With the intention of clarifying opinions and developing points of view, this column will occasionally provide a forum for comments and reply by the authors in connection with various articles.

István Csillag –Péter Mihályi

We still have a lot to learn…

In his review appearing in the fourth issue of the Public Finance Quarterly in 2006, György Szakolczai – remaining committed to his values – gave a comprehensive and meritoriously unbiased presentation of our book titled 'Double Bind' which was published in the spring. It is unusual in this country that someone pays so much attention to a scholarly paper which contains economic policy proposals, in the first place, but which is written in the style of a pamphlet. It is even more noteworthy that the editorial committee of a professional journal provides a forum to a debate unfolding in connection with a book review. Our book has tried to break the "ear-splitting silence" characterised by hesitancy to present the troubles caused by making people happy with taxpayers' money as well as the methods to eliminate them between 2000 and 2005. There is also an acute need for an exchange of views because – as György Szakolczai[1] highlights it is another paper – "men of letters" like us have a part to play in the matter of alleviating troubles.

Before coming to the questions in which – based on our belief – we are in disagreement with the reviewer's opinion, we hereby grasp the opportunity to express our heartfelt thanks to him for the positive tone and synergic thinking which are apparent even in the critical remarks and set an example by rising above the local culture of acrimonious debate. This is what the title of our paper refers to.

In a nutshell, the difference between the key conclusions of our book and the reviewer's opinion can be summarised in three points.

- We believe that if small countries with an open economy want to catch up with the more advanced ones they have little choice but motivate and apply pressure on the individuals to make saving. They must promptly develop and operate systems that more advanced countries will perhaps only have to introduce in the future. In the case of the latter it will have to be done gradually and for demographic reasons "only". In Hungary, in addition to demographic reasons, the new system is also justified because of the need to change the concept inherited from socialism that "we live for today and are leaving the debts to our grandchildren". This savings task can in no country be assumed by the state instead of the individuals, especially in a country like Hungary which does require capital injection for its business investments and infrastructure developments in order to catch up. It was in this sense that we have cited the famous sentence from Ronald Reagan's inaugural address: "the government is not the solution to our problem". Nothing can illustrate this better than the relationship

between the redistribution rate of public finance, the economic growth rate and public finance deficit. The rate of redistribution is lower in all post-communist, transition countries, i.e. the size of the state is smaller, than in Hungary. This is one of the reasons why we have dropped to the bottom of the league in the competition for economic growth.

■ The second source of our disagreement lies in the interpretation of globalisation and the analysis of the change in the state's role in from that respect. Although György Szakolczai does not explicitly mention this question in this form, but refers to it in connection with the so-called reform dictatorship (to which we will come back later), when he writes "…the solution applied in the individual countries is path dependent: it depends on the historical background and the ensuing public opinion," (page 492). Indeed, continuity cannot be ignored when a government is compelled to make economic policy changes which are principally aimed at breaking "bad continuity". (For example: we are leaving our debts to our grandchildren.) In other words, we are of the opinion that path dependency is a barrier rather than a goal or a value. The same applies to public opinion and to the so-called traditions.[2] Today, countries of the world, particularly small ones, are characterised by a strange paradox. While the political forces in power want to consolidate their position primarily in the rivalry for domestic voters, this can only be achieved if they are successful in the competition for a privileged minority: the domestic and foreign investors. Namely, governments and parties competing for power in a parliamentary democracy have to "play" to their electors as well as to those who "vote with their feet", i.e. investors. Twenty-year old brokers – whether Hungarian or Singaporean – of investment banks managing the money of large pension funds are hardly interested in a country's specific historical path and the "path dependency" of the solution applied or failed to be applied until then. By pushing a single button, they can withdraw the savings managed by them. And with that they can start a financial, then a political avalanche. This is painful as well as beneficial. Since it is the very requirements of our globalised age that make a country's populists work for the revival of their fatherland and for the benefit of their people rather than wasting voters' income on buttering their own bread and on cementing their own power.

