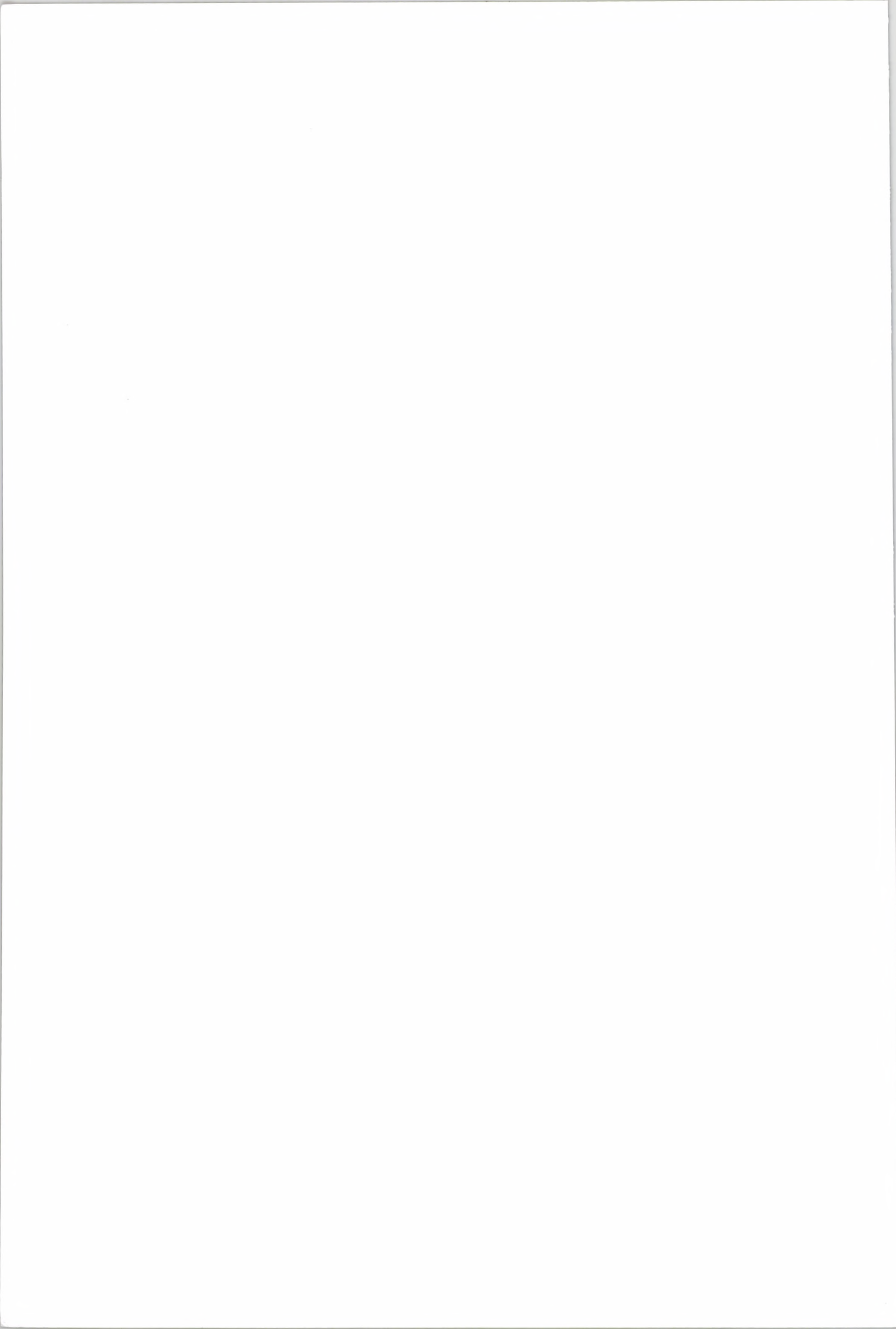


# Monthly Report | 2/11

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*wiiw Spring Seminar on 25 March 2011 (see overleaf)*

**wiiw Spring Seminar 2011**  
**'The Ways Out of the Crisis: Are They Sustainable?'**

**Friday, 25 March 2011**

sponsored by Raiffeisen Bank International AG  
1030 Vienna, Am Stadtpark 9, 'Raiffeisensaal'

**Programme**

09:00	Opening Remarks	<i>F. Lacina, President wiiw</i>
09:10	Welcome Address	<i>G. Deuber, Economics and Financial Market Research Raiffeisen Bank International AG</i>
09:20	Keynote Speech: Global Crisis – Global Implications – Local Impacts	<i>J. Fischer, Vice President EBRD and former Prime Minister of the Czech Republic</i>
10:00	Medium-Term Economic Prospects for CESEE	<i>P. Havlik et al., wiiw</i>
11:00	Post-Crisis Labour Market Challenges	<i>H. Vidovic, wiiw S. Leitner, wiiw</i>
11:45	Impacts of the Crisis on European and Global Emerging Economies: Why Do They Differ?	<i>M. Landesmann, wiiw</i>
12:30	Lunch	
14:00	Keynote Speech: Two Years of the Euro in Slovakia: Lessons and Challenges	<i>I. Miklos, Deputy Prime Minister and Minister of Finance of the Slovak Republic</i>
15:00	The New EU Governance and Implications for CESEE	<i>V. Gligorov, wiiw</i>
16:00	End of the Seminar	
18:00	Informal gathering at a Viennese 'Heurigen' by invitation of wiiw	

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For Registration Form see end of Report.

## Hungary: taking stock

BY JÁNOS KORNAI\*

Barely eight months have passed since Hungary's new Parliament met – and since then the words and deeds of the party and new government have turned the political life and the workings of the state and the economy upside down. We are constantly perplexed; we have not even recovered from our astonishment at yesterday's political measure when today's new announcement or measure arrives. It is hard to stay upright in the whirlwind of events and absorb their import.

Let us stop for a moment, take a deep breath, and reconsider what has actually happened. Let us try to form a *comprehensive* picture of the change out of the hundreds of fragmentary details. What has happened to this country in so short a time?

It would call for a different study to cover how the country had arrived at the situation it was in when the new government took over. The questions of who, which political figure, which party, which interest group bore responsibility, and to what degree, or an account of the previous political and economic processes cannot be included here. This article considers only what the new party and its government that took over in the spring of 2010 has done so far.

I will cover eight fields – areas that may suffice to identify the most important changes. I have not aimed at new discoveries; in discussing each field, I am joining in with those who have likewise been examining it, probably in greater detail than I have.

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\* Allie S. Freed Professor of Economics Emeritus at Harvard University, Permanent Fellow Emeritus of Collegium Budapest – Institute for Advanced Study, and Distinguished Research Professor at the Central European University in Budapest. János Kornai is a member of the Hungarian Academy of Sciences and the European Academy, and Foreign Member of the American, British, Bulgarian, Finnish, Russian and Swedish Academies. – The present contribution is a translation of his article 'Számvetés', published in the leading Hungarian daily *Népszabadság*, 6 January 2011.

My aim is a summary, an overview of where we stand.

### 1 Democracy

In the period between 1989/1990 and the summer of 2010, Hungary was a democracy. It is no longer one now – the political formation today is an autocracy.

This statement will make full sense only if I outline what I mean by democracy, the more so as the term has been defined in several different ways. The East European version of the socialist system was dubbed in its official ideology as a 'people's democracy', while the formal 'bourgeois' democracy of the West was denounced as a sham. Those in power today are claiming that their type of rule is the true embodiment of democracy.

However, it is not on a basis of claims or aspirations ('let the people rule') that my definition of the term rests, but on the observation of actual practices. Let us take the set of countries usually termed developed democracies, including those of Western Europe and North America, Australia, New Zealand, and Japan. Which are the *common features* that *actually* manifest themselves in them? The question is not whether those features are codified in a constitution or are based on tradition or historical conventions. What counts is the practical application of those features in a democracy.

The essential features are the following:

- Powers are strictly separated.
- Certain important governmental tasks are fulfilled by bodies independent of the government.
- There is a clear line separating a rather small group of political appointees from a large group of civil servants and public sector employees whose jobs are independent of, and uninterrupted by, the political changes.
- The principle of checks and balances is applied. No branch of power or organization of state is allowed to prevail for a long time, as the other branches and organizations prevent it.

- The enactment of bills by Parliament is preceded by extensive prior debate and negotiations, followed by a thorough, and therefore time-consuming, debate about each in Parliament. In some countries the process of prior negotiations is controlled by law, but the democratic political culture is an even stronger force than the word of law in applying the requirements of prior discussions and negotiations and careful and responsible parliamentary debate.

It is almost unbelievable what deep wounds have already been inflicted on the face of democracy, and how many of the essential features installed in the past twenty years have been marred by the Orbán government and their party, Fidesz.

Everything is decided in the 'central field of power'.

The practice of widespread debate and negotiation before the introduction of new legislation has ceased. Parliament has been converted into a voting machine that turns out laws on an assembly line at incredible speed.

