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Yet Another Change of System

What can be learnt from history and what cannot

Debrecen, 2004

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Introduction

We cannot complain about the uneventfulness of economy, society and politics in Hungary in past years – we have lived through some exceptionally interesting times. New problems, and challenges have emerged in an expanded world on a daily basis. We are generally prone to analyse most problems in the short run in terms of days, months, years, election cycles, crises and booms.

About 15 years have passed since the end of the 1980s, the beginning of the change of system. This period may cause us to stop for a moment and think over where we have come from and which direction Hungary is heading for. How this period is connected with the past, and perhaps what is even more important, what we can learn or could have learnt from history and the recent historic era.¹ This study – from a personal standpoint – attempts to do this.

It has become particularly appropriate to look back now, because while at the beginning of this period, in 1989, preparations for the first democratic elections were in progress, signalling great changes, now Hungary is going to start a new chapter in its national history as a member of a broader political-economic union – the European Union, from May 2004. Nobody can predict what that new life is going to be like, or how new it will really be, but it is certainly worth pondering on.

Historical antecedents

In the years of the latest change of system the political atmosphere was full of optimism, hoping that a new life could be started, that everything could be started again. Later it became more and more obvious that “we have not even finished our former life” as the society of the 1990s, its political, economic and everyday life, and people’s ways of thinking and actions were closely linked with previous decades, or earlier historic antecedents, whether consciously or, more often, subconsciously, ignoring their own hidden motivations.

The previous centuries in Hungarian history give no cause for nostalgia. We can declare that our aims have been to adapt, to take over ‘western’ and ‘European values’, to survive and ‘catch up’ since our arrival in the

¹ It is a pertinent question, who to believe; Cicero, who thought that “history is the witness of times and the mentor of life”, or Hegel who considered several centuries later that “the moral of history is that nations and governments have never learnt from it”.

Carpathian Basin, which is very rich in natural resources. Naturally this is not a unique situation, as the same tendencies can be recognised in the whole of Central and Eastern Europe. What has hampered, and occasionally eased, the situation of Hungary within the region was that Hungary is situated not only on the border of East and West, but at the crossroads of North and South.

The special situation of Central and Eastern Europe – that while it does not belong to the leading regions of development, the difference is not as big as for countries that are less developed – is the main reason why ‘catching up’ is not only a dream or idea of political demagoguery, but can be a real alternative for different countries at different periods.

The relative proximity of developed societies and economies represents a continuous stimulating force pushing and pulling these regions (Gerschenkron [1984]). At the same time frequent and repeated failures and unsuccessful attempts often lead to precisely the opposite results and cause further lagging behind, or estrangement.

Examples from the world economy prove that such catching up is possible, although not typical, but there is no magic formula for it, no guarantee. In most cases the keys to the situation are unforeseeable factors that are difficult to define. Naturally we can see many developments in the opposite direction. We should not forget that constant development has always been necessary to maintain the relative situation in the dynamic and constantly rearranging world economic development process. We have to run to stand still. History reminds us that it is an illusion to hope that the backwardness of respective countries is bound to diminish in time and it is only a question of patience and growth rate.

Backwardness and closing up are difficult problems which have occurred several times over previous centuries and recent world economic development. One of the major areas of appearance is precisely in Central and Eastern Europe, including of course Hungary.

The period before World War I

During the formation of the modern capitalist world economy the first significant attempt in Hungary to close up can be noticed in the decades following the Settlement of 1867. The second half of the nineteenth century is the period of the ‘change of system’, the transition from feudalism to capitalism. It lagged behind substantially compared to processes underway in England and Western European, so the backwardness of the region considerably increased in the first part of the nineteenth century compared to the dynamically developing Western European countries.

Continental Western Europe tried to close up with England through the banking system and fast industrialisation in the nineteenth century. Unifying Germany became the determining power in this process. The rise of Germany in the nineteenth century is a good example of the earlier mentioned catching up, then followed by a forging ahead.

The fast development of Germany had a pull effect on its neighbour, the Austro-Hungarian Monarchy, and within it Hungary, which found itself in a relatively favourable position after the Settlement. Hungary was able to utilise world economic possibilities induced by the growth of a more developed region in an integrated economic unit, within a protected internal market, benefiting from its attendant advantages.

One of the major driving forces was the intensifying foreign trade, based primarily on agriculture and the food industry, the other being the development of infrastructure, mainly railways, which stimulated enormous direct and indirect demand and growth. Developing cheap, mass transport made it possible to join the dynamic world economic growth.

The hugely capital-intensive feature of these processes exceeded Hungary's capital accumulation capacity. Financing them was possible because of capital dis-investment in the world economy starting from the middle of the nineteenth century.

Beside foreign capital, the prominent role taken by the state was also important in underdeveloped parts of Europe, including Hungary. Earlier the state had played a role in creating the prerequisites for development in Western Europe and later in building railroads. While it happened in a more indirect way and at an earlier stage in more developed regions, in Hungary we can recognise the state taking a role in helping industrialisation and establishing the foundations of modern transport later and in a more direct way.

The most typical Eastern European and Hungarian characteristic of this direct state activity in the development of the economy was the state subsidy of industry. Several laws were passed in this area in Hungary between 1881 and 1907 guaranteeing more and more prominent state support. Tax exemption, interest free state loans and subsidies were common practice. It even extended to buying shares in companies making use of state support.

Hungary could utilise the dynamic world economic growth period of the fifty years preceding World War I, connected to the price and capital movements of more developed regions, as part of an integrated economic unit with twofold integration. The decades following the Settlement have

proved to be the longest golden age of modern Hungarian economic history (so far).

The division of labour in the protected market of the Monarchy, substantial foreign capital and the policy of actively supporting industry played an important role in this.

But not even the prominent economic performance of Hungary was enough to diminish the traditional backwardness. It is especially true if we look at Central and Eastern Europe as a whole. Attempts at modernisation based on following the West did not achieve their aims, indeed the differences became bigger.

The period between the two World Wars

The losses Hungary suffered after the World War are well known. The country lost two thirds of its territory, and its economic structure was thrown into disorder. Its wider integrated environment disappeared due to the disintegration of the Monarchy. Conflicts with most successor states – ‘programmed’ into the peace-treaties – followed.

The region could not rely on the political and economic stabilising role of the West, which was struggling with its own problems. The ‘loneliness’ of the region is a vital element if one wishes to understand historic events of the twentieth century. In this ‘vacuum’ extremist systems grew stronger – communism in the Soviet Union and fascism in Germany in the 1930s.

Countries in numerous conflicts with each other, living within redrawn borders, having suffered enormous war losses, bearing the burdens of earlier public debts and/or indemnities were trying to recover after the World War. Unfavourable trends prevailed in the world economy, making recovery even more difficult. Newly established countries in the region could not overcome historic conflicts in economic relations either and they did not start trade co-operation, but instead chose isolation, adopting import duties.

