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Let's carry on learning from each other

I wish to express my gratitude to *István Csillag* and *Péter Mihályi* for their quick reply to my review about their book as well as their positive tone. I also wish to thank that the *Public Finance Quarterly* wastes no time in publishing the authors' reply and my response to them. This quickness is rather rare, albeit very useful, in the Hungarian professional press, because it is essential to help the debate move forward quickly, particularly, in such a topical issue.

As an introductory note, I also wish to add that even in the review I totally agreed with the authors' first underlying principle that this country is managing its economy to the detriment of the generations to come and is consuming the future, and this is intolerable. At the same time, I considered the second basic principle unfounded or, in fact, a hasty judgement that the cause of our troubles is the excessive size of general government and the solution is to reduce redistribution and to radically cut back the welfare state. This fundamental agreement and this fundamental disagreement continue to exist, but the debate has contributed to clarify the points of agreement and disagreement. That is why it appears the most appropriate approach for me to provide an overview in this reply of the points in which we agree and in which we disagree. It would be hardly possible to aspire for more within this framework, but if the debate produces such an overview it will be a significant achievement.

◘ *The standpoint of the authors and the reviewer is practically identical in several questions.* Let us thus look at the points in which apparent is has been reached as a result of the discussion and the learning process.

❶ According to the authors' reply we "… have little choice but motivate and apply pressure on the individuals to make saving" (page 169). The reviewer does not agree with the pressure, he is nevertheless fully supportive of the motivating of the individuals. What is more, in his article published recently (Szakolczai, 2006), he argues that the well-known concept of twin deficit should be complemented to triple deficit, where the third triplet is the insufficient level of household savings. Although the authors do not deal with this, they probably share the view that the long-term current payment deficit is a serious and independent problem, so we are in complete agreement on that.

❷ According to the authors' reply, "when a government is compelled to make economic policy changes (they are) principally aimed at breaking "bad continuity" (page 170). The reviewer is of the same opinion and when emphasising path dependence, he means that although we must preserve our traditions, where possible, we must radically modify the elements of our attitude that are proven wrong – such as the concept of "leaving our debts to our grandchildren".

❸ According to the authors' reply, "...they [..] (have to be) successful in the competition for a privileged minority: the domestic and foreign investors" (id.). This is again absolutely true and perhaps only one further remark needs to be added that we must endeavour to harmonise the investors' objectives with our concepts for the country's future rather than trying to accept their conditions under any circumstances.

❹ The authors disapprove "cautious progressives", referring to them as "Mr Pál Pató", the Hungarian anecdotal figure, "whose slogan was "all in good time"" (page 170). Elsewhere they write that "a government that is putting off or even failing to announce reforms is stealing our time" (page 171) and "the implementation of the stabilisation programme and the reforms cannot be drawn out long at will" (page 172). Again, we are in full agreement. The reviewer has already pointed out in another article and is reiterating it here that it is not possible to cope for long with such a high budget and current payment balance deficit, and there is a need for immediate action.

❺ To the greatest delight of this reviewer, the authors state "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 necessity of (this)" (page 171). We cannot agree with this more and this leads to far-reaching conclusions relating to the strategy to be followed.

❻ Following that, the reply discusses in details how important "the transparency of public finance" (page 171) is and that "the government deceived itself with budgetary tricks that reduced the very transparency" (ibidem), and finally: "...it is a shame that Hungary does not take part in such an important and prestigious research", such as "the international research project, called Open Budget Initiative" (ibidem). The reviewer confesses that albeit he is a qualified economist and welcomes these statements, he is not able to make an appropriate overview of the budget on the basis of the disclosed materials.

❼ Closely related to the above is the claim that it is necessary that "general government had an accounting system capable of monitoring current changes as well as changes in assets", because "it would (then) 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" (page 175). This statement is of utmost importance because the Hungarian governments – both the current and the former ones – which, in contrary to international recommendations, treat privatisation revenues as budget revenue and fail to present the resulting decrease in assets, are deceiving themselves and the nation.

❽ In respect of the Maastricht criteria, the reply ascertains that they "are arbitrary rather than scientifically proven", and the financial policy built on them is "often unscientific, but the only one that is internationally acknowledged" (page 175). This is the possible most correct perception. So long as these games of rule are applicable, we must stick to them. It also follows from this statement that we must support the efforts which try to create professional consensus by taking account of the specific position of the new EU member states, with special regard to that fact that these regulations had been formulated according to the position of the EU-15, and even to that of the EU-6, in the first place.