The post of Hungary's head of state, the President of the Republic, is no longer held by a personality who stands above parties and embodies unity of the nation, but by a willing, obedient party devotee.

The key office of Chief Prosecutor has been filled by a tried supporter of the ruling party.

The National Elections Commission, whose task is to oversee elections, was replaced before its term expired, by a new committee composed almost exclusively of Fidesz supporters.

The powers of the Constitutional Court, the chief guardian of constitutionalism and the fundamental office of judicial independence, were brutally restricted, a step that in itself dealt a fatal blow to the principle of checks and balances.

When the independent Fiscal Council dared to criticize government plans, it was dissolved. It was not an independent and distinguished professional

expert who was appointed to head the State Audit Office, but a faithful member of the ruling political group. Also exerted at that time was the right to appoint the president *and* the two vice-presidents of the Competition Authority.

It is natural with a change of government that new people should be appointed to such leading state offices as are usually filled by political appointees. But what actually happened was a political cleansing far beyond that, so that the principle of a standing civil service with relative independence from politics was denied. Now a new law makes it possible to lay off central or local governmental officials and employees without explanation. There is an atmosphere of fear and subservience forming among those working for the state apparatus, due to the threatening statements being made by leading politicians.

The ultimate test of democracy is the *procedure* followed when removing a person, group or party in power. The fundamental criterion of a democracy is lack of violence: no murder of tyrants, no military coups d'état, no secret camarilla conspiracies, no violent crowd demonstrations to force out those in power; no bloody uprising or revolution is required. It is possible to carry out the transfer of power in a peaceful and civilized way, through elections between rival parties. As in other tests, the results can be decided only after the event. *A posteriori* it can be stated that the Hungarian political structure passed the *removability test* between 1990 and the spring 2010 elections, for Hungarian voters removed several previous governments and elected new ones in clean elections.

It should be noted that this does not necessarily entail automatic alternation. The question is not whether the change happens at every single election, but whether the removal is *possible* or not. Has the present political leadership 'barricaded itself in' to a degree that leaves no likelihood of their removal? Such cases are not confined to totalitarian regimes, e.g. Nazi or communist dictatorships. They occur also in autocracies like the Horthy regime in Hungary between the two world wars.

In that long historical period Parliament had regular sessions, there were legal opposition parties, several parties stood in the elections – but the state and the political sphere were so organized as to secure automatic success for the governing political group in each and every election of the Horthy period. The political order *guaranteed* the immovability of the governing power.

It would be too early (and too disheartening) to state whether this is already the case in present-day Hungary. It would be too early even if Fidesz won again at the next elections. It will only be possible to establish the results of the final procedural test of removability after a long historical period. What can be said today is that Viktor Orbán declared even before the elections that the political situation had to be organized in a way that would ensure them power for at least 15–20 years. Since taking power, they have made irreversible steps towards realizing that plan. They have destroyed or severely weakened the institutions to ensure the principle of removability. And let me add, they have not exhausted all the possibilities in this short period. I would not like to suggest ideas, for they know them anyway: gerrymandering election boundaries, introducing election laws that decrease the chances of rival parties, giving Hungarians domiciled abroad the right to vote, etc.

## 2 Free press

An independent and free press is usually given prominence among the political checks and balances. The press is often called the fourth branch of power in democracies, additional to the legislative, executive and judiciary. It is indispensable in ensuring that the government should not feel secure in possessing unlimited and uncontrollable power. A free press can reveal the abuses of those in power and peek behind the political scenes. If political announcements are misleading or silent on important facts, the free press can expose the truth.

The new media regulations, i.e. the institutional reorganization of the media authority and the passage of the Media Act, produces a level of central-

ization in the world of public media and political communication comparable only to the propaganda machine of a communist dictatorship. The head of the media authority has the power to issue decrees, and the body can levy financial penalties. It is entitled to control not only the state-owned media, but also the privately owned media, not only television and radio, but also the printed press, internet portals and blogs. The body, exclusively made up of Fidesz delegates, regulates the allocation of television and radio frequencies, where rejection of an application marks the end of an applicant television or radio company. Private media owners may shy away from criticism of the government not only because of the possible rejection of an application to renew their operating licence or the threat of a crippling fine, but also because advertising from companies close to the 'central field of power' may dry up.

The war over the free press is far from over, but the first battle has been won by the Orbán government. Even if they have not enforced their new rules, the sheer possibility has an intimidating effect. There will certainly be brave people (there are already some) who bear the risk heroically. But there is every reason to fear that several media owners, editors and journalists, even if otherwise ready to criticize the government, will prefer to watch their words or stay silent, applying self-censorship. The programmes on public television and radio have already become skewed: some important news items (those ones awkward to the authorities) are not being broadcast or being presented as insignificant, and no fair coverage is being given to opposing opinions. And this is only the beginning, for the new 'Media Tzar' and her apparatus have not started open retaliation.

## 3 The state of law

Fidesz gained power in a legal and valid way, and it has complied with the law in most of its actions. So *legality* rules in a narrow sense.

But the description must continue: if a law in force is in its way, the government changes it. If it wants to make an exception for a favoured person or

group, it tailors the law to ensure them that privilege. If the law the authorities introduce conflicts with the Constitution, they amend it (as they have done no less than ten times). And if the Constitution, with its multitude of impromptu amendments, is still in their way, they will sweep it away and impose a new one on the country. In more than one case so far they have trickily circumvented the law, for example by taking a bill onto an MP's motion to circumvent legally compulsory negotiation processes. Moreover, they openly flout Hungarian and EU regulations, the Constitution and the basic requirements of a state of law in significant matters. In one unprecedented case, they re-enacted a retroactive law that had been nullified by the Constitutional Court by curbing the latter's powers.

The principle of a state of law – *Rechtsstaatsprinzip* – is a wide and complex concept that would be difficult to define in any mathematically precise way, but a democrat will sense the *spirit* of such a state of law. It means respect for the Constitution and the laws in force, even if they were not enacted by those now in power. A state of law means that legal security applies, that citizens are assured their rights by the state, that those rights are stable and long-lasting, and that they cannot be curtailed on the impulse or at the whim of political decision-makers.

Using the term 'state of law' in this wider sense, I would not like to go to the lengths of saying that Hungary no longer is a state of law. Important legal guarantees have been destroyed in the past few months, including first of all the crude attack on the Constitutional Court. The new political leadership has publicly tried to instruct prosecutors or to summon judges before Parliament. Still, we fortunately cannot claim that the independence of judges has been eliminated, or that politically relevant verdicts are actually being dictated by a group of politicians for judges to sign. The practice in the coming years will tell how far judicial independence continues, or is eradicated and becomes an empty formality. There will be worries about the future activity of the police and the public prosecutors' offices as far as their practice of investigating and charging politi-

cally related cases are concerned. These worries are justified by several previous bitter experiences: cases may be hushed up when they are awkward to those in government, or handled with bias when the suspects are the opponents of those in power. We will see – let us hope these worries turn out to be unsubstantiated.

#### 4 Capitalism

Having reviewed the political field, let us consider the economy.

The capitalist system prevails in Hungary. I am convinced it will continue to do so throughout the Orbán government, and survive the present political regime. Capitalism is a particularly tough and robust system.

The historical example of the socialist system proves that however strong capitalism may be, it is possible to abolish it in a country or group of countries, and replace it by another viable system. However, this can only be achieved with an iron will, by eliminating private property, and replacing it everywhere (or almost everywhere) by state property; by eliminating market coordination (or keeping only fragments of it), and replacing it by bureaucratic coordination in every section of the economy. Those presently in power have not done so, and there are no signs pointing in that direction for the future. Even if there are similarities between Bolshevik parties and the present-governing group in their style of government, Fidesz is obviously not a Marxist-Leninist party. It does not have a policy of eradicating capitalism.

People frequently have illusions about the efficiency of the capitalist system. Its sheer existence is often believed to guarantee efficient allocation and utilization of resources. That, however, is certainly not the case. While some capitalist economies are highly efficient, others struggle along with a lot of friction.

Far from aiming to eradicate capitalism, the Orbán regime is linked to it by multiple strands and enjoys the support of some big-business oligarchs and



many small-business entrepreneurs. It is ready to exchange political and economic support for economic and political support. At the same time, the regime's interventions in the economy keep throwing sand in the works. The anti-capitalist slogans of its public rhetoric do damage to the economy, but much more is done by their actions. The economic policy of the past eight months has decreased the efficiency of Hungarian capitalism, weakened it, and reduced its development chances.