■ The third important divergence of opinion between us and our thorough reviewer, György Szakolczai, is our approach to the government's responsibility for initiating changes and for the depth and radicalism of these changes. He understands and even approves the cautiousness of politicians, the slow progress and the time sacrifice made for the sake of building a consensus. On the other hand, we do not think that the political forces in power delay the necessary economic policy interventions and reforms which encourage and force out a change of attitude for the sake of achieving social consensus and convincing citizens. We are referring to " cautious progressives" as the Hungarian anecdotal figure, Mr Pál Pató, whose slogan was "all in good time". In our view, politicians often strive to avoid addressing the necessary changes during their own period in office. This is not a Hungarian peculiarity, the same has happened in Germany and Great Britain, Luxembourg and Italy, as well. It is not a mere coincidence that we concluded the Foreword of our book with the words of Jean-Claude Juncker, Prime Minister of Luxembourg and President of the Eurogroup Council of Finance Ministers: "We all know what needs to be done, but we do not know how to be re-elected after we have done it." We might as well stop discussing the matter in dispute between us here, but in actual fact this is where the real debate begins.

WHOSE TIME IS IT?

With his theoretical knowledge and wide practical experience, György Szakolczai warns us to what has already been pointed out to us by *János Kornai*[3] i.e. the reforms we are pushing are of two kinds. There are some according to which the broken equilibrium of public finance needs to be restored by one-time measures, by the decisions of the government and government majority (tax increase, freezing, the parametric reduction of expenditures) and others require a stable change in the attitude of the public. There is a need for at least the silent support of the public even for corrective measures, but persuasion and conviction, i.e. wide social support, are indispensable for reforms aimed at changing the attitude. We do not mean to reject the justification of this distinction and the necessity of social support which constitute the basis for the distinction. What we wanted to emphasise in our book, by outlining the reform scenario and the measures that can be squeezed into eighteen months, was the importance to – at last – make it clear to voters, to the public and to various groups of the society how the different steps are interrelated. To make it clear why it is worthwhile and necessary to coordinate and build measures on one another and to launch others simultaneously, thus helping to replace bad conditioning (path dependency) by the favourable effects of the new systems. We thought that the period of eighteen months would also be sufficient to see the outcome of the reforms. We believe, however, that with prudent preparation and clear policy, the era of substantial reforms will be concluded with the adoption of the 2008 budget (i.e. in December 2007) right in the eighteenth month from the establishment of the government so as to give place to fine-tuning and to the preparation for the next general elections.

In April 2006, when our book was published, we "only reckoned with a general government deficit of 8 per cent (including the impact of the pension reform) and we did not think that the debt stocks would exceed 70 per cent. It is obvious from our book that we did not and do not intend to get involved in a "number war" or to waste our time on accurately assessing the extent of the deficit and debt. We considered it more important that the government should without delay embark on curtailing deficit and curbing the growth of debts. We presumed that because of the time required for implementation, preparation and persuasion, the tasks should be divided into three groups. Immediate steps followed by medium-term adjusting measures can put a halt to deficit growth, but in order to move towards a healthy balance there is a need to change the attitudes, formerly looked upon as usual and normal, in almost all levels of public finance. In addition to adjustments and restrictions, reforms are also needed. The above tasks classified into three groups can and must be developed and launched within the timeframe of eighteen months because it is partly a learning process. It may take less and less time for developing consecutive proposals building on the effect of the previous ones into actual measures and laws. The individual measures make it increasingly clear how to achieve long-term equilibrium and sustained and sufficiently robust economic growth and how to identify with the reforms.

That is about the length of time the population can accept and cope with the implementation of reforms, adjust themselves to the reforms introduced and put up with their teething troubles. Our conclusions mentioned above are founded on Hungarian reform experience, and we also regard continuity in the reforms as a given or acceptable basis. Our starting point is that a government that is putting off or even failing to announce reforms is stealing our time. The issue at stake is that the price to pay for our relative prosperity will be the huge debt we will be leaving to our children

and grandchildren and the longer and longer time needed for catching up with the developed countries. We are also stealing the time spent on catching up from our children and grandchildren with the drop-by-drop portioning out of the necessary measures.