❾ Although not dealt with in the reply, the question of the Convergence Programme is closely linked to this, since it is focused on approximation to the Maastricht criteria. This reviewer finds it essential to make it absolutely clear that, despite his reservations about the Convergence Programme, we must stick to the appropriations set out in it as long as experience and the calculations prove that it is necessary to modify them. At present, there are no such experience and calculations, and we hope that there will not be. I trust that the authors agree with my reasoning.

⑩ Finally, *János Kornai* is quoted in the last paragraph, according to whom "without a plan prepared with a cool head and without its implementation" (page 176) our problems cannot be resolved. Again, we cannot agree with it more, however, our opinions are likely to begin to diverge here because the reviewer, who has always praised the authors for putting forward a comprehensive and complex concept, has presumably higher expectations vis-a-vis a "plan prepared with a cool head" than the authors.

In spite of our agreement in a number of questions, *our differences continue to exist or, in fact, they are rather strong.* The major differences are outlined below.

■ The first is the *timeframe of eighteen months and its justification.* The question is what justifies such a hasty action. For there is no doubt about the need to act promptly, but the reviewer can by no means agree with the timeframe of eighteen months. This view can be backed up with the following arguments.

❶ The eighteen months are not justified by international economic considerations. The authors write: "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." (page 172). It may be added that international and trans-national agencies are patient. It can be well illustrated by the fact that in some cases debt stocks amounting to 100 per cent of GDP have been accepted by them if they saw a firm commitment and real chance for their reduction. Consequently, the eighteen months are not justified by international considerations.

❷ The eighteen months are – solely or primarily – justified by internal policy considerations. The authors write the following about this: "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.*" (page 171, author's italics, Gy. Sz.) Thus, the authors' concept is that reforms should be pushed through within eighteen months in the hope that – seeing the justification and success of the reforms – the public opinion and the country will re-elect the government at the coming vote. In the reviewer's opinion, the subordination of economic policy to internal policy and election considerations in such an extent is inadmissible.

❸ We have already experienced the subordination of economic policy to internal policy and election considerations; this has given rise to the current crisis and that is why it is imperative to break with this practice. *Békesi* (2006) made the following remarks about this: "It was absolutely clear from professional point of view that what the government had done was utterly mistaken. An economic policy built on long-term over-distribution leads to financial bankruptcy in Hungary. Nevertheless, the majority of the experts did not want the ruin the chances of Gyurcsány and the Hungarian Socialist Party (MSZP) by urging immediate action, no matter how sensible it would have been." The same was even more expressly stated by *Eszter Rádai* who conducted the Békesi interview. *Kornai* (2006) put it more carefully saying: "the inescapable question (is) [..] what was more important from the perspective of *the country's interest* (italics in the orginal, Gy. Sz.). Should the incumbent government stay at helm, and not hand over power to an opposition that is advocating irresponsible policies – so that the economy could recover as fast as possible, and the country's citizens could receive more extensive and more honest information about the difficulties. Could a more fortunate compromise be found among the three – then conflicting – objectives, between achieving political victory, overhauling the economy and observing the requirements of honest communication?" The quoted passages unquestionably prove that the present state of play is the consequence of the prioritised internal policy and election considerations. The reviewer wishes to point out here that, on the one hand, there was undoubtedly a rivalry between the populist campaigns before the elections, with both parties advocating "irresponsible policies". On the other hand, this author holds the view that – despite the obvious pressure for prompt and firm action – *"the country's interest"* enjoys a priority and the country must not be forced into the strait-jacket of eighteen months under pretext of free elections.

❹ It does not appear to be feasible to implement the reforms in eighteen months. This is shown by the several-page long table presented in the reply. A number of proposals have not even been put on the agenda, other proposals are postponed or can only partly be executed or cannot be executed at all.

❺ The calculations disclosed in the Appendix of the book and the baselessness of their results reinforce that the reforms do not appear to be feasible within eighteen months. In reply to the comments made in the review of the book, the authors write: "...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". (page 175) If – based on the numerical results – the reforms are of an "inconceivable and unrealisable" magnitude, then they are very likely to be so in practice too.

❻ Even if the reforms could be implemented during eighteen months, no substantive acceleration of economic growth can be expected from it. International experience and the teachings of modern economic science relying on such experience clearly point out that stabilisation, even if successful, is not necessarily followed by growth. It does not require special economic knowledge or reasoning to realise that. Why would there be a radical or marked economic growth as a result of excluding the neediest 15 per cent of the society from health care services and introducing the system of multiple health insurers?