The socialist system is centralized by nature; state property and the dominance of bureaucratic coordination allow centralized command. But not even that system could make headway by voluntarism, the fallacy that the dictator and his group could achieve anything just by wanting it enough. There is a similar voluntarism apparent in the Orbán government's actions. But though they may widen the sphere of state interference and intervene in economic processes in a more aggressive way, we will still live in a *capitalist economy*. Market rules are in operation. Economic agents in Hungary and abroad have wills of their own. Sellers and service providers cannot be forced to sell or provide services, neither can financial investors be forced to buy government bonds, or investors to create real capital. Even the most aggressive government, over a longer period, is unable to impose its will on the economy in every aspect. And the more unscrupulously a government tries to do so, the more stubborn the backlash will become, and the more damage will be caused to the development of the economy.

## 5 Private property

The edifice of the capitalist system is founded on private property. Looking at real historical practice instead of theoretical models, it will be seen that private property has never been the exclusive type in any capitalist economy, other types having also been present, but private property has been the *dominant type*, and *respect for private property* is integral to it: it must be present in the regulations and in the value judgments of public opinion.

What has happened recently in Hungary to private pension funds seriously undermines trust in the government's respect for private property. That trust could be maintained if a pension reform led to accumulated wealth handled as private property shrinking, and savings managed by the state growing, provided that the changes were based on the principle of voluntary choice. That would be the case if the following conditions are satisfied: (i) the active employees faced a genuine choice between different alternatives, including a return from the private to the public pension scheme, (ii) they changed of their own free will, based on information that evaluated the advantages and disadvantages, and (iii) they had sufficient time for consideration. But that is not what is happening. There have been vague, fuzzy promises instead of adequate information, hectic rush instead of fair time to consider, and threats and severe discrimination instead of a free choice. Those remaining with the private pension funds will partly or wholly lose their rights to a state pension (the loss ratio being dependent on a range of factors). In the midst of self-contradictory official announcements and shallow or downright false information, i.e. in a state of confusion, members of the private pension funds are being forced to make crucial decisions that will essentially influence their financial position in old age.

The whole procedure raises sad memories for the historically experienced older generations. The agricultural cooperative movement fits in well with capitalism so long as there are farmers with full control over their own private property *volunteering* to cooperate. That applies even though cooperative ownership differs from private ownership. But the aim of those who confiscated the lands of Hungarian farmers and forced them into cooperatives in the 1950s and 1960s was precisely to eradicate capitalism in the countryside. Those who dreamed up and implemented the present-day pension reform cannot be accused of wanting to eradicate capitalism. What they have done, however, seriously damages the principles of capitalism, and is not far short of crude confiscation.

6 Growth and development

The stated economic policy of Fidesz and the government centres on enhancing growth. Hardly an economist would disagree that lasting growth is the key to the well-being and development of a society. But growth paths can be of a diverse nature, each with different characteristics, as every economist will admit. It is also generally agreed that the government can employ varied methods to increase growth, each differing in their outcomes and side-effects. Whether growth *should* be the central question of the economic policy is not worth arguing now. The real issue is what type of growth to promote and by what methods.

Analysts would be in an easier position if they could see clearly what the government was really planning to do now, next year, in the following years, or in 15–20 years' time – the span of office they plan for themselves. Their oral announcements are full of empty phrases, wild promises with no deadlines, and self-contradictory ideas. What is even more dangerous is that their first definite, figure-based 'statement of intent', the 2011 state budget, does not state clearly, either, what the government is planning to do. Thus no coherent economic policy is decipherable from the announcements of leading politicians or from the 2011 state budget. Practical regulations are not being introduced after thorough professional debates, careful consideration of short- and long-term effects, or comparison of alternative solutions. A sadly low level of professionalism has seeped into the creation of the economic policy. Without a coherent plan to analyse in a consistent and intellectually rigorous way, I am confined to raising a few questions left vague, and to refute a few misleading statements.

- When the topic is discussed, we keep hearing a single declaration: taxes will be lowered, and *that* will give an impetus for growth. However, the many studies that have sought to clarify the causal connection between tax reduction and growth have certainly not reached unambiguous conclusions. We do not know exactly how much GDP increment one million forints' tax reduction will produce, or when it will do so, after how much delay. But those one million forints will

certainly be missing from the revenue side of the state budget, and the deficit will have to be balanced either by expenditure reduction (through austerity measures, in spite of recurrent promises to the contrary), or by loans (in which case what will happen to government debt reduction, another loud promise?) So *overall* reduction of the taxes imposed on society is not the real plan. Instead it is a question of tax burdens being reallocated. In the absence of careful calculations, we do not know the answer to an embarrassing question. Even if certain tax reductions do result in the growth of total demand and that does generate additional output, will not the loss caused to long-term growth by the reallocation of taxes be greater? True, the household sector (especially well-to-do households) will pay less tax, but business sectors hit by the 'crisis taxes' will pay more. The consequences, however, do not stop at this point, but spill over into other areas. Sectors hit by the crisis-tax will transfer much of the burden onto their customers: other companies and the household sector. Their profits may truly decrease, but that will have a backlash, as their profits are a major source of their investments. The disproportionately severe tax burden can be expected to have a deep impact on the short-, mid- and long-term business policies of some key branches of the financial, production and trade sectors. The capitalist economy is unable to operate and develop in the long run without a flexible, pro-active, effective credit system. The unacceptably severe tax burden on the banking sector, introduced to spare individual taxpayers, will not hit 'rich bankers', but will slow down the active flow of the economy. We should not listen only to the banks' public complaints. We should also notice what is happening in the day-to-day activity of the financial sector: that they have already started restricting the credit supply, although credit is needed more than ever. All the sectors involved in the crisis tax are restricting their investment activities, and this will eventually put a brake on lasting growth.

- Does the government wish labour productivity to grow as fast as possible and technical devel-

opment to flourish in this country? Or does it rather want to maintain or restore jobs due to be closed down by international or domestic competition? Is the main aim a rapid increase in *employment*, or is an increase of *production*, *productivity* and *competitiveness* the real main aim? I am afraid some leading politicians and their propagandists are unaware that these aims are contradictory to a degree; one cannot go around believing that 'employment', 'growth' and 'development' are synonymous terms.

- Are small and medium-sized enterprises the group of producers destined to be given a competitive advantage? All right, but then other producers will be disadvantaged. Or is it not some Hungarian oligarchs close to governing circles who are to be preferred over their competitors? Is it easier for a company 'close' to governing circles to get a state contract than for a 'distant' company? Or should the competition run on strictly equal terms?
- The experience of economic history has shown repeatedly that small countries are incapable of fast and lasting growth if they are 'inward-looking', trying to base growth on artificial acceleration of domestic demand. Is the present government really ready to give up on the well-tried and sound growth policy of *export-driven growth*? Is the economic policy of supporting sustainable growth more advantageous for the nation, not one obscuring the idea of advantageous adaptation to the international division of labour while mouthing national slogans?
- Some related questions can be raised about the *financial resources of growth*. Is the economic policy of national isolationism and self-reliance to be followed also in finding resources? Do they wish to achieve fast growth with *that* policy? Though not advantageous, it could be achieved in a country where the rate of savings is large, and people do not consume a huge fraction of the new value produced by them. But national isolationism is no more than an arrogant, empty slogan if the economy is ultimately *dependent* on imports of capital. It is easy to observe that the following three requirements are in conflict: (i) a low level of savings (i. e., a permanent release from the responsibility for one's future); (ii) large investment needed for fast growth and technical development; and (iii) exclusion of international capital. These requirements are contradictory not only empirically, but logically. Which is the one they really wish, and which are only lip service?
- Should Hungarian commercial chains be given preference over international chains? Should Hungarian banks be given preference over international ones? Opposition to 'multinationals' is being fomented. But should the biggest Hungarian bank and the Hungarian energy-sector mega-corporation be allowed to become multinational themselves, taking abroad and investing some of the profits they have gained in Hungary?
- The governing group wishes for growth within a modern capitalist system, so how could the expression 'gambling on the stock exchange' become a ubiquitous pejorative term? 'Private pension funds have gambled away members' money at the stock exchange', says the government spokesperson, as if the investment in stocks and bonds traded at the stock exchange were not the normal, recommended, or to a certain degree compulsory activity of every savings institution. They speak as if stock exchange investment resembled a careless father gambling away the family's money at the racetrack, or a baron gambling away a family estate at the casino. Can capitalism exist without a stock exchange or other organizations of a flexible capital market? If a company cannot raise capital by issuing shares, how else can it do so? Exclusively from bank loans? Or should it ask for state subsidy?
- Does the government make the most of the huge opportunity of Hungary being a member of the European Union, with the advantage of having the structural transformation of the country supported by EU financial resources? Or if that is their aim, why are they delaying the practical utilization of EU support? Why do they keep getting into conflict with various EU organiza-

tions, instead of listening to their advice and learning from the criticism and warnings offered in a reserved diplomatic style?

Organizers of present-day Hungarian economic policy like to call themselves Keynesians, but what they are doing can more accurately be termed a kind of 'vulgar Keynesianism'. They seem to have half-digested the theory of the great English economist, and ignored the profound debate of decades among the different schools of macroeconomics. Economic policy inspired by Keynes certainly includes the recommendation that economic growth should be given an impetus, greatly needed in times of recession and depression, by increasing fiscal expenditure. The train of thought also includes the idea, repeatedly emphasized by the critics of Keynes based on several painful historical experiences, that long-lasting fiscal overspending carries the danger of inflation. Unleashing inflation is too high a price to pay for production growth!