Hungary tried to overcome difficulties through imposing import duties and turning inwards, just like other countries in the region. After the slump, in the thirties, the beginning of economic expansion was closely connected with the aforementioned military preparations of Germany. Germany’s role became one of the determining factors again, but this time unfortunately, it did not lead to the return of the ‘golden age’, but to tragic participation in another lost war.

In the 1930s Germany attracted many ‘lonely’ countries into its sphere of influence. The ‘lonely’ isolation of these countries would not have been enough for their survival; they needed an ‘integrated’ isolation. Germany

represented the determining, organising power in this system, reaching a clearing agreement with the countries in the region giving favourable conditions for their agricultural and raw materials exports and gaining favourable conditions for the inflow of German consumer goods into those countries.

Between the two World Wars Hungary reverted to its 'usual' role as an agricultural exporter and consumer goods importer, but in a more unfavourable world economic situation, with a worse partner and within a closed market. Between the two World Wars the Hungarian economy – similarly to those of other Central and Eastern European countries – did not approach, but rather drew away from the main lines of development of the world economy. The backwardness was mainly quantitative and structural as the era was not favourable to fast growth anywhere.²

The period following World War II ***Transition – Cherishing illusions***

The Second World War wreaked destruction and suffering never experienced before all over the world, including in Central and Eastern Europe. There were incredible casualties, the destruction of national wealth and infrastructure and a substantial recession in production potential following the war. Just as after the First World War the region underwent a complete transformation.

The period between 1945-1948 was the era of reconstruction, stabilisation, curbing inflation and the introduction of the new forint. At first Hungarian democratic political forces had confidence in the future and hoped that Hungary could take its fate into its own hands (Muraközy [1991]). But shaping an independent democratic Hungary proved increasingly to be an illusion. The protagonists of world politics considered Hungary and this region as a Russian sphere of interest and it was doomed to a 'change of system' against its wishes. The events of 1947/1948 forced Hungary and the whole of Central and Eastern Europe into the political and economic system of socialism.

² Excluding the Soviet Union

Decades of socialism in Hungary

The system of classical socialism

Socialism was introduced in Hungary not as a result of internal development, but due to external influences. A particular system formed in the Soviet Union was transplanted into Hungary and the other countries of Central and Eastern Europe. Socialism as a specific modernisation strategy could be born and strengthened because the region was unable to cope with problems arising from its backwardness and the developed capitalist world could not (and did not) want to deal with them.

Although socialism did not originate in the historical development of Hungary, it can be traced to the historical development of the region. The extension of the socialist system over the Central and Eastern European region happened with the silent consent of the West, which is why efforts aimed at democratic development after the Second World War and the historical attempt of 1956 proved to be illusory. International politics played a dominant role in the 'victory' of the planned economy in Hungary, in 'choosing' the transition from capitalism into socialism.

This isolation lasted for more than three decades, while the globalising economy of developed countries found newer and newer progressive paths of development in booms and recessions. States and peoples involved in this socialist modernisation experiment could only follow or register the events of the West from an ever-increasing distance.

Classical socialism came to power and the political change of system took place very quickly in Hungary and the countries of the region. It took longer to achieve the system's economic purpose, to carry out the change of the economic system – the transition – to lay the foundations of socialism. Establishing property relations and forming the (bureaucratic) institutional system of socialism was of utmost importance.

The source of forced growth was the 'genuine socialist accumulation' (Brus [1966] p 56-77) described in the Soviet disputes of the 1920s, which derived mainly from huge withdrawals from agriculture and declines in the standard of living. Experience gained during socialist decades showed later that in addition, the national infrastructure was one of the biggest losers (Csernok-Ehrlich-Szilágyi [1975]), the backwardness of which is one of the losses that is most difficult to make up for.

Many similarities can be noticed – concerning Hungarian post-war socialist industrialisation – with the period between the two World Wars. Both periods can be characterised by isolation and by attempts to replace imports. After the First World War they tried to replace mainly

consumer goods; in the fifties, in the second phase of import-replacing industrialisation the main emphasis was on industrial raw materials and investment goods (Berend T. [1983] p. 396). It was not an unparalleled case in that period as similar import-replacing politics could be recognised in different countries in Latin America and Asia, with little success there either.

By the beginning of the sixties it was more and more noticeable in Hungary (as well) that the extensive industrial growth had met with its own obstacles. Increasing problems occurred in the functioning of the Hungarian economy. The well known symptoms of the classical socialist system – exaggerated investment, low efficiency, accumulating unnecessary stocks on the one hand, and shortage on the other – indicated that all the measures taken remained ineffective. As a result of all these the Hungarian economy continually struggled with problems related to its equilibrium.

The way in which the classical socialist system was connected to countries with 'market co-ordination' through foreign trade, to all of which it tried to open to some extent, paradoxically resulted in a further closing in, a turn inwards and a strengthening of import-replacing policies. The efficiency of market coordination strengthened the closing up in autarky.

The 'reform thinking', which started in 1953 and led to more comprehensive ideas in 1957, demonstrated (again) in the 1960s – after several years of standstill – that repairing one or another element of the economic mechanism could not lead to any positive results, only a comprehensive reform offered any real solution.

The problems of the foreign trade balance were especially shocking and made it clear that the whole internal economic mechanism had to be changed to increase exports and with the help of it, helped by a change in the structure of production, in order to have a chance of making competitive products in domestic and world markets.

The question of the foreign trade balance is of course not the root of the problem, only a manifestation of it, but this is exactly the area where the market could make its judgement on the system of classical socialism built on bureaucratic co-ordination. Reformers of the time understood the signal.

***The beginning of the so called “long” reform era
(1968-1973)***

The “reform era” lasted for more than twenty years, from the introduction of the new economic mechanism in 1968 to the collapse of

socialism. History seems to have answered the big question of reformers as to whether market socialism is able to make the socialist economic system competitive or not.³ At the same time it is still a fascinating and topical question to discover what influence the market socialism experiment had and continues to have – as a historical antecedent – on the transition itself and the developing new system.

Anti-reform forces already attacked the reforms before 1968 and forced the reformers to step back, to compromise. So finally the reforms were less comprehensive and had a more moderate extension than envisaged in 1966. Pro-reform forces hoped to 'fill out' the process in the following years. They hoped that 1968 was just the first step to be followed by a second one in the 1970s.

According to the basic conception of the reform, unlike the earlier plans, the new economic plans would be communicated to enterprises through centrally 'controlled markets' and enterprises would operate independently, according to the needs of the market. The national economic plan formed this 'controlled market' itself by employing a wide range of economic regulators. It was a simulated, not a real market. However, in the round, we can consider the 1968 economic reform a major change. It put an end to direct plans initiated from the centre and acknowledged a multi-sectored economy, including private property.