If we make an inventory we cannot be satisfied with how speedily and deeply our measures are implemented. It is not visible yet whether we have been able to make solid bases for the restoration of public finance balance. We can hardly say that the higher saving incentives have become the fundament for financing pension, health-care and education. Without them, however, there is no hope of mitigating the increased government redistribution of incomes which provides scope for generating funds for investments required for convergence.

In *Table 1* we have compared our original proposals with their implementation. There are two main problems: there is an ongoing stabilisatory operation with the direction varying. The government has muddied the water around measures which are easy to comprehend by all (for instance, enforcing the price of imported gas cannot be a reform), while deliberately playing down important measures, such as the radical holding back of early retirement. With the governing parties trying to continue to free the majority of the voter base (such as pensioners) from the effect of the imperative change, the steps of the indispensable reform in public burden sharing as well as their impacts on the sense of justice are lost. The otherwise sensible steps (for example, the visit fee) seem chaotic and unpredictable even in the eyes of pro-reform public opinion.

The time elapsed since the publication of the book has proved that our train of thoughts was partly founded on a mistaken assumption. We presumed that the patience of markets was limited and would very soon be running out. Although the first measures of the government were taken only more than two months after the second round of the general elections (April 23 2006), nevertheless, the Hungarian forint did not collapse. The risk-taking strategy of the former Prime Minister who had been re-elected has worked. Markets were apparently more tolerant than expected on the basis of theoretical considerations. Markets are patient because they can see what direction the government is heading. They are not really bothered with the pace of progress since with the interest rate kept high they are guaranteed an easy profit-making opportunity.

This, however, does not make us conclude that our proposals formulated in April and, most of all, the set time-frame of eighteen months would all be wrong. We still believe that the implementation of the stabilisation programme and the reforms cannot be drawn out long at will. Sooner or later the thread will break. If not the patience of money markets then the supporting votes for government MPs will be eroded. If they do persist, then the stabilisation efforts and the reforms will be brought to an early end by the fatigued public opinion and the worsening general political sentiment. If something is left unfinished, it has to be started over and over again. This will lead either to political erosion (weimarisation) or economic depression (see Yugoslavia). Yet people want a peaceful and predictable life and progress rather than an unending reform and political puppetry.

THE APPLE OF OUR EYES: TAXPAYERS' MONEY?

The purpose of a large part of the proposals outlined in our book is that the financial resources required for public services are ensured by the state using taxpayers' money with the possible smallest proportion of income centralisation. A significantly lower

Table 1

OUR PROPOSALS AND THEIR IMPLEMENTATION

Proposals	Implementation	What happened?
	Immediate proposals	
Confirming the date of 2010 for euro adoption	No	The target date is not considered a priority by government.
Adjusting the 2006 Budget (central budget + social security funds)	Yes	
Establishment of the Budgetary Council	No	The Convergence Council had operated for a few months.
	Medium and long-term proposals	
Switch to sector-neutral TAXATION	No	
LOCAL GOVERNMENT reform (increasing the role of micro-regions)	The government has attempted to do it	There is no two-third majority without the opposition.
Abolishment of local enterprise tax	No	The EU-prohibition is not unambiguous.
Introduction of property tax	No	Postponed until 2009?
PPP-financing reform	Yes	No debate of principle, but it has been carried out.
SOCIAL SECURITY reform		
Grossing up wages and salaries and pensions	No	Not considered a priority by government.
HEALTH-CARE		
Individual account management	Yes	The National Health Insurance Fund (OEP in Hungarian) is leading the process.
Health ticket	No	The precondition would have been: adjusting the 13th month pension.
Settlement of disability benefits	Yes	The Heath Fund has been exempted from the burdens.
Guaranteeing the predictability of OEP-budget	No	Not taken on the agenda.
Stricter social security card system	Yes	OEP is leading the process.
Clearer definition of the service package	Yes	
Receiving invoices of private practitioners by OEP	No	Not taken on the agenda.
Legislation needed for launching the system of multiple health insurers in 2006	Started but with delay	Parliament has decided on establishing supervisions.
Re-regulation of pharmaceutical subsidies and distribution	Yes	The law has been adopted by Parliament.
Qualitative ranking of health service provider institutions	No	Not taken on the agenda.
Auditing hospitals	Yes	The law has been adopted by Parliament.
Roma health programme	No	Not taken on the agenda.
PENSION		
Individual account management	Yes	1st pillar reform has been postponed.
Raising retirement age limit	Yes, but not in the sufficient extent	
Stricter regulation of early retirement	Yes, but not in the sufficient extent	
Imputation of all service time	Yes	In the wake of early retirement reform.
Addressing the problem of disability	No	Only budget-technical regrouping has taken place.
Conclusion of PRIVATISATION	No	Not taken on the agenda.
Reform of EDUCATION FINANCING	Partly	Decision on the matter of university tuition fee, but not on the reinforcement of education.