Keynes, however, does not only emphasize such an increase of demand by fiscal methods, but also the optimism, investing spirit and expansion drive of entrepreneurs as the engine of recovery, followed by lasting growth – in Keynes's oft-cited words, the *animal spirits* that motivate the investors. But this optimistic atmosphere and investing spirit is not stimulated, but on the contrary damped by the unpredictability about when and how the principle of private property is being damaged, when and how much tax is being imposed on it, and when and why it is being discriminated against.

Let me add that I am not talking only about the mood of foreign investors, but of Hungarian investors too. A wealthy taxpayer who has more to spend after the introduction of the single-rate income tax will think twice before investing that capital in the Hungarian capital market (for example, by 'gambling on the stock exchange' with it), buying Hungarian state bonds and probably thus supporting state-financed investments, rather than buying foreign securities, depositing it in a foreign bank, or spending it on domestic consumption. Every Hungarian company will be concerned about how much

to spend on self-financed investment and how much to earmark for dividends. The less predictable the country's economic policy is and the more damage is done to private property, the slower the *domestic* investment mood can be expected to improve.

The economic profession has discussed extensively the relationship between monetary stability, budgetary balance, the balance of inflow and outflow of foreign resources, the stability of the purchasing power, the amount of admissible government debt, the level of satisfactory foreign currency reserves on the one hand, and the rate of growth on the other. Nowadays the debate has become more emphatic, as every country is looking for methods to overcome the recession. But a broad consensus has been achieved on the following idea: *sustainable growth* is gravely endangered if there are serious troubles with the *financial equilibrium* of the economy. Those addressing this topic in a responsible way cannot be reassured by the repeated declarations of the government that the budget deficit will not exceed the upper limit targeted for 2010 and 2011. That is a necessary, but not a sufficient condition for financial stability, especially not for a vulnerable economy like ours. The promise of lasting growth will be credible only if the government makes it clear what economic policy it wishes to employ to sustain financial equilibrium in the wider sense after 2011. Unfortunately, the methods the government is planning to use to achieve the target deficit this year and next year threaten to open a much wider gap between state revenues and expenditure in later years, while other types of troubles appear in other aspects of the financial equilibrium.

### 7 Distribution

Fidesz, in its election campaign, promised to avoid restrictive austerity measures. Since then the official propaganda machine has tried to give the impression that the promise is being kept, that no restrictions have been made or will be made in the future.

But this is only playing with words, cleverly exploiting the vagueness in the concept of 'restriction'. Let us put it simply: the earlier decisions and announced plans of the government actually will cause concrete losses of real present and future consumption to some of the people, decrease the value of their wealth and savings, and increase their debt. The redistribution is continual, causing continual rearrangement of the groups of winners and losers, and change in the size and composition of their gains and losses. Those who have suffered losses, or will suffer them in the future, have indeed been 'restricted', and a great many people belong to that group.

So who has suffered the losses? Let me list only those whose losses are certain, although others may well have suffered them too. And of course there may be individuals or families with multiple losses, who belong concurrently to several of the groups listed below.

- The losers include those with low or medium incomes (or more precisely, with income only from employment, earning above the minimum wage but below 293,450 forints a month (about EUR 1100 or USD 1400), and with no dependent children. Their net nominal income will decrease due to changes in taxation and income policy.
- The losers include those with a loan expressed in foreign currency, as their debt has been increasing due to the weakening forint exchange rate. For it has been shown that there is a clear causal relationship between the irresponsible statements of leading politicians, the announced economic policy of the government, and uncertainties about the budget for 2011 and onwards on the one hand, and the weakening of the forint on the other.
- The losers include households affected by the gas price increase. The increase, long overdue, cannot be sensibly opposed by any economist. It is repulsive, however, first to promise the contrary and then to break it without so much as an admission that the promise was irresponsible and unfeasible.
- The losers include producers, small and medium-sized companies among them, which do not export their products, yet use imported materials and components, as their production costs have risen and their sales been hit by the weakening exchange rate.
- The losers include employees laid off without explanation from jobs in state service, during a process of purges and restructuring.
- The losers include employees laid off from industries hit by 'crisis taxes'. Those industries are trying to recoup costs by restructuring and rationalization, which means shedding staff and increasing workloads on remaining employees.
- The losers include those unemployed who cannot get another job due to the sluggish investment climate.
- The losers include those who have accumulated savings in the private pension funds. That real wealth is being confiscated now, and contributors herded into the state pension system, against unspecified pension promises for the distant future.
- The losers include those selling their real estate. In an already depressed market situation, their assets continue to lose value as the government sets out to speed up housing construction artificially, using taxpayers' money, at a time of strikingly conspicuous excess supply. The loss of value intensifies the problems of borrowers of foreign currency-based loans for purchasing or building real estate.
- The losers include consumers, who have shouldered a significant part of the 'crisis tax' burden. That burden will be passed on whether the government prohibits it or not, whether it is done by the supplier/seller in an open or a concealed way.
- The losers include a high proportion of employees. Wage negotiations are occurring right now. In several spheres, agreements on nominal wages (shaped in such a way that real wages should freeze) have been settled in line with official inflation predictions. Their real wages will fall if inflation proves faster than that.

- The losers include all consumers hit by the accelerating inflation. More definite statements about the influence of the Orbán government's economic policy on consumer prices can only be made at the end of 2011. Now we can consider only effects that appear to be inflationary: the weakening national currency, the rising interest rates on loans used to finance the budget deficit and government debt, and the increase in the tax burden on key branches of the economy. Inflation is a levy that hits everyone, but the effect is felt most by the poorest. The impact of the government's economic policy points in the direction of an increase, and not a decrease in inflation. Central bank monetary policy to combat that danger has to face recurrent attacks from the government's side.

Apart from losers, there are winners as well. But the losers are not consoled by the fact that others have won. Losers will rightly deduce that 'restrictive austerity measures' have occurred, but the screws of the press are unevenly adjusted.

Fidesz in opposition happily made populist statements and attacked economically useful but unpopular measures, as champions of the poor. They often sought to give the impression that they wanted to combine the principles of right-wing ideology with a neo-Kádárite economic policy. What has remained of this now that Fidesz is in power? Only a few conspicuous gestures: early retirement for a certain category of women (a move in the opposite direction to the Europe-wide efforts to delay retirement,) re-opening a few railway feeder lines, instead of efforts to reduce the operating losses of the railways. Meanwhile two undoubtedly important moves have yet to begin: change in the government financing of the health care and education sectors. Nobody knows whether or not future changes in these, labelled 'structural reform', will really change present practice. Let me emphasize that their present structures created under the Kádár regime are still being maintained.

So while traces of Kádárism remain in Fidesz policy, moves that redistribute income, tax burdens

and privileges *favouring the wealthy* are becoming conspicuous. A 'rightwing-conservative' orientation of redistribution is appearing in the measures of the tax reform.

That direction clearly appears in the uniform single-rate tax system: the higher the taxed income, the larger the gain to the taxpayer. Diverse family benefits have a similar effect. It is especially worth observing that a significant part of the state social security support is provided through tax concessions, so that those in the weakest situation, with no taxable income, are excluded.

Redistribution includes distribution of gains and losses, advantages and disadvantages between present and future generations. Some people had naive hopes that the new leadership, on taking power and wishing to keep it for 15-20 years, apparently, might risk temporary unpopularity for the sake of future generations and sustainable growth. But there is no sign of that. The old routine continues: immediate problems are being solved, but otherwise there is an attitude of 'crossing that bridge when we come to it'. Do the holes in the 2011 budget really have to be filled now? Let us impose some taxes of astonishing magnitude on those loathsome banks and multinational corporations, without thinking of what effect they will have on the payers' propensity to invest or the future economic situation. Let us seize the assets of the private pension funds, and take over the pension entitlements, regardless of future costs to the state. Let us not worry what will happen to the state pension fund in the far future, when life expectancy is longer, the active population even smaller, and the proportion of the population entitled to a pension has grown.

I could bring up some other examples, e. g. in connection with infrastructural or environmental issues, where the state economic policy is choosing to *postpone* measures due to be taken today and passing them on to future generations, instead of seeking to spread the burdens proportionately among the generations.

## 8 Trust

It makes no sense to make sweeping statements about trust, which is a complex social phenomenon requiring detailed analysis.

So far, no dramatic change can be seen in the distribution of voters' *political* trust. Few have left the segment of about one-third of voters who gave Fidesz its present two-thirds majority in Parliament, although the latest surveys have shown some wavering. My task here is not one of political prediction. Historical experience shows things going sometimes one way, sometimes another. Sometimes a party's support shrinks over years, and sometimes it plummets abruptly. But a party may sometimes remain politically popular for a long time.