The biggest problem was that the revision of economic policy and economic development strategy itself was not considered when the reform conception was worked out. The governing idea was that reforms of the economic mechanism were necessary because the defects in the older mechanism hindered the realisation of proper aims. The economic development strategy of national or COMECON autarky was not rethought until the world economic 'storm' of the seventies.

The 1968 Hungarian reform which, excluding Yugoslavia, can be considered the most significant in the socialist countries of Central and Eastern Europe, meant significant progress despite its odd nature. This progress appeared in the increase of production and a rising standard of living. Even that limited market led to differentiation, which caused significant resentment and resistance among the 'losers' and the social groups they controlled.

Among the anti-reformist forces were most of the party and state apparatus, whose former power was significantly cut by decentralisation.

³ China, which started its reforms at the end of the 70s, still declares itself a socialist country. Developments in China represent one of the major issues in the future development of the world economy.

The importance of the leaders of big enterprises, who were usually in alliance with them, must also be stressed, as their enterprises found it hard to adapt to the challenges of the 'regulated markets'. Their poor performance affected the workforce of big enterprises, many of whom could be easily turned against the reforms.

All this, together with the unfavourable international background in other socialist countries meant that reformers and efforts at reform were forced back at the beginning of the seventies.

The reform process stopped short and the 'second step' of the reform, which was planned for the seventies was struck from the agenda. Well-known political leaders of the reform were removed and a significant regression started. Normative regulation was replaced by a 'tailor-made' 'breakdown of regulations' (Antal [1980] pp. 50-51) with masses of exceptions, increasing direct intervention and centralisation. A centralised, indirect system of control was formed.

Market socialism did not fulfil the hopes placed in it in Hungary. Not only because it was realised inconsistently, but because the system and its basic elements and essence could not be changed by reforms. Connecting bureaucratic and market co-ordination – while improving the operation of the system at certain points – itself became the source of further confusion.

The world economic crisis of the 1970s – the decline of socialism

The two oil price explosions in the 1970s did not simply mean that the price of oil quadrupled in 1973-74, or doubled again after 1978. It also brought about the transformation of the whole world economy and of the leading mixed economies within it. Just as the 1873 crisis led to more comprehensive capitalist control of the whole world economy and to the strengthening of the monopolistic firms, banks and the financial sector, and almost fifty years later the 1929-33 crisis resulted in the strengthening of state intervention, and the development of modern mixed economies after World War II, it can also be said that the world economic crisis in the 1970s was the overture and ferment of a new era.

The above mentioned crises indicated and forced the necessity of periodic changes in countries and regions that were capable of adapting. Those painful changes were justified by further booms later. This series of significant changes caused the rearrangement of the international political and economic balance of forces, and what is more it resulted in a deeper

integration, joining and interweaving of the whole world economy. In a modern expression: the deepening of globalisation.

Countries and regions that were open and adaptable could make progress in the long run. Defensive isolation, which can be noticed so often in the world economy both in space and time, has never proved to be a successful economic strategy historically. With the progress of globalisation it is an increasingly forced concept in the competitive atmosphere which is intensifying in all areas.

Socialism, as we have already mentioned, can be interpreted as a modernisation strategy which tries to close up through forced accumulation of capital and accelerated growth in underdeveloped, neglected regions. Socialism, following a more and more out-of-date extensive industrialisation model from the end of the 19th and the beginning of the 20th century, lagged behind and moved away from the main development trend of the world economy, despite significant initial developments.

Internal resources were gradually used up in socialist countries and the out-dated development decelerated, with more numerous and greater problems. The more developed a country is, the less successful this type of development strategy becomes. That is why the more progress socialist industrialisation makes, the more operating disturbances it will have. These trends are characteristic of countries of both classical and market socialism, as is demonstrated by the example of Hungary.

The crisis of the 1970s set off profound world economic changes, which resulted in a new era by the 1980s-90s, through structural, technical and technological transformations, basic structural changes in the leading economies, the expansion of globalisation and its qualitative deepening.

Socialist economies were unable to keep up with these changes and they were fatally backward in the world economic competition. They were marginalised at an accelerating pace in an economic, political and military sense, which led to the collapse of the system in the Soviet Union and consequently in most other socialist countries. The attempt – started at the beginning of the 20th century – which aimed at modernisation, breaking out of the past and joining up, was caught in a fatal storm in the 70s-80s.

Growth – in crisis (1973-1978)

Reform attempts stopped short before the price shock in socialist countries, and even in Hungary, where reforms went furthest, regression occurred as a result of internal and external anti-reformist forces. It would be a mistake to blame the price shock for the abandonment of the

reforms, since it was world economic changes which influenced Hungary during this period. Short-sighted political leadership considered the crisis striking the hostile capitalist world to be transitional and almost welcomed it, thinking it would not affect the country.

The result was immediate and lasting. There was less need for Hungarian exports, which hardly reached an average standard of quality, in the narrowing and more and more sophisticated international market. Exchange rates deteriorated by 20-30%. The equilibrium of the balance of payments and foreign trade was quickly upset. The problems of the Hungarian economy were only increased as the country continued the earlier extensive path – fast quantitative production increases, and rises in the standard of living – which stimulated a faster growth in imports, which could not be compensated by exports. The difference was covered by foreign loans.

The middle years of the 1970s were marked by great contradictions. Internal economic growth and the rising standard of living continued despite the breaking down of external balances and growing indebtedness. Hungary enjoyed an apparent golden age during these years as the transformation of the world economy and deteriorating exchange rates did not have a direct influence on internal economic processes. The source of this sustained fast growth and consumption was inevitably the increase in external debt.

Seven lean years (1979–1985)

The second oil price shock and growing indebtedness put the Hungarian economy into a catastrophic situation, so at the end of 1978 the leadership was forced to take immediate steps to hold back production and imports so as to ease the deficit in the foreign trade balance. The priority given to the balance, as opposed to growth, was an important characteristic of the change of policy; the other priority was the standard of living, as opposed to developing the economy (Csikós-Nagy [1982]). Growth and equilibrium became very important for the Hungarian economy in its relations with the world economy. It has been recognised many times before that the internationally uncompetitive production structure poses the main problem⁴, but not a great deal of progress has been made.

⁴ As we have already seen this was one of the reasons for the reforms of 1968, but its 'rediscovery' reflected the Central Committee's 'Development direction of the long term external economic policy and the organization of production' accepted in October 1977.

The economic policy of the 'seven lean years' between 1978-1985 tried to reduce the increase in indebtedness and keep the Hungarian economy breaking even through general restrictions, holding back production and maintaining the standard of living. The emphasis was on restriction and it was accompanied – although only in words – by the development of a new growth path and the reforms to serve it.