❼ In the case of pressing the eighteen months, the reforms will not even lead to stabilisation and to improving our international economic assessment. The key component of stability is political stability. Again, no special economic knowledge is needed to see that the social and political differences, which have been further intensified mainly by the insistence on the eighteen months, damage our international assessment in a greater extent than the extent of improvement that could be accomplished by a one or two-point decrease in budget deficit.

❽ Pressing the eighteen months may result in weimarisation and political disaster. It is with good reason that the reply refers to the danger of "political erosion (weimarisation) or economic depression (see Yugoslavia)" and the writers also put down with good reason that "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." (page 172) The authors believe that these arguments support the insistence on the eighteen months, while in the reviewer's view, they justify abandoning the set timeframe. It is already visible where pressing the eighteen months will lead. On the other hand, there is nothing to back up that the prudent and consistent implementation of the reforms with the support of the public opinion and civil organisations would have such consequences.

❾ Pressing the eighteen months results in an identity crisis in politics. This identity crisis can best be illustrated by what has been written in an article by *Gáspár Miklós Tamás* (2007) about "the Hungarian liberals' new-born enthusiasm towards police boots" and about "the socialist party which has no concern for unemployment benefit, is hostile towards trade unions and supports the abolishment of health insurance due by subjective right". The reviewer does not claim that the identity crisis is completely the consequence of the eighteen months, but it can hardly be questioned that the eighteen months have a considerable part in deepening the identity crisis.

❿ Finally, this conception and programme is counter-productive in political sense. Several socialist politicians are beginning to realise that pressing the eighteen months is likely to lead to an unprecedented failure rather than success of the election which will take place after the eighteen-month programme. This reinforces what has been outlined above. The reform cannot be carried through during eighteen months and after the eighteen-month programme the country's economic position cannot be expected to improve at such a pace that would bring about the election victory.

■ The second major difference is related to the question of *whether the actual objective, the enormous cutback of the welfare state, is justified and viable.* In the reviewer's opinion, it is not justified or viable. The two arguments supporting the authors' views in the reply cannot be substantiated, and numerous other arguments can be brought forward against the justification and viability.

❶ The authors' first argument, i.e. our lag is caused by the relatively large-scale redistribution, is not proven. With reference to that the reply explains that "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". (page 170) Three comments will suffice here. First, the rate of redistribution tends to be higher in Hungary because the provision of pensioners is comparatively better, the reproduction ratio began to decline at an earlier point in time and the percentage of the ageing population is higher. Second, it is generally known that in the Soviet Union and thus in the former Soviet Republics pension was not enough to keep the wolf from the door and provision for the elderly was the responsibility of the family. Consequently, if there is smaller pension and faster growth in the Baltic States, it does not necessarily mean that the reason behind faster growth is the smaller pension. Third, it seems as if the figures presented in the reply (page 174) were buttressing up the reviewer's arguments and not so much the authors'. The faster growth in the three Baltic States as well as Bulgaria and Romania, namely in the most underdeveloped states of the EU, may spring from an usually faster growth in the first phase of convergence rather than a lower level of social welfare..

❷ The authors' second argument is not proven, according to which "a significantly lower redistribution and an 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 […] (the) consequence that […] tax consciousness, the principled stance based on values and the transparency of public finance may enhance.". (page 174) This argument seems to suggest that the lower the tax the more we are interes-ted in its proper use. In the reviewer's view, just the opposite is true. The authors are also right in stating that society must be made aware that it is not a gift they get but they are paying the bill. But if we manage to make them aware of that, then the higher the bill the more carefully it will be checked.

❸ The authors do not specifically refer to tax competition but it is as a matter of course contained in their reasoning. This is a serious argument, however, the counter-argument is just as serious that extreme tax competition will not only result in the collapse of the welfare state and social services but also in the collapse of the state as well as public and legal security, and thus the whole economy, society and culture. The way out is therefore extending the legal harmonisation to the restriction of tax competition, which has already begun: see the discussion commenced on this issue in the EU and the case of Lex Audi. So the way out is not the unconditional submission to unsustainable objectives.

❹ There are numerous arguments in favour of maintaining the welfare state but it is not possible to tackle them in details within this paper. We can only make allusions to the following facts.