It is of great significance (though it has to be separated from voters' *political* trust) how much the *business community* trusts the state. To be honest, this type of trust may be independent of whether the governing form of the state in question is a democracy or an extreme dictatorship, or at some intermediate level of autocracy. Capitalism is a system that can function amidst a dictatorship that flouts human rights. Indeed it may prefer stable, strong-handed dictatorship to unstable, weak-handed democracy, provided the former clearly supports private property, enforces contracts, and guarantees security of rights. Capital welcomes an iron-handed regime such as Singapore's or communist China's.

What shakes the trust of the business world are ambiguities in government statements; if gaps in the budget are filled by methods unviable even in the medium term. However emphatically the government may deny the significance of unfavourable credit ratings from respectable credit-rating institutions, repeated downgradings reflect a collective judgement from the business world. And they are not simply a passive reflection of an assessment, for they influence it in a negative future direction.

*In the short run* Hungary cannot exist without selling its state bonds regularly. The downgrading of its reliability as a debtor causes immediate losses in

the hundreds of billion forints, as the government is forced to pay a higher yield if it wants to sell its bonds, whether to Hungarian or international investors. Let me add, the hundred-billion-forint losses are manageable, however difficult. The real threat is that trust may not just weaken, but collapse. The government should not rage at those who warn them of this grave danger, but reconsider what causes it.

*In the long run* the weakening trust of the business community will slow growth, as I have emphasized from another aspect earlier. That process cannot be easily quantified, but the phenomenon can be perceived. The investment climate of functioning enterprises is deteriorating. There are fewer entrepreneurs than would be in a more favourable business climate. Foreign and domestic firms are pushing less hard. The expansion drive is weaker and there is a stronger temptation to invest their capital somewhere else.

### Summary

What has been happening in the *political* sphere is easy to summarize. Several important basic institutions of democracy have been destroyed. Hungary has become an autocracy. The Hungarian political regime is threatening to resemble Putin's. The direction of the changes is clear: they are profound enough to be irreversible (or more optimistically, almost irreversible) and guarantee (or more optimistically, almost guarantee) the long-lasting rule of the group that has gained power.

What has been going on in the *economic* sphere is less easy to describe briefly, because it is full of mutually contradictory actions, regulations impossible to implement, and tendencies impossible to follow. There is no clear direction in the new rules. Let us hope that capitalism is a strong enough system to survive bad economic policy. It is indeed, but it charges a high price for weaknesses.

In the political sphere, the Machiavellian aim (grasping power and retaining it for a long time) has been attained in a *masterful* way. The plan was

clear and definite. Obstacles encountered have been removed without delay or hesitation.

As far as the economy is concerned, I have not really been able to discern what the aim is. It seems as if there may not have been any detailed plans to implement. According to government pronouncements, we may in a few months' time be

informed of the plans for 'structural reforms', and then be in a position to understand the aims of the economic policy. But whatever the aims may be, they have been *bungled* in their implementation.

We have every reason to be worried about the future of this country.



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## TAKING STOCK

JÁNOS KORNAI\*

Barely eight months have passed since Hungary's new Parliament met – and since then the words and deeds of the party and new government have turned the political life and the workings of the state and the economy upside down. We are constantly perplexed; we have not even recovered from our astonishment at yesterday's political measure when today's new announcement or measure arrives. It is hard to stay upright in the whirlwind of events and absorb their import. Let us stop for a moment, take a deep breath, and reconsider what has actually happened. Let us try to form a comprehensive picture of the change out of the hundreds of fragmentary details. What has happened to this country in so short a time?

It would call for a different study to cover how the country had arrived at the situation it was in when the new government took over. The questions of who, which political figure, which party, which interest group bore responsibility, and to what degree, or an account of the previous political and economic processes cannot be included here. This paper considers only what the new party and its government that took over in the spring of 2010 has done so far.

I will cover eight fields – areas that may suffice to identify the most important changes. I have not aimed at new discoveries; in discussing each field, I am joining in with those who have likewise been examining it, probably in greater detail than I have. My aim is a summary, an overview of where we stand.

### Democracy

In the period of 1989–1990 and the summer of 2010, Hungary was a democracy. It is no longer one now – the political formation today is an autocracy. This

statement will make full sense only if I outline what I mean by democracy, the more so as the term has been defined in several different ways. The East European version of the socialist system was dubbed in its official ideology as 'people's democracy', while the formal '*bourgeois*' democracy of the West was denounced as a sham. Those in power today are claiming that their type of rule is the true embodiment of democracy.

However, it is not on a basis of claims or aspirations ('let the people rule') that my definition of the term rests, but on the observation of actual practices. Let us take the set of countries usually termed developed democracies, including those of Western Europe and North America, Australia, New Zealand and Japan. Which are the common features that actually manifest themselves in them? The question is not whether those features are codified in a constitution or are based on tradition or historical conventions. What counts is the practical application of those features in a democracy.

The essential features are the following:

- Powers are strictly separated.
- Certain important governmental tasks are fulfilled by bodies independent of the government.
- There is a clear line separating a rather small group of political appointees from a large group of civil servants and public sector employees whose jobs are independent of, and uninterrupted by, the political changes.
- The principle of checks and balances is applied. No branch of power or organization of state is allowed to prevail for a long time, as the other branches and organizations prevent it.
- The enactments of bills by the Parliament are preceded by extensive prior debates and negotiations, followed by thorough, and therefore time-consuming, debates about each in the Parliament. In some countries the process of prior negotiations is controlled by law, but the democratic political culture is even stronger force than the word of law in applying the requirements of prior discussions and negotiations and careful and responsible parliamentary debate.



\* Collegium Budapest – Institute for Advanced Study. This is an English translation of the article 'SZÁMVETÉS' published in the 6 January 2011 issue of NÉPSZABADSÁG.

It is almost unbelievable what deep wounds have already been inflicted on the face of democracy and how many of the essential features installed in the past twenty years have been marred by the Orbán government and their party, Fidesz:

- Everything is decided in the ‘central field of power’.
- The practice of widespread debate and negotiation before the introduction of new legislation has ceased. Parliament has been converted into a voting machine that turns out laws on an assembly line at incredible speed.
- The post of Hungary’s head of state, the President of the Republic, is no longer held by a personality who stands above parties and embodies unity of the nation, but by a willing, obedient party devotee.
- The key office of Chief Prosecutor has been filled by a tried supporter of the ruling party.
- The National Elections Commission, whose task is to oversee elections, was replaced before its term expired, by a new committee composed almost exclusively of Fidesz supporters.
- The powers of the Constitutional Court, the chief guardian of constitutionalism and the fundamental office of judicial independence, were brutally restricted – a step that dealt in itself is a fatal blow on the principle of checks and balances.
- When the independent Fiscal Council dared to criticize government plans, it was dissolved. It was not an independent and distinguished professional expert who was appointed to head the State Audit Office, but a faithful member of the ruling political group. Also exerted at that time was the right to appoint the president and the two vice-presidents of the Competition Authority.
- It is natural with a change of government that new people should be appointed to such leading state offices as are usually filled by political appointees. But what actually happened was a political cleansing far beyond that, so that the principle of a standing civil service with relative independence from politics was denied. Now a new law makes it possible to lay off central or local governmental officials and employees without explanation. There is an atmosphere of fear and subservience forming among those working for the state apparatus, due to the threatening statements being made by leading politicians.

The ultimate test of democracy is the procedure followed when removing a person, group or party in

power. The fundamental criterion of a democracy is lack of violence: no murder of tyrants, no military *coups d’état*, no secret camarilla conspiracies, no violent crowd demonstrations to force out those in power; no bloody uprising or revolution is required. It is possible to carry out the transfer of power in a peaceful and civilized way, through elections between rival parties. As in other tests, the results can be decided only after the event. *A posteriori* it can be stated that the Hungarian political structure passed the removability test between 1990 and the spring 2010 elections, for Hungarian voters removed several previous governments and elected a new ones in clean elections.

It should be noted that this does not necessarily entail automatic alternation. The question is not whether the change happens at every single election, but whether the removal is possible or not. Has the present political leadership ‘barricaded itself in’ to a degree that leaves no likelihood of their removal? Such cases are not confined to totalitarian regimes, e.g. Nazi or communist dictatorships. They occur also in autocracies like the Horthy regime in Hungary between the two world wars. In that long historical period the Parliament had regular sessions, there were legal opposition parties, several parties stood in the elections – but the state and the political sphere were so organized as to secure automatic success for the governing political group in each and every election of the Horthy period. The political order guaranteed the immovability of the governing power.