In summer 1979 consumer prices rose by 20%, which meant the beginning of a long 'open' inflation era in Hungary. Between 1979 and 1990 there was a two and a half fold increase in consumer prices, which rose by 10% annually (Ehrlich-Révész [2001] p. 15). According to independent estimates the average annual level of inflation in Hungary was 3.7% between 1960 and 1980 (Pryor [1985] p. 123). Accelerated inflation was a good means in the 80s to hold back consumption and real wages and also good for reducing consumer price supplements.

Stimulation and resolution (1985–1989)

In 1985, after the seven lean years, the leadership voted for growth and equilibrium as opposed to the decision taken in 1978, but no progress was made in transforming the outdated, uncompetitive Hungarian production structure. The chances of increasing exports by direct methods were slim. Forcing growth in such circumstances had a catastrophic effect. The import needs created by growth could not be compensated by exports, so the process of indebtedness accelerated.

Following the introduction of the Bankruptcy Act in 1986, the two-tier bank system was established again in Hungary in 1987, Hungary being the first among socialist countries in this respect. In 1988 a western type tax reform was introduced, which changed the Hungarian tax system fundamentally. In 1988 Parliament passed the Corporations Act, which came into force on 1st January 1989. The State Property Agency was established in summer 1990. The number of economic organisations operating as entities increased suddenly. But despite important institutional changes, symptoms of crisis increased and inflation accelerated.

The three-year stabilisation programme was launched under the Németh government, which covered salaries, prices and the freedom of company organisation besides foreign trade. Its fast and consistent completion was carried out by the Antall government. But the country could not start down the road towards stabilisation. The country's gross external debt exceeded the critical level of 20 billion dollars in 1989.

Government expenditure in socialist Hungary

It is worth dealing separately with one of the most important indexes of the economic process, the budget and public finances. Officially published data generally had to be handled critically in socialist countries, and this is especially true for budget figures, which were considered almost as secrets. Many aspects of this period can be seen more clearly if we look at changes in the budget. It is worth examining the volume, structure and main characteristic features of Hungarian budgets of previous decades and continuing the examination of the transition starting in the 90s in this light.

Government expenditure in classical socialism

Budget centralisation was extremely high in the 1950s; expenses approached 45% of GDP. Quite understandably in 1953, at the peak of forced industrialisation, expenditure reached the highest point during the Hungarian classical socialist period, at 48.6%. Later it moved around the 40-42% mark until 1968 (Muraközy [1989a] p. 482).

Looking at it from an international perspective, it is a higher level than the budget proportion of a capitalist country at a similar stage of development. This is especially true if we take into consideration that the increasing role of the state and hence the budget had just begun in the developed world in the 50s and 60s. Hungarian budget centralisation was exceptionally high, clearly the result of a planned economy. Economic expenses, such as accumulation and investment, were dominant in Hungary, as well as in other socialist countries, the majority of which flowed into industry, heavy industry and mining.

Government expenditure in market socialism

The Hungarian budget changed in a very interesting way after 1968, following the launch of the new economic mechanism based on indirect control and decentralisation. 1968 caused a very interesting change of policy. Fiscal revenues and expenses rose to 50% of GDP from the 42% of 1967. This was an increase of nearly 20%. This phenomenon deserves our attention, as it is the paradoxical concomitant phenomenon of the introduction of decentralised economic management. The strengthening of budget centralisation is also significant compared to other socialist countries. In 1970 fiscal expenses accounted for 52.8% of GDP in Hungary

while it was 40.8% in Poland and 40.6% in the Soviet Union (Muraközy [1986b] p. 166).

The difference is even more marked compared to capitalist countries, although the role of the state increased significantly there in that period as well. Unlike capitalist states which had high budget centralisation, in Hungary it was not welfare, but economic expenses that were the source of budget increases. Before 1968 accumulation expenses were the determining factor among these economic expenses. In 1968 the sudden increase was caused by the other important economic expenses: assistance for corporations and 'economic transfers'. The volume of these reached one tenth of GDP in 1968-1969.

While the (before the 1968 period) more or less maximalist state scaled down the dimensions of the plan, it forged ahead in another dimension: in applying budgetary financial instruments. After 1968, with the declared growth in independent enterprises making direct intervention less applicable, the economic and financial relations between state and companies came to the fore. The main theatre for this was the state budget and its regulatory system. A slow growth in budget centralisation can be noticed between 1968 and 1973.

Answering the 1973 world economic challenge, Hungary – which had already seen the scaling down of reforms – reacted not by increasing market effects, but by strengthening bureaucratic co-ordination. Budget centralisation increased significantly again in 1974-75. Fiscal expenses grew from 54.2% to 65.5% of GDP in the two years between 1973 and 1975. This proportion is not only the highest in the history of the Hungarian economy, but was unique even by international standards in 1975. Only capitalist countries with huge welfare expenses reached a budget ratio of over 60% at the beginning of the 1980s.

An increase in economic expenses can be detected behind the increase in centralisation. In 8 years – between 1967, the last year before the reform, and 1975 – fiscal expenses grew by 23.5% of GDP, by 56% and within this economic expenses by 15.4% of GDP, by more than 80%. The increase in this proportion meant a strengthening re-centralisation through indirect bureaucratic means.

Budget centralisation decreased to some extent after the peak in the middle of the 70s, but expenses remained at around 60% until the second half of the 80s. It was outstandingly high even by international standards despite the fact that the importance of the budget grew significantly in capitalist countries as well in the 1970s. The Hungarian budget was permanently and significantly higher than in other planned economies that were under direct control.

The support for enterprises represented a very peculiar transfer, with the help of which they could redistribute from 'wealthier' companies to 'poorer' ones, from profitable to loss-making ones, thus levelling off economic disparities. This 'economic-social' redistribution necessarily worked disastrously against the performance- and profit-orientation of corporations.

The state redistribution established a new structure of profit among companies. It was a structure of profit only in name since following the redistributive, determining effect of the price system (Augusztinovics [1987] p. 507) the state redistributed between three-quarters and four-fifths of corporate profits.

The roots of the premature welfare state

In 1980 economic expenses amounted to half of budget expenses in Hungary. In 1990 to only one fifth, but in spite of this, budget centralisation had hardly decreased. At the end of the 80s the expenditure of the Hungarian state still exceeded 60% of GDP, surpassing the figure of welfare capitalist states while the level of its development was increasingly lagging behind.

In 1990, at the change of system, four-fifths of the extremely high fiscal expenses, nearly half of the GDP, was devoted to welfare functions (education, healthcare, social security) as well as to traditional state roles (public administration, defence, etc.) and not to the formerly dominant economic tasks.