◗ The size of the welfare state depends on historical traditions. The size of the welfare state is smaller in colonial states, whereas it is larger in traditional societies, and this difference does not affect efficiency.

◗ Radical decreasing in the magnitude of the welfare state has never been successful anywhere; its further growth could be curtailed at most. The radical decrease in the results already achieved gives rise to such a public resistance that makes this plan unfeasible.

◗ Experience shows that many countries do extremely well, such as the Scandinavian countries, where there are extensive welfare services and large-scale redistribution. Naturally, the system needs to be adjusted to the changes, thus to the rise in the average age and medical expenses.

◗ It is scientifically proven that the major contributors to a country's advancement include the appropriate level of health care and education as well as support granted to science, research and development. This cannot however be achieved without a larger welfare state and a higher level of public expenditures.

◗ It is also scientifically proven that the prerequisite of economic and social upturn is the well-functioning state and a future-oriented and widely accepted concept and that the principal reason behind financial bankruptcy, in most cases, lies in the bankruptcy of the state and the executive power.

It is thus not an unfounded statement that the cutback of the welfare state and the state's role is a preconception which is not adequately reinforced with facts and scienti-fic arguments, and it is even less unfounded that is the prerequisite of speeding up development.

▪ The third basic divergence of opinions relates to reform dictatorship: *whether it is possible to implement any or even the best idea against the will or even without the active participation of the stakeholders?* The reviewer holds the view that it is not possible, and it is better not even to strive for it. In the authors' opinion, people cannot be made happy against their will. *László Csaba* (2007) writes the following about this: "It seems that in social sciences the day of experimenting with and implementing plans conceived at a writing-desk for societies as a whole, in brief, the day of *constructivism*, is on the decline. As an unforgettable legacy of the terrible 20th century, democratic societies, in general, and researchers of various branches of the economy and society, manifestly, rightly distance themselves throughout the world from other researchers who still wish to organise and re-organise the world as a whole or just one country, together with its population of several millions, along a single huge plan conceived by them and, most often, to be implemented under their direction. The resistance is especially justified and widespread if they try to reshape our everyday life via secret plans concocted in closed cabinets by persons not known to and not elected by anyone, i.e. plans without detailed discussion and social legitimisation. Whatever is the intention of the initiators, the justified fear from the outcome cannot be eliminated, especially if we continue to profess that the end does not justify the means. […] And let us add that the Indian *Amartya Sen* was granted the economic Nobel-prize for the very demonstration that the masses of the poor cannot be regarded even temporarily as the object of the enlightened elite's experimenting spirit, rather, they must be the subjects and shapers of turning their own life for the better."

It cannot be questioned that there can be no social support behind the radical constraint of the welfare state and even the state and especially behind its execution during eighteen – or now only nine – months. In addition, if we continue to profess – as already seen in the previous paragraph – that the end does not justify the means. However noble is the end of reducing budget deficit and complying with the Maastricht criteria, its means must not lead to one-sixth of the Hungarian society being doomed to die in the ditch without medical help because this is what the consequent application of the insurance principle in health care implies. The author of the above cited passage puts it in a milder way by saying that "the aspect of cost saving must never be placed ahead human dignity". Therefore, the reviewer is of the opinion that the program of radically cutting back the welfare state and mainly its implementation during eighteen months should be taken off the agenda.

■ With this we have come to the last question: *what can and what is to be done under such circumstances?* In line with the spirit of the above quotation, we may add the following.

Hungarian society and economy are confronted with the following two major tasks:

- first, there is a need to cut budget and current payment deficit and to increase net private savings, and in order to achieve that certain components of household consumption need to be decreased, including particularly non-essential consumption financed from credit;
- second, there is a need to pursue an efficient social policy and to develop a system relating to health care and education, to pension and family support, to the catching up of the social groups and regions falling behind and even to scientific research and development, which system satisfies social and national considerations and can be financed in the long term.

It is evident that the above two objectives can only be realised at the expense of compromises. It cannot be immediately ascertained to what extent these two objectives can and should be served by increasing the capacity of the economy, by reducing costs or by rationalising the system of services and what the role and share of public services and business services, including the distribution of functions and the manner of co-operation between them, will be. It will take a longer time to work that out. One thing is however certain. As the authors very correctly underline we cannot manage the economy at the expense of the future, and cannot consume the future even to the effect that our institutional system and thus our future are sacrificed for the sake of the immediate reduction of budget deficit.

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