It would be too early (and too disheartening) to state whether this is already the case in present-day Hungary. It would be too early even if Fidesz won again at the next elections. It will only be possible to establish the results of the final procedural test of removability after a long historical period. What can be said today is that Viktor Orbán declared even before the elections that the political situation had to be organized in a way that would ensure them power for at least 15–20 years. Since taking power, they have made irreversible steps toward realizing that plan. They have destroyed or severely weakened the institutions to ensure the principle of removability. And let me add, they have not exhausted all the possibilities in this short period. I would not like to suggest ideas, for they know them anyway: gerrymandering election boundaries, introducing election laws that decrease the chances of rival parties, giving Hungarians domiciled abroad the right to vote, etc.

## Free press

An independent and free press is usually given prominence among the political checks and balances. The press is often called the fourth branch of power in democracies, additional to the legislative, executive and judiciary. It is indispensable in ensuring that the government should not feel secure in possessing unlimited and uncontrollable power. A free press can reveal the abuses of those in power and peek behind the political scenes. If political announcements are misleading or silent on important facts, the free press can expose the truth.

The new media regulations, i.e. the institutional reorganization of the media authority and the passage of the Media Act, produces a level of centralization in the world of public media and political communication comparable only to the propaganda machine of a communist dictatorships. The head of the media authority has the power to issue decrees, and the body can levy financial penalties. It is entitled to control not only the state-owned media, but the privately owned media, not only television and radio, but the printed press, internet portals and blogs. The body, exclusively made up of Fidesz delegates, regulates the allocation of television and radio frequencies, where rejection of an application marks the end of an applicant television or radio company. Private media owners may shy away from criticism of the government not only because of the possible rejection of an application to renew their operating license or the threat of a crippling fine, but also because advertising from companies close to the central field of power may dry up.

The war over the free press is far from over, but the first battle has been won by the Orbán government. Even if they have not enforced their new rules, the sheer possibility has an intimidating effect. There will certainly be brave people (there are already some) who bear the risk heroically. But there is every reason to fear that several media owners, editors and journalists, even if otherwise ready to criticize the government, will prefer to watch their words or stay silent, applying self-censorship. The programs on public television and radio have already become skewed: some important news items (those ones awkward to the authorities) are not being broadcast or being presented as insignificant, and no fair coverage is being given to opposing opinions. And this is only the beginning, for the new 'Media Tzar' and her apparatus have not started open retaliation.

## The state of law

Fidesz gained power in a legal and valid way, and it has complied with the law in most of its actions. So legality rules in a narrow sense. But the description must continue: if a law in force is in its way, the government changes it. If it wants to make an exception for a favored person or group, it tailors the law to ensure them that privilege. If the law the authorities introduce conflicts with the Constitution, they amend it (as they have done no less than ten times). And if the Constitution, with its multitude of *impromptu* amendments, is still in their way, they will sweep it away and impose a new one on the country. In more than one case so far they trickily circumvented the law, for example by taking a bill onto an MP's motion to circumvent legally compulsory negotiation processes. Moreover, they openly flout Hungarian and EU regulations, the Constitution and the basic requirements of a state of law in significant matters. In one unprecedented case, they re-enacted a retroactive law that had been nullified by the Constitutional Court by curbing the latter's powers.

The principle of a state of law – *Rechtsstaatprinzip* – is a wide and complex concept that it would be difficult to define it in any mathematically precise way, but a democrat will sense the spirit of such a state of law. It means respect for the Constitution and the laws in force, even if they were not enacted by those now in power. A state of law means that legal security applies, that citizens are assured their rights by the state, that those rights are stable and long-lasting, and that they cannot be curtailed on the impulse or at the whim of political decision-makers.

Using the term 'state of law' in this wider sense, I would not like to go to the lengths of saying that Hungary no longer is a state of law. Important legal guarantees have been destroyed in the past few months, including first of all the crude attack on the Constitutional Court. The new political leadership has publicly tried to instruct prosecutors or to summon judges before the Parliament. Still, we fortunately cannot claim that the independence of judges has been eliminated, or that politically relevant verdicts are actually being dictated by a group of politicians for judges to sign. The practice in the coming years will tell how far judicial independence continues, or is eradicated and becomes an empty formality. There will be worries about the future activity of the police and the public prosecutors' offices as far as their practice of investigating and charging politically related

cases are concerned. These worries are justified by several previous bitter experiences: cases may be hushed up when they are awkward to those in government, or handled with bias when the suspects are the opponents of those in power. We will see – let us hope these worries turn out to be unsubstantiated.

### Capitalism

Having reviewed the political field, let us consider the economy. The capitalist system prevails in Hungary. I am convinced it will continue to do so throughout the Orbán government, and survive the present political regime. Capitalism is a particularly tough and robust system. The historical example of the socialist system proves that however strong capitalism may be, it is possible to abolish it in a country or group of countries, and replace it by another viable system. However, this can only be achieved with an iron will, by eliminating private property, and replacing it everywhere (or almost everywhere) by state property; by eliminating market coordination (or keeping only fragments of it), and replacing it by bureaucratic coordination in every section of the economy. Those presently in power have not done so, and there are no signs pointing in that direction for the future. Even if there are similarities between Bolshevik parties and the present-governing group in their style of government, Fidesz is obviously not a Marxist-Leninist party. It does not have a policy of eradicating capitalism.

People frequently have illusions about the efficiency of the capitalist system. Its sheer existence is often believed to guarantee efficient allocation and utilization of resources. That, however, is certainly not the case. While some capitalist economies are highly efficient, others struggle along with a lot of friction.

Far from aiming to eradicate capitalism, the Orbán regime is linked to it by multiple strands and enjoys the support of some big-business oligarchs and many small-business entrepreneurs. It is ready to exchange political and economic support for economic and political support. At the same time, the regime's interventions in the economy keep throwing sand in the works. The anti-capitalist slogans of its public rhetoric do damage to the economy, but much more is done by their actions. The economic policy of the past eight months has decreased the efficiency of Hungarian capitalism, weakened it, and reduced its development chances.

The socialist system is centralized by nature; state property and the dominance of bureaucratic coordination allow centralized command. But not even that system could make headway by voluntarism, the fallacy that the dictator and his group could achieve anything just by wanting it enough. There is a similar voluntarism apparent in the Orbán government's actions. But though they may widen the sphere of state interference and intervene in economic processes in a more aggressive way, we will still live in a capitalist economy. Market rules are in operation. Economic agents in Hungary and abroad have wills of their own. Sellers and service providers cannot be forced to sell or provide services, neither can financial investors be forced to buy government bonds, or investors to create real capital. Even the most aggressive government, over a longer period, is unable to impose its will on the economy in every aspect. And the more unscrupulously a government tries to do so, the more stubborn the backlash will become, and the more damage will be caused to the development of the economy.

### Private property

The edifice of the capitalist system is founded on private property. Looking at real historical practice instead of theoretical models, it will be seen that private property has never been the exclusive type in any capitalist economy, other types having also been present, but private property has been the dominant type, and respect for private property is integral to it: it must be present in the regulations and in the value judgments of public opinion.

What has happened recently in Hungary to private pensions funds seriously undermines trust in the government's respect for private property. That trust could be maintained if a pension reform led to accumulated wealth handled as private property shrinking, and savings managed by the state growing, provided that the changes were based on the principle of voluntary choice. That would be the case if following conditions are satisfied: (i) the active employees faced a genuine choice between different alternatives, including a return from the private to the public pension scheme; (ii) they changed of their own free will, based on information that evaluated the advantages and disadvantages; and (iii) they had sufficient time for consideration. But that is not what is happening. There have been vague, fuzzy promises instead of adequate information, hectic rush instead of fair time to consider, and threats and severe discrimination

instead of a free choice. Those remaining with the private pension funds will partly or wholly lose their rights to a state pension (the loss ratio being dependent on a range of factors). In the midst of self-contradictory official announcements and shallow or downright false information, i.e. in state of confusion, members of the private pension funds are being forced to make crucial decisions that will essentially influence their financial position in old age.

The whole procedure raises sad memories for the historically experienced older generations. The agricultural cooperative movement fits in well with capitalism so long as there are farmers with full control over their own private property volunteering to cooperate. That applies even though cooperative ownership differs from private ownership. But the aim of those who confiscated the lands of Hungarian farmers and forced them into cooperatives in the 1950s and 1960s was precisely to eradicate capitalism in the countryside. Those who dreamed up and implemented the present-day pension reform cannot be accused of wanting to eradicate capitalism. What they have done, however, seriously damages the principles of capitalism, and is not far short of crude confiscation.

### Growth and development

The stated economic policy of Fidesz and the government centers on enhancing growth. Hardly an economist would disagree that lasting growth is the key to the well-being and development of a society. But growth paths can be of diverse natures, each with different characteristics, as every economist will admit. It is also generally agreed that the government can employ varied methods to increase growth, each differing in their outcomes and side-effects. Whether growth should be the central question of the economic policy is not worth arguing now. The real issue is what type of growth to promote and by what methods.