redistribution and income centralisation decreasing in comparison to what we have today would result in a different relationship between the use of taxpayers' money and political decisions taken on them. The reduction in the extent of redistribution may have two consequences. On the one hand, we can consider the quality of services and, at last, accessibility by all a value, on the other, we find it natural that contribution to the financial resources required for services needs to be proportionate to our capacity of burden sharing. Tax consciousness, the principled stance based on values and the transparency of public finance may enhance. We are still far from that today.

At present, the population is not in the least concerned with the transparency of public finance. This is a big enough trouble not only because the government deceived itself with budgetary tricks that reduced the very transparency (for instance, by including the sums already paid for motorway construction under expenditures spent in Public Private Partnership), when it demonstrated a deficit lower than the actual figure. Moreover, such tricks, – especially if found out – are also extremely detrimental to the international assessment of Hungary's state of public finance. “It hurts credibility”. It tells a lot about our position that Hungary is not part of the survey conducted by the international research project, called Open Budget Initiative, which examines the budget of 59 countries from the perspective of transparency. In the 2006 survey, France was the top performer, but Slovenia, Poland and the Czech Republic were also placed high. Further ten post-socialists countries are bringing up the rear, including – for example – Russia and Vietnam. In brief, it is a shame that Hungary does not take part in such an important and prestigious research, which was last time also published in the London Economist (28 October 2006).

The author of the review questioned the economical foundation of the Maastricht criteria and their applicability to emerging countries like Hungary. He does not stand alone with his opinion; several other prominent economists share his view. We are not in disagreement that the criteria formulated more than a decade ago in the treaty are arbitrary rather than scientifically proven. Moreover, there is no proven and scientific consistency in their interrelation. It is especially difficult to apply the inflation criterion in transition countries which want to create

Table 2

GDP GROWTH AND THE PERCENTAGE OF BUDGET DEFICIT IN SOME COUNTRIES

	GDP-growth				Budget deficit in the percentage of GDP				Budgetary expenditure in the percentage of GDP				Primary deficit proportionate to GDP			
	2000	2004	2005	2006	2000	2004	2005	2006	2000	2004	2005	2006	2000	2004	2005	2006
Bulgaria	5.4	5.6	5.5	6	–0.5	1.9	3.1	3.3	n.a.	38	38.7	37.3	3.6	3.7	4.8	4.7
Estonia	10.8	8.1	10.5	10.9	–0.2	2.3	2.3	2.5	36.5	34.2	33.2	32.3	–0.3	2.5	2.5	2.7
Hungary	5.2	4.9	4.2	4	–3	–5.3	–6.5	–10.1	46.5	48.8	49.9	51.7	2.6	–1.1	–2.6	–6.1
Latvia	6.9	8.6	10.2	11	–2.8	–0.9	0.1	–1	37.3	35.8	36	39.5	–1.8	–0.2	0.7	–0.4
Lithuania	4.1	7.3	7.6	7.8	–3.2	–1.5	–0.5	–1	39.1	33.3	33.6	34	–0.8	–0.5	0.3	–0.2
Romania	2.1	8.4	4.1	7.2	–4.6	–1.3	–0.4	–1.4	40.6	38.3	38.2	38.8	–0.7	0	0.5	–0.4
Serbia-Montenegro	5	7.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Eurostat

real convergence but are unable to deal with it due to the Balassa-Samuelson effect. It should also be noted, however, that apart from the application of the inflation criterion, the other criteria could be complied with both in the large EU Member States and the smaller accession countries. What is more, in countries where these criteria are satisfied the growth rate is also significantly higher than in Hungary *(See Table 2)*.

