cases with an exaggerated official optimism) analysis of the post-accession period: Hungary's membership accelerates growth, enhances competition – which, in turn, curbs inflation –, it has released the country from the consequences of the balance of payments barrier, and accession is expected to bring around the strengthening of the middle class and the improvement of the cohesion between various social groups. Yet today, in a situation so close to stagflation, the analysis (written a year ago) either seems far too optimistic or leads to the conclusion that the economic policy in question was even less adequate than it is currently believed because regardless of the highly favourable circumstances and conditions it brought about the present situation. The essay by *László Akar* and *Tamás Kopik* (Göröngyös úton az euró felé; [“The Rugged Path to the Euro”]) offers a more critical survey of the performance of economic policy; András Vértes's closing essay (A magyar gazdaság versenyképessége [“The Competitiveness of Hungary's Economy”]), despite the author's well-known optimism, presents a balanced picture.

What is the conclusion to be deduced from the work of the workshops analysed, the research material and conference studies cited above? Since the 1960s, the weaknesses of the demographic structure and of the structure of employment offering lawful and sufficient income, made an unduly great majority of the population depend on public redistribution; the era of reformed communism failed to bring about a definitive improvement in efficiency, and the subsequent spread of quasi market norms resulted but in illusory advantages. The real economy saw profound and radical changes at the beginning of the transition and, consequently, Hungary became capable of receiving foreign investment (as well as technology and management practices) faster than its fellow countries; yet to continue development and, in particular, to take advantage of the growth impulses resulting from EU accession, Hungary would have needed a successful accomplishment of a new period of modernisation and structural change.

Obviously, personal opinions at this point start to differ as the various trends of thinking among Hungarian intellectuals interpret the events of recent years in highly diverse ways: those of the different stances attribute various degrees of responsibility to political actors who made or influenced decisions. Yet the final outcome, as the Economist puts it (27 March 2008), is a *Magyar mess.* The Economist also touches upon the consequences: the neighbouring countries will soon outrival Hungary, provided that they have not done so already. The fact that with proper efforts other countries can carry out the tasks which have proven too difficult for Hungary (the reforms of the taxation and social welfare system, meeting the criteria of accession to the euro zone) have started to engage the attention of even those who tend to give an over-simplified explanation of (and, at the same time, an absolution for) Hungary's problems.

Adjustment fatigue may be a plausible explanation for the loss of pace of Hungary's early and initially fast transformation. Yet, having taken into consideration the problems comprehensively documented, I must draw the conclusion that the problems were caused not by far too many reforms and changes, or an excessive adjustment compulsion – quite the contrary, they have been about by the insufficient magnitude of reforms. In public life, those people who had already practised their profession in the former system frequently emerged as new faces. Far too often did they try to employ the same government tactics on the society. In addition, the society, in terms of its internal relations, preserved far too much from a system which, whether reformed or not, had proven to be historically non-competitive.

Thus, tasks to be done have accumulated and there are few fields where it can be said that at least professionals know what to do next.

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