Analysts would be in an easier position if they could see clearly what the government was really planning to do now, next year, in the following years, or in 15–20 years' time – the span of office they plan for themselves. Their oral announcements are full of empty phrases, wild promises with no deadlines, and self-contradictory ideas. What is even more dangerous is that their first definite, figure-based 'statement of intent', the 2011 state budget, does not state clearly, either, what the government is planning to do. Thus

no coherent economic policy is decipherable from the announcements of leading politicians or from the 2011 state budget. Practical regulations are not being introduced after thorough professional debates, careful consideration of short and long-term effects, or comparison of alternative solutions. A sadly low level of professionalism has seeped into the creation of the economic policy. Without a coherent plan to analyze in a consistent and intellectually rigorous way, I am confined to raising a few questions left vague, and to refute a few misleading statements.

When the topic is discussed, we keep hearing a single declaration: taxes will be lowered, and that will give an impetus for growth. However, the many studies that have sought to clarify the causal connection between tax reduction and growth have certainly not reached unambiguous conclusions. We do not know exactly how much GDP increment one million *forints*' tax reduction will produce, or when it will do so, after how much delay. But those one million *forints* will certainly be missing from the revenue side of the state budget, and the deficit will have to be balanced either by expenditure reduction (through austerity measures, in spite of recurrent promises to the contrary), or by loans (in which case what will happen to government debt reduction, another loud promise?) So overall reduction of the taxes imposed on society is not the real plan. Instead it is a question of tax burdens being reallocated. In the absence of careful calculations, we do not know the answer to an embarrassing question. Even if certain tax reductions do result in the growth of total demand and that does generate additional output, will not the loss caused to long-term growth by the reallocation of taxes be greater? True, the household sector (especially well-to-do households) will pay less tax, but business sectors hit by the 'crisis taxes' will pay more. The consequences, however, do not stop at this point, but spill over into other areas. Sectors hit by the crisis tax will transfer much of the burden onto their customers: other companies and the household sector. Their profits may truly decrease, but that will have a backlash, as their profits are a major source of their investments. The disproportionately severe tax burden can be expected to have a deep impact on the short, mid and long-term business policies of some key branches of the financial, production, and trade sectors. The capitalist economy is unable to operate and develop in the long run without a flexible, pro-active, effective credit system. The unacceptably severe tax burden on the banking sector, introduced to spare individual taxpayers, will not hit 'rich bankers', but will slow down the active flow of



the economy. We should not listen only to the banks' public complaints. We should also notice what is happening in the day-to-day activity of the financial sector: that they have already started restricting the credit supply, although credit is needed more than ever. All the sectors involved in the crisis tax are restricting their investment activities, and this will eventually put a brake on lasting growth.

Does the government wish labor productivity to grow as fast as possible and technical development to flourish in this country? Or does it rather want to maintain or restore jobs due to be closed down by international or domestic competition? Is the main aim a rapid increase in employment, or is an increase of production, productivity and competitiveness the real main aim? I am afraid some leading politicians and their propagandists are unaware that these aims are contradictory to a degree; one cannot go around believing that 'employment', 'growth' and 'development' are synonymous terms.

Are small and medium-sized enterprises the group of producers destined to be given a competitive advantage? All right, but then other producers will be disadvantaged. Or is it not some Hungarian oligarchs close to governing circles who are to be preferred over their competitors? Is it easier for a company 'close' to governing circles to get a state contract than for a 'distant' company? Or should the competition run on strictly equal terms?

The experience of economic history has shown repeatedly that small countries are incapable of fast and lasting growth if they are 'inward-looking', trying to base growth on artificial acceleration of domestic demand. Is the present government really ready to give up on the well-trying and sound growth policy of export-driven growth? Is the economic policy of supporting sustainable growth more advantageous for the nation, not one obscuring the idea of advantageous adaptation to the international division of labor while mouthing national slogans?

Some related questions can be raised about the financial resources of growth. Is the economic policy of national isolationism and self-reliance to be followed also in finding resources? Do they wish to achieve fast growth with that policy? Though not advantageous, it could be achieved in a country where the rate of savings is large, and people do not consume a huge fraction of the new value produced by them. But national isolationism is no more than an arrogant, empty

slogan if the economy is ultimately dependent on imports of capital. It is easy to observe that the following three requirements are in conflict: (i) a low level of savings (i.e. a permanent release from the responsibility for one's future); (ii) large investment needed for fast growth and technical development; and (iii) exclusion of international capital. These requirements are contradictory not only empirically, but logically. Which is the one they really wish, and which are only lip service?

Should Hungarian commercial chains be given preference over international chains? Should Hungarian banks be given preference over international ones? Opposition to 'multinationals' is being fomented. But should the biggest Hungarian bank and the Hungarian energy-sector mega-corporation be allowed to become multinational themselves, taking abroad and investing some of the profits they have gained in Hungary?

The governing group wishes for growth within a modern capitalist system, so how could the expression 'gambling on the stock exchange' become a ubiquitous pejorative term? 'Private pension funds have gambled away members' money at the stock exchange,' says the government spokesperson, as if the investment in stocks and bonds traded at the stock exchange were not the normal, recommended, or to a certain degree compulsory activity of every savings institution. They speak as if stock exchange investment resembled a careless father gambling away the family's money at the racetrack, or a baron gambling away a family estate at the casino. Can capitalism exist without a stock exchange or other organizations of a flexible capital market? If a company cannot raise capital by issuing shares, how else can it do so? Exclusively from bank loans? Or should it ask for state subsidy?

Does the government make the most of the huge opportunity of Hungary being a member of the European Union, with the advantage of having structural transformation of the country supported by EU financial resources? Or if that is their aim, why are they delaying practical utilization of EU support? Why do they keep getting into conflict with various EU organizations, instead of listening to their advice and learning from the criticism and warnings offered in a reserved diplomatic style?

Organizers of present-day Hungarian economic policy like to call themselves Keynesians, but what they

are doing can more accurately be termed a kind of 'vulgar Keynesianism'. They seem to have half-digested the theory of the great English economist, and ignored the profound debate of decades among the different schools of macroeconomics. Economic policy inspired by Keynes certainly includes the recommendation that economic growth should be given an impetus, greatly needed in times of recession and depression, by increasing fiscal expenditure. The train of thought also includes the idea, repeatedly emphasized by the critics of Keynes based on several painful historical experiences, that long-lasting fiscal overspending carries the danger of inflation. Unleashing inflation is too high a price to pay for production growth!

Keynes, however, does not only emphasize such an increase of demand by fiscal methods, but also the optimism, investing spirit and expansion drive of entrepreneurs as the engine of recovery, followed by lasting growth – in Keynes's oft-cited words, the 'animal spirits' that motivate the investors. But this optimistic atmosphere and investing spirit is not stimulated, but on the contrary damped by the unpredictability about when and how the principle of private property is being damaged, when and how much tax is being imposed on it, and when and why it is being discriminated against.

Let me add that I am not talking only about the mood of foreign investors, but of Hungarian investors too. A wealthy taxpayer who has more to spend after the introduction of the single-rate income tax will think twice before investing that capital in the Hungarian capital market (for example, by 'gambling on the stock exchange' with it), buying Hungarian state bonds and probably thus supporting state-financed investments, rather than buying foreign securities, depositing it in a foreign bank, or spending it on domestic consumption. Every Hungarian company will be concerned about how much to spend on self-financed investment and how much to earmark for dividends. The less predictable the country's economic policy is and the more damage is done to private property, the slower the domestic investment mood can be expected to improve.

The economic profession has discussed extensively the relationship between monetary stability, budgetary balance, the balance of inflow and outflow of foreign resources, the stability of the purchasing power, the amount of admissible government debt, the level of satisfactory foreign currency reserves on the one

hand, and the rate of growth on the other. Nowadays the debate has become more emphatic, as every country is looking for methods to overcome the recession. But a broad consensus has been achieved on the following idea: sustainable growth is gravely endangered if there are serious troubles with the financial equilibrium of the economy. Those addressing this topic in a responsible way cannot be reassured by the repeated declarations of the government that the budget deficit will not exceed the upper limit targeted for 2010 and 2011. That is a necessary, but not a sufficient condition for financial stability, especially not for a vulnerable economy like ours. The promise of lasting growth will be credible only if the government makes it clear what economic policy it wishes to employ to sustain financial equilibrium in the wider sense after 2011. Unfortunately, the methods the government is planning to use to achieve the target deficit this year and next year threaten to open a much wider gap between state revenues and expenditure in later years, while other types of troubles appear in other aspects of financial equilibrium.

### Distribution

Fidesz, in its election campaign, promised to avoid restrictive austerity measures. Since then the official propaganda machine has tried to give the impression that the promise is being kept, that no restrictions have been made or will be made in the future. But this is only playing with words, cleverly exploiting the vagueness in the concept of 'restriction'. Let us put it simply: the earlier decisions and announced plans of the government actually will cause concrete losses of real present and future consumption to some of the people, decrease the value of their wealth and savings, and increase their debt. The redistribution is continual, causing continual rearrangement of the groups of winners and losers, and change in the size and composition of their gains and losses. Those who have suffered losses, or will suffer them in the future have indeed been 'restricted', and a great many people belong to that group.