The non-economic expenses of the Hungarian budget grew over a 30-year period from 20% of GDP at the beginning of the 50s, to 30% by the end of the 70s. Then there was an explosive growth in this area. In 1985 38.4% of GDP and in 1989 48% of GDP was devoted to non-economic expenses. In the 80s the proportion rose by 18.4% by more than 60% in one decade.

Administration and defence expenses, even if official figures were distorted downwards, were not so high as to fundamentally influence specific features and changes in the Hungarian budget. That is why the other areas of non-economic expenses, namely welfare expenses, are important for our research. These are budget expenses that serve the general public, that are considered public consumption. They include education, healthcare, pensions, various social benefits and many other allowances in money and in kind. These expenses affect two of the main actors in the economy: households and the state. Our research

here concentrates on the relationship between the households and the budget.

Socialist countries cannot be really called 'welfare states', especially not during the period of 'original socialist accumulation'. Public incomes, maintaining public consumption at a low level and redistributing earnings are among the main sources of forced accumulation.

From the beginning of the 60s socialist countries tried to ease the earlier extremes, and issues related to public consumption and the standard of living were emphasised by reducing the extreme increase in accumulation. This was helped by the undeniable economic progress and the desire to consolidate and legitimise power following previous 'hard' dictatorships. 'Power' wanted to 'give to', 'provide for' and 'allow' the 'people' more. This was especially true for Hungary, partly because of the 1956 revolution.

The total income of households in Hungary amounted to half of GDP, while it amounted to three quarters in capitalist countries (Muraközy [1987a] p. 828). The public received a quarter less gross income as a proportion of GDP after primary income distribution than the public in capitalist countries.

The official 'explanation' for low salaries and wages was that the state took care of its citizens, so there was no need for higher wages. The public, the citizen had a one-way relationship in this system – a paternalistic state provided for them. But financed from what? This was a secret to the public. The majority of the revenue was derived from indirect value added taxes and corporate payments that the public could not perceive directly, direct taxes were not too much of a burden, indeed they were a kind of punishment for people who were 'still' rich and for entrepreneurs.

At the same time sources from high budget centralisation made it possible to extend social allowances in pursuance of the above mentioned aims. This conveyed the illusion of a 'free lunch', making people feel that they could get a lot of services free, e.g. education, healthcare, holidays, etc. The budget statistics were not public, in fact they hardly existed.

The paternalistic relationship between the public and the budget only deteriorated with the 1988 tax reform, when it became clear – from the introduction of personal income tax and from the fact that VAT was visible – that the public contributed heavily to the financing of the budget. It also became clear that you could redistribute something only after it had been paid in. The paternalistic behaviour had become so deeply rooted in people's minds that in spite of the changes in the tax system, it became part of the nation's 'general feeling' which lived on after the change of system.

In the 1980s redistribution had a parallel effect on the economic sphere and on the general public in Hungary. The Hungarian redistribution was higher in both fields than in other socialist countries, partly because of the indirect bureaucratic control and partly because of the conciliating politics of the Kádár regime, which preferred to increase welfare. It bequeathed a particularly high budget centralisation, inherited paternalistic behaviour and a 'premature welfare state' to the Hungarian transformation after the change of system.

The proletarian state tried, to a certain extent, to follow its own ideology right from the beginnings, and so attempted to provide certain communal provisions. The introduction of the pension scheme was gradual, becoming full-scale in 1982, which meant that every citizen was entitled to a pension. Extensions and promises were made easier by the fact that the age profile of the population was very favourable in the 50s and 60s. But in the 80s more than one fifth of the population were pensioners. A low retirement age also contributed to this proportion. As soon as it came to fulfilling promises, the state showed a very moderate performance.

The healthcare system showed similarities to the pension scheme. Different layers of the population were gradually included, and from the 70s every citizen was entitled to care. Education was also free. Social allowances, childcare benefits and subsidised holiday systems were developed.

Before the Second World War only a marginal part of the population participated in such allowances, but in the socialist system the development of the necessary infrastructure and conditions did not keep pace with the extended allowances. It is well-known that infrastructure was neglected during extensive industrial development and this is also characteristic of healthcare, education and other services. Free or cheap services were of very low quality. Quality deteriorated in parallel with the extension of allowances. Shortages were a recurrent feature of the system, leading to the development of 'tipping'.

Between 1960 and 1985 the income of the population was around two thirds of GDP, but while at the beginning of the period the rate of social allowances was less than 20%, at the end it was nearly 40%. During this time the net income of the public decreased from 55% of GDP to 43-44%.

Social allowances had doubled by the beginning of the 80s, reaching a quarter of GDP. The 60:40 ratio of allowances in money and allowances in kind changed to 40:60 between 1960 and 1985. The volume of allowances in money grew from 4.8% of GDP to 13.4% in 25 years, in other words

it nearly trebled (Muraközy [1987a] p. 829). In 1985 one third of total public income was devoted to social allowances, and one fifth of this was allowances in money.

Pensions constituted the determining part of the dynamically growing allowances in money. In 1960 pension expenses amounted to 2.5% of GDP, while in 1985 this figure had already reached 8.9%. Allowances in kind were represented by the healthcare expenses of the budget. In 1960 these amounted to 2.2% of GDP, in 1985 to 2.8%. Education represented the other important item of allowances in kind. It amounted to 2.6% of GDP in 1960 and to 3.9% in 1985 (Muraközy [1987b] pp. 24-25).

It is worth examining the development of social expenses in the Hungarian budget in an international comparison. The comparison made on the basis of the methodology and data of the OECD considers healthcare public expenses, social security allowances in money and social services as social expenses. According to this, social expenses in 1980 amounted to 15.1% of GDP in Hungary, to 17.4% in 1985 and to 25.2% in 1990. In 1980 Hungary's social expenses were three quarters of the OECD average, while in 1990 they exceeded the average by 25% (Tóth [1994] pp. 317-318).

It can be seen from different perspectives that welfare expenses, pensions, healthcare and education became more important, and an increasingly larger part of the GDP had to be devoted to them. The rate of social earnings increased in parallel within the increased earnings of the public. Earnings in money became more and more important within social earnings. At the same time the importance of economic expenses significantly declined in the Hungarian budget.

The western style tax reform introduced in 1988 also resulted in a significant rearrangement in the budget. As a result of the tax reform direct and indirect taxes collected from households became the most important items on the revenue side while previously the state was financed by 'hidden' items. However, apart from personal income tax, the 'tax consciousness' of the electorate hardly changed.

As we discussed above there was a significant change in Hungarian public finances in the 80s. Traditional centralisation continued while welfare payments increased and economic expenditure decreased. The redistribution of incomes was prevalent in each and every sector of Hungarian society, and besides enterprises, households also got used to the paternalistic state. In this sense the change of the system did not change attitudes. At the end of the crisis-stricken 80s the Hungarian economy entered the change of system with a significantly restructured budget and public finances.