No matter how we are beating about the bush, we must state that an undisciplined and untransparent budgetary policy jeopardises financial stability as well as fast economic growth. There is no difference in that respect between the financial risks of developed countries who invented the Maastricht criteria for themselves and those of emerging countries. This is the key message of global markets. To date, many have believed, said and taught that every government could do whatever it pleased with the citizens' money within the national borders. This "same old story" has melt into thin air in the era of global money markets. Good money drives out bad and governments not respecting their taxpayers' money will drift into financial crisis whatever justification they give for spending. The financial policy of disciplined governments that show responsibility towards taxpayers might be "unsophisticated" and often unscientific, but the only one that is internationally acknowledged. And only discipline is appreciated under the rules of the international club.

In the Forward to the English-language publication of our book[4], Josef C. Brada, renowned researcher of economic systems and expert on Eastern-Europe, writes: "If countries had personalities, then Hungary would be like a spendthrift relative, albeit one who, by virtue of an economics degree from a good university and a stint working on Wall Street, should be able to manage his or her finances with no difficulty." In our view, observers sympathetic to Hungary are pretty much aware that the government's squandering on the pretext of solidarity with the poor and the maintenance of the wasteful welfare systems basically originate from the gentry features of the political class which is too understanding towards itself. The gentry, the main character in many of the Hungarian writer Kálmán Mikszáth's novels, commits one bill forgery after another and makes one marriage proposal after another in the hope of a huge dowry instead of relying on his own intelligence, talent and abilities and accepting responsibility for himself and his family. It might be that the calculations, only attached as an appendix to the message of our book, imply radical reforms and debt mitigation which may look inconceivable and unrealisable. But if once general government had an accounting capable of monitoring current changes as well as changes in assets, then it would become obvious that the financial assets lost and wasted are at least as large as the extent of debt mitigation we propose to be implemented by backing it up with the graphical calculations. If we could get through this debt mitigation, it would be unnecessary to blindfold creditors, investors and, first of all, ourselves by accounting tricks year in year out. The government ultimately deceived itself by hiding in a "forgiving way" the immense work ahead of it when opting for the motorway construction in the PPP scheme and for recording the extra deficit due to the pension reform as extra savings.

When proposing – in a number of areas – new solutions and reforms which prompt and encourage saving and responsibility and help diminish the humongous debt, we did not mean to meet the demands of foreign investors and analysts. In writing our book, we were driven by the same passion as János Kornai who had formulated a proposal back in 1989 that a stabilisatory operation should be carried and who was then criticised even by us because of his very proposal. Yet, he was right. Without

a plan prepared with a cool head and without its implementation, this country would still remind investors of the land of bill forgers rather than a place worth investing in. It is possible that the calculations presented in the appendix are wrong so we still have a lot to learn. But there is one thing we definitely do not want: fearing the eyes of our children and grandchildren because we have let this happen. With his constructive criticism, our reviewer, György Szakolczai, has furthered us in our efforts.

Notes

[1] György Szakolczai: The responsibility of the men of letters, *Népszabadság 26 July 2006.*

[2] We discussed this question in details in an article published a few years ago. See László Antal - István Csillag - Péter Mihályi: We are explaining the globalisation. *Népszabadság, 12 August 2000.*

[3] János Kornai: Balance, growth and reform, *Népszabadság 28 and 29 June 2006.*

[4] István Csillag - Péter Mihályi: "Last Chance" An Eighteen-Month Program for Stabilization and Reform in Hungary, *Eastern European Economics, Vol. 44,6 2006. November-December, Foreword*