So who have suffered the losses? Let me list only those whose losses are certain, although others may well have suffered them too. And of course there may be individuals or families with multiple losses, who belong concurrently to several of the groups listed below:

- The losers include those with low or medium incomes (or more precisely, with income only from

employment, earning above the minimum wage but below 293,450 *forints* a month (approximately 1,100 euros or 1,400 US dollars), and with no dependent children. Their net nominal income will decrease due to changes in taxation and income policy.

- The losers include those with a loan expressed in foreign currency, as their debt has been increasing due to the weakening *forint* exchange rate. For it has been shown that there is a clear causal relationship between irresponsible statements of leading politicians, the announced economic policy of the government, and uncertainties about the budget for 2011 and onwards on the one hand, the weakening of the *forint* on the other.
- The losers include households affected by the gas price increase. The increase, long overdue, cannot be sensibly opposed by any economist. It is repulsive, however, first to promise the contrary and then to break it without as much as an admission that the promise was irresponsible and unfeasible.
- The losers include producers, small and medium-sized companies among them, which do not export their products, yet use imported materials and components, as their production costs have grown and their sales been hit by the weakening exchange rate.
- The losers include employees laid off without explanation from jobs in state service, during a process of purges and restructuring.
- The losers include employees laid off from industries hit by the crisis taxes. Those industries are trying to recoup costs by restructuring and rationalization, which means shedding staff and increasing work loads on remaining employees.
- The losers include those unemployed who cannot get another job due to the sluggish investment climate.
- The losers include those who have accumulated savings in the private pension funds. That real wealth is being confiscated now, and contributors herded into the state pension system, against unspecified pension promises for the distant future.
- The losers include those selling their real estate. In an already depressed market situation, their assets continue to lose value as the government sets out to speed up housing construction artificially, using taxpayers' money, at a time of strikingly conspicuous excess supply. The loss of value intensifies the problems of borrowers of foreign currency-based loans for purchasing or building real estate.
- The losers include consumers, who have shouldered a significant part of the crisis tax burden.

That burden will be passed on whether the government prohibits it or not, whether it is done by the supplier/seller in an open or a concealed way.

- The losers include a high proportion of employees. Wage negotiations are occurring right now. In several spheres, agreements on nominal wages (shaped in such a way that real wages should freeze) have been settled in line with official inflation predictions. Their real wages will fall if inflation proves faster than that.
- The losers include all consumers hit by the accelerating inflation. More definite statements about the influence of the Orbán government's economic policy on consumer prices can only be made at the end of 2011. Now we can consider only effects that appear to be inflationary: the weakening national currency, the rising interest rates on loans used to finance the budget deficit and government debt, and the increase in the tax burden on key branches of the economy. Inflation is a levy that hits everyone, but the effect is felt most by the poorest. The impact of the government's economic policy points in the direction of an increase, and not a decrease in inflation. Central bank monetary policy to combat that danger has to face recurrent attacks from the government's side.

Apart from losers, there are winners as well. But the losers are not consoled by the fact that others have won. Losers will rightly deduce that 'restrictive austerity measures' have occurred, but the screws of the press are unevenly adjusted.

Fidesz in opposition happily made populist statements and attacked economically useful but unpopular measures, as champions of the poor. They often sought to give the impression that they wanted to combine the principles of right-wing ideology with a neo-Kádárite economic policy. What has remained of this now that Fidesz is in power? Only a few conspicuous gestures: early retirement for a certain category of women (a move in the opposite direction to the Europe-wide efforts to delay retirement) re-opening a few railway feeder lines, instead of efforts to reduce the operating losses of the railways. Meanwhile two undoubtedly important moves have yet to begin: change in the government financing of the health care and education sectors. Nobody knows whether future changes in these, labeled 'structural reform', will really change present practice or not. Let me emphasize that their present structures created under the Kádár regime are still being maintained.

So while traces of Kádárism remain in Fidesz policy, moves that redistribute income, tax burdens and privileges favoring the wealthy are becoming conspicuous. A 'rightwing-conservative' orientation of redistribution is appearing in the measures of the tax reform. That direction clearly appears in the uniform single-rate tax system: the higher the taxed income, the larger the gain to the taxpayer. Diverse family benefits have a similar effect. It is especially worth observing that a significant part of the state social security support is provided through tax concessions, so that those in the weakest situation, with no taxable income are excluded.

Redistribution includes distribution of gains and losses, advantages and disadvantages between present and future generations. Some people had naive hopes that the new leadership, on taking power and wishing to keep it for 15–20 years, apparently, might risk temporary unpopularity for the sake of future generations and sustainable growth. But there is no sign of that. The old routine continues: immediate problems are being solved, but otherwise there is an attitude of 'crossing that bridge when we come to it'. Do the holes in the 2011 budget really have to be filled now? Let us impose some taxes of astonishing magnitude on those loathsome banks and multinational corporations, without thinking of what effect they will have on the payers' propensity to invest or the future economic situation. Let us seize the assets of the private pension funds, and take over the pension entitlements, regardless of future costs to the state. Let us not worry what will happen to the state pension fund in the far future, when life expectancy is longer, the active population even smaller, and the proportion of the population entitled to a pension has grown.

I could bring up some other examples, e.g. in connection with infrastructural or environmental issues, where the state economic policy is choosing to postpone measures due to be taken today and passing them on to future generations, instead of seeking to spread the burdens proportionately among the generations.

### Trust

It makes no sense to make sweeping statements about trust, which is a complex social phenomenon requiring detailed analysis. So far, no dramatic change can be seen in the distribution of voters' political trust. Few have left the segment of about

one-third of voters who gave Fidesz its present two-thirds majority in the Parliament, although the latest surveys have shown some wavering. My task here is not one of political prediction. Historical experience shows things going sometimes one way, sometimes another. Sometimes a party's support shrinks over years, and sometimes it plummets abruptly. But a party may sometimes remain politically popular for a long time.

It is of great significance (though it has to be separated from voters' political trust) how much the business community trusts the state. To be honest, this type of trust may be independent of whether the governing form of the state in question is a democracy or an extreme dictatorship, or some at intermediate level of autocracy. Capitalism is a system that can function amidst a dictatorship that flouts human rights. Indeed it may prefer stable, strong-handed dictatorship to unstable, weak-handed democracy, provided the former clearly supports private property, enforces contracts, and guarantees security of rights. Capital welcomes an iron-handed regime like Singapore's or communist China's.

What shakes the trust of the business world are ambiguities in government statements; if gaps in the budget are filled by methods unviable even in the medium term. However emphatically the government may deny the significance of unfavorable credit ratings from respectable credit-rating institutions, repeated downgradings reflect a collective judgment from the business world. And they are not simply a passive reflection of an assessment, for they influence it in a negative future direction.

In the short run, Hungary cannot exist without selling its state bonds regularly. The downgrading of its reliability as a debtor causes immediate losses in the hundreds of billion *forints*, as the government is forced to pay a higher yield if it wants to sell its bonds, whether to Hungarian or international investors. Let me add, the hundred-billion-*forint* losses are manageable, however difficult. The real threat is that trust may not just weaken, but collapse. The government should not rage at those who warn them of this grave danger, but reconsider what causes it.

In the long run, the weakening trust of the business community will slow growth, as I have emphasized from another aspect earlier. That process cannot be easily quantified, but the phenomenon can be perceived. The investment climate of functioning enter-

prises is deteriorating. There are fewer entrepreneurs than would be in a more favorable business climate. Foreign and domestic firms are pushing less hard. The expansion drive is weaker and there is a stronger temptation to invest their capital somewhere else.

### Summary

What has been happening in the *political* sphere is easy to summarize. Several important basic institutions of democracy have been destroyed. Hungary has become an autocracy. The Hungarian political regime is threatening to resemble Putin's. The direction of the changes is clear: they are profound enough to be irreversible (or more optimistically, almost irreversible) and guarantee (or more optimistically, almost guarantee) the long-lasting rule of the group that has gained power.

What has been going on in the *economic* sphere is less easy to describe briefly, because it is full of mutually contradictory actions, regulations impossible to implement, and tendencies impossible to follow. There is no clear direction in the new rules. Let us hope that capitalism is a strong enough system to survive bad economic policy. It is indeed, but it charges a high price for weaknesses.

In the political sphere, the Machiavellian aim (grasping power and retaining it for a long time) has been attained in a masterful way. The plan was clear and definite. Obstacles encountered have been removed without delay or hesitation. As far as the economy is concerned, I have not really been able to discern what the aim is. It seems as if there may not have been any detailed plans to implement. According to government pronouncements, we may in a few months' time be informed of the plans for 'structural reforms', and then be in a position to understand the aims of the economic policy. But whatever the aims may be, they have been bungled in their implementation.

We have every reason to be worried about the future of this country.