The change of system and transition in Hungary

The change of the political system, with its raised hopes and high expectations opened the road again to, or perhaps just towards, the West. It was the Soviet Union that forced the socialist system upon the countries of our area, and both the creation as well as the collapse of this system should be looked upon as an impact from outside. Just as for that – earlier – change of system, economic and political aspects should be clearly separated. The change of the political system was carried out quickly, in quite a short time. Although the economic transition had started even before the political change of 1948, (nationalisation, organisational changes etc.) it could and did become irreversible only after the change of the political system. The latter served as a decisive point.

The situation was quite similar when the socialist systems collapsed. True enough, certain preconditions for the change could and did develop in Hungary even during the reform process of socialism (private ownership and the beginnings of certain institutions, for example), but a decisive and irreversible change was brought about by the turn in the political system. Economic transition can extend and truly develop only after this.

A significant historical experiment for modernisation in the 20th century, lasting for several decades, eventually failed. The peoples of the area lived through the collapse of socialism and the promise of a possibly better system with shock and fear but with hopes and high illusions, at the same time. We should not forget, however, that "... the Central-Eastern European region still struggles with the same unsolved questions and problems that were already there even before the revolutionary experiment, such as: unfinished nation-building, the creation of a democratic society and economic modernisation, that are still out there waiting for solution. The target is to reach Europe. Can this new experiment be successful or are there simply new disappointments down the road following this new attempt to break out? Only the 21st century will answer these questions." (Berend T. [1999] p. 9).

Historical conclusions

It is worth examining the system change of the 1990s, the issue of the post socialist transition, in the light of the historical experience we have covered so far. This perspective lets us evaluate the events and opportunities ahead of us while taking longer term experience into consideration. Backwardness is measured in centuries and successful catching up also requires historical steps. Still, even the short term analysis

can make use of various insights into the question of which road we are moving on now – are we successfully catching up, or hopelessly left behind, or perhaps somewhere in the middle?

The question is a live one, since even the results of the socialist economic developments up to the seventies could not guarantee that Hungary would catch up. Since then the whole area has gone through a significant downturn, caused partly by the crisis of the socialist system and partly by the crisis of transition. The gap has widened compared with leading nations.

We can look at the period after 1867 or the one after 1945, and conclude that the decision was not in Hungarian hands – and this happened repeatedly in our history – but rather it was fate, history, world politics or the great powers, who called the shots. The examples of 1848-49, 1945-48, or 1956 clearly demonstrate that the country's fate and future is determined by outside powers even in cases when the internal political forces have decided differently. The country itself actually did not have a real chance to choose between right and wrong; what it could decide on was simply the option of adjusting to the predetermined path in a better or worse way. This is, of course, the common fate of small countries, but it can make a difference what kind of main international current, what kind of world power or world order is the driving force of a country's future. A number of small countries who were in a better geopolitical situation were able to 'live through' better decisions, others, however, got worse.

Before the First World War Hungary was pushed towards the mainstream by Austria and Germany. In between the two wars falling into the 'Lebensraum' of fascist Germany fatally isolated Hungary both politically and economically. Communism, introduced here by the Soviet Union after the Second World War cut off Hungary from a dynamically developing, changing and increasingly global capitalist world and world economy.

For Hungary decisions were made by history, or they were made by others for us, our fate was written somewhere else. Our own political and moral responsibility should not be neglected, of course, but in most cases our question has been: to what extent and to what purpose we can use the good or bad road or system that has been handed to us. How could we be the second determining nation, at least, inside the Monarchy? Could we take advantage of our relations with the Germans in between the two wars? And we tried to make the best out of socialism during the 'soft' dictatorship of the Kádár regime.

Without lessening its historical significance it is worthwhile thinking about the 'latest' system change, our situation after the collapse of

socialism in the light of the history of past centuries. Even if we wished to, we could not state that internal Hungarian developments led to the collapse of the system at the end of the eighties. The general crisis of the socialist system was felt increasingly here as well, of course, but the final blow was given by the collapse of the Soviet Union.

At the same time it would be hard to claim that after the collapse of socialism we had numerous alternatives to choose from. Neither the reviving 'third option' (e.g. neither socialism nor capitalism), nor the turning back to inter-war ideas, which would be almost incomprehensible at the end of the 20th century, could be considered seriously as real alternatives. In the global world economy of the nineties, in the middle of Europe, there was one single real alternative in front of Hungary – to "choose" capitalism. The perspective of Balkanisation, a not desirable but certainly potential alternative can be considered as a strong argument in favour of making the right choice, just to avoid Balkanisation.

The developed West advised, suggested and directed the countries of the region to choose capitalism, and the West itself became a role model in the nineties for these countries. We chose this, too and the socialist system was replaced by capitalism in this area. History repeated itself; the road to be followed by Hungary was given by outside forces.

Historical experience shows, however, that if a positive turn in the world political and economic system brings an economy into a favourable position, this can give tremendous opportunities to the given country. It depends a lot on the country itself, how it makes the best of its opportunities or how it lets its historical chances go by.

Concerning the question of the basic system the change is evident – from socialism to capitalism. The terms 'market economy', 'mixed economy' and 'social market economy' etc. all indicate the same basic capitalist system. There is only one capitalist system, but it may have different varieties, in the same way as socialism had.

The determinism that arises out of our historical situation does not put a stop to our own responsibility, indeed it confirms the two basic questions: what kind of capitalism do we want? And how can we achieve our desired alternatives? In its determination and development there are many factors that play a huge role and they depend profoundly on the country's traditions; its historical background and political and social traditions.

In the case of Hungary the transition and 'Hungarian' capitalism are inseparable from the country's experiences over the past decades and from its history, in spite of the change of system. The most important

questions came and will come after the political change of system: What kind of capitalism should Hungary have and how can we achieve it?

Transitional illusions

The change of system in 1989/90 was accompanied by many illusions, which are usually noticeable during such events. These illusions often affect not just ordinary people but politicians and professionals as well. Of course this is not just a Hungarian speciality, sometimes professionals from the West share the same illusions. The reason why we have to deal with them is that they can be very harmful since they make it hard or even impossible to make realistic evaluations or to recognise the appropriate steps we have to take.

One of the illusions mentioned earlier is that at the time of the change of system we lived for the moment of the 'miracle' of full freedom, while at exactly the same moment the 'right' decision, the development of capitalism 'came' to us. Of course it may require huge resources to identify ourselves with the objectives and decisions taken, but identification is not in itself a decision.

The other illusion is more dangerous – and we cannot even say that it is past – that with the choice of capitalism comes social welfare. People expected a Swiss or Swedish welfare system, or at least an Austrian level of welfare as a result of the change of system. What they experienced in the change of system – even in the leading post socialist countries – was huge recession due to the transitional crisis. But the illusion lives on. At the time of the growing lagging behind compared to Europe's developed regions the objectives of the 'social market economy' or the 'social change of system' can be classified among these illusions – in the worst case it can be a manifestation of a dangerous sign of populism.

The next illusion is also closely related to the previous ones but is connected to the need to catch up experienced by underdeveloped countries and regions. Illusions, beliefs and misconceptions, radical and social theories found better ground in underdeveloped regions partly as forces to progress but often hiding the contradiction between desire and reality. Communism can be classified in this group. Leading countries generally do not need them, but these beliefs and illusions have strong roots in Central- and Eastern European regions. The promise of the modernisation of socialism was that we would reach and leave developed capitalist countries behind.

Nowadays the same is expected of capitalism. The illusion still lives on that after the change of system catching up with the West is only a question

of the growth rate and time. In this analysis it is a quantitative question. The growth rate seems to be one of the most important economic priorities, even at the expense of the deterioration of the balance. We have heard many times and will hear it again that the Hungarian growth rate should be twice the European average, or at least it should be higher than the EU average.

The importance of growth cannot be overemphasised, but what is most important is what type of growth we achieve. Historically we have just passed through a socialist system that led us to lasting backwardness and uncompetitive economic structures etc. and that is the reason why we lagged behind and could not catch up with the West. Structural adaptation, the enhancement of competitiveness, sustainable long term growth are first of all complex quality questions.

Let us set aside the quality of growth and let us examine the illusion of catching up itself. The most important economic advantage of capitalism in contrast with socialism is that it is more efficient. But only compared with socialism. So we have reason to assume that 'Hungarian capitalism' will be more efficient than 'Hungarian socialism'. For the moment we have no evidence that 'Hungarian capitalism' will be more effective than capitalism in other countries and especially in economies overtaking us.

The intensifying illusion from the second half of the change of system is that joining the European Union is the cure for all our problems, and the reason why we have to tolerate part of the problems is because we want to join the EU. This is the combination and reincarnation of several above mentioned illusions and in its present day embodiment is expressed by the phrase 'Western freedom and welfare'. It contains very dangerous illusions as it not only encourages us to have unreal expectations before joining the EU, but at the same time it veils over our present day problems which have diversified roots. It creates unreal desires and unfounded resentment at the same time, which may well rebound on us after we join the EU.

From the various diverse illusions, I have just focussed on the most important ones. It is very important to think them over because mixing up illusions and reality, confusing 'harmless' facts and problems can be harmful in a country's development.

The above mentioned illusions are dangerous because they distract attention from the real reason for problems which undoubtedly exist and from their real solutions. Illusions can ease tensions temporarily, but in the long run they can cause dissatisfaction which can have a negative effect on development.

Transformational crisis – instead of a social market economy

The political change of system was momentous, but the critical tasks of the economic change of system still faced Hungary. Without doubt the contradictory, but decades-old period of market socialism represented a huge advantage. The adoption of goods and financial relationships, the existence of profit and incomes, the various types of small enterprises, the beginning of privatisation, the reform of the tax system, the introduction of the two-tier banking system, the acceptance of the company act, the transformation of people's economic mentality, etc. are all factors that offered the promise of a market economy despite the former strict boundaries.

On the other hand the crisis of the 80s 'left behind' an economy in crisis. A slow growth rate, cumulative indebtedness and an enormous inflation rate were the characteristics of the Hungarian economy at the end of the 80s.

After a long time the first democratically elected government took over control of the country to initiate a programme of liberalisation, stabilisation and privatisation. The Antall government, unlike those in some countries in transition did not adopt shock therapy methods. They wanted to achieve the transition gradually. They hoped that the transition would happen smoothly and they would have the opportunity to develop a social market economy.

The Antall government carried out and consistently achieved liberalisation, including external trade, they liberalised prices, cut back on subsidies dramatically, liberalised the labour market and demolished all barriers facing enterprises. The most important achievement of the government was the fast and consistent establishment of the institutions of the market economy. They passed the strict Bankruptcy Act, the Accounting Act, the Financial Institutions Act etc. Hungary – due to these fast institutional changes and liberalisation – became the number one country for capital investments in our region.

The faster inflow of foreign capital was due to the openness of Hungarian reform socialism compared to other socialist countries. Stronger economic contacts had evolved in the previous period. Privatisation also began in the 80s, on a small scale and with domestic resources.

After some fluctuations financial privatisation became dominant in Hungary and foreign capital was crucial for this. Until 1995 privatisation in the region made huge progress. The ratio of privately owned medium and large companies in Hungary reached 60% by the middle of the decade. Of

this 70% was market privatisation and the proportion of compensation stocks was less than 7%.

In spite of political changes of system, institutional changes and the development of privatisation the Hungarian economy was in a huge economic recession at the beginning of the 90s. The dramatic effects of the collapse of eastern markets, growing inflation and serious unemployment characterised the Hungarian economy in contrast to the expectations of the government and people.

In line with the above mentioned symptoms, the previous state of full employment turned into 12% unemployment by 1993. According to certain estimates 1.5 million jobs were lost in the first few years of the change of system, roughly as many as were created during the 40 years of forced industrialisation. (Antal [2000] p. 3). The new-old problem of public finances did not occur only through the unprecedented unemployment and related provisions but through the 'escape' into pensions and the disappearance of visible and taxable incomes related to the growing number of jobs in the black and grey economy.

An economic recession was noticeable not just in Hungary, but in all countries undergoing transition independently of the fact that they all had different backgrounds, whether in terms of the type of reform, their indebtedness or the gradualist or shock therapy chosen. Therefore decline is a transformational crisis following from transition. The degree of the transformational crisis in Hungary reflects the decline that occurred after a longer stagnation and it was deeper than the country had had to face in the crises of 1929-1933. (Kornai [1993] p. 571) And it was still gentler than in the other countries of the region.

One of the most important factors of the decline was the fall in exports due to the collapse of COMECON. It was crucial that in the liberalised economy traditional Hungarian structural problems, such as the low level of competitiveness, became obvious. The collapsed market positions in the east could not be made up for in the west. The positive effects of the institutional reforms were still late, or even made problems previously hidden more noticeable in the short run (in the case, for example, of the strict Bankruptcy Act). The entrepreneurial sphere and the banking system were in a critical situation. The transformational decline came with a high rate of inflation.

Hungary did not use the instruments of shock therapy but the strictest package of laws in the whole region was introduced to build up the institutional system of the market economy. The Bankruptcy, Accounting and Financial Acts and the Bank of Issue Act had a shock effect first of all on the entrepreneurial system and secondly on the banking system. All

this together with the liberalisation of prices and external trade placed the actors of the economy between the symptoms of the domestic and international markets. In parallel with the above-mentioned privatisation, the expansion of domestic and foreign private property and the overall effects of the strict budgetary limits, resulted in a dramatic change in the Hungarian economy.

The economic change of system – in contrast to expectations – began with a serious decline and transformational crisis. To achieve the transition between the two economic systems we apparently needed a destructive-creative crisis. Characteristics of the crisis burdened the actors of the economy, at the same time they cleaned the market, contributing to the beginning of essential structural and institutional changes.

Government expenditure at the turn of the 1990s

The transformational crises influenced the Hungarian government budget in many ways. Indeed, it became the source and the factor of difficulties, because the crucial change expected from the change of the political system lagged behind in this field, and it was intensified by new problems during the changed conditions.

The changes of the political system in 1990 created a fundamentally new situation concerning the Hungarian budget and public finance. Through the Hungarian example we can follow the enormous differences between the budget of modern market economies and the budget of socialist countries over more than four decades. However, now we are given a very difficult task i.e. the transition between the above mentioned two systems and the carrying out of the change of the political system at home.

In 1986, with the failure of the economic intensification, the expenditure of the budget was two-thirds of the GDP. Then a GDP-weighted gradual decrease of revenue and expenditure was introduced. Expenditure of the budget was 54.3% of GDP in 1991. (Magyarország [1995] p. 158). The decrease was substantial – 10-12% of the GDP over five years.

The decrease of budgetary centralisation during the 1988-1991 recession was an exceptional performance, which resulted in a 20% decrease in budgetary expenditure in real terms over 3 years. (Magyarország [1995] p. 159). This can be carried out only in a crisis and for a relatively short time but, of course, it is still not a reform, but a restriction. This tendency reversed after 1991 and the crash diet proved to be temporary and budgetary centralisation was restarted. By 1993 the budgetary expenditure rose to 61.5% of GDP. (Magyarország [1995] p. 4)

Over two years expansion of budgetary expenditure had accounted for 7.2% of GDP.

Parallel with the increase of the public finance centralisation there was an increasing deficit in contrast with the balance of 1990. The budgetary deficit was 6.6% of GDP in 1993. The revenues could not cover the increase in budgetary expenditure, and so the deficit increased.

As we have seen before, the Hungarian budget of the 1980s was characterised by a twofold process; the economic expenditure dramatically decreased, but at the same time the welfare expenditure on the population increased.

The production subsidies, the accumulation expenditure and the price subsidies were 20.5% of GDP in 1988 and accounted for one-third of the total budgetary expenditure. However, by 1993 they were only 12% of GDP and one-fifth of the total expenditure. Because of the recession this means that their total in 1993 in real terms was only half of that in 1988. (Magyarország [1995] pp. 158-159) The production subsidies were 9.6% of GDP in 1986 (Muraközy [1989b] p. 117) and in 1993 only 1.7% (Magyarország [1995] p. 158). This accounted for the lion's share of the decrease in economic expenditure. Over five years the economic expenditure dropped by 8-9% of GDP between 1988 and 1993. This explains why the budgetary centralisation decreased until 1991.

To understand the changes after 1991 and the renewed increase in budgetary centralisation we have to examine other expenditure as well. As has been mentioned before, in the 80s the budget expenditure on the population, i.e. welfare expenditure, significantly increased. This tendency continued at the beginning of the nineties as well.

Subsidies and allowances in kind together made up 19% of GDP in 1988 and 26.1% in 1993. Over five years the increase was 7.1% of GDP and this was one of the most important areas of increasing expenditure. Their proportion within the budget increased from 30.5% to 41.6% over five years. Such expenditures increased in real terms as well – by 18.3% over the five years.

The social subsidies accounted for most of the state's welfare expenditure. In 1988 they were 13.7% of GDP in contrast to 19% in 1993. From 1988 to 1993 social subsidies increased by 5.3% of GDP. In this increase it is not the increase of traditional elements which was the determining factor, but the appearance of new types of expenditures in Hungary; unemployment and social benefits to ease the social tensions caused by the change of the political system which accounted for 3.9% of GDP in 1993.

From 1988 to 1993 the expenditure on interest payments also increased from 1.6% to 4.7% of GDP (Magyarország [1995] pp. 158-159).

The sudden increase in budgetary expenditure after 1991 was not the result of a single factor, but as we have seen, originated from several factors. The most significant influences were unemployment, social benefits and interest expenditure.

In the first years after the change of the political system the Hungarian budget was on the one hand influenced by the transformation crises, while on the other hand there was a drifting continuity with respect to the eighties. The economic expenditure significantly decreased and the size of welfare-like elements continued to grow.

In international comparison – as we saw in the 1980s – Hungarian social expenditure for a long period increasingly rose above the volume determined by the level of the country's development. At the beginning of the 1990s this social system represented a burden for the Hungarian economy and public finance. To use a term coined by János Kornai, a 'premature welfare state' came into being. It is instructive to compare this fact with the intention of creating the 'social market economy' mentioned in the illusions concerning the transition. What is the actual task here? Do we have to build up a social market economy or to destroy a premature welfare state?

According to international comparisons from the OECD, social expenditure⁵ as a proportion of GDP increased from 15.1% in 1980 to 25.2%. (Tóth [1994] pp. 317-318) From 1990 to 1993, in addition to a significantly falling GDP, the rate of social expenditure in Hungary increased to 27.7% of GDP.

One of the reasons for this was that Hungarian health-care expenditure is rather high by international standards. The other very significant expenditure is pensions. In Hungary pension expenditure was only 2.5% of GDP in 1960, in 1985 it was 8.9% in 1985 and in 1993 9.9% (one-tenth of the GDP). Similar to the health-care expenditure this is higher than that of the European Union average. The pension expenditure, which was one-tenth of the GDP, already indicated at the beginning of the 1990s that the reform of the pension system, just as in many other countries of the world, is one of the burning issues of the Hungarian welfare system.

The Hungarian pension system, without any assets and reserves, found itself in a very difficult situation after the change of the political system.

⁵ In their examination the OECD included health-care expenditure, social security subsidies and social public services in social public expenditure.

The importance of the problem that had to be faced at the beginning of the nineties can be grasped by “calculating the present value of the contribution paid by current pensioners and by the still active workforce who have already acquired some pension rights”. This ‘implicit pension debt’ is 118% of GDP concerning current pensioners and 145% in the case of the present active workforce so ‘the total implicit pension debt is 263% of GDP’ (Magyarország [1995] p. 36).

Besides the health-care system and pensions the state has several smaller or larger social expenditures. According to international comparisons on the basis of the data quoted from the OECD these amounted to 11.5% of GDP in Hungary in 1993. In the OECD report education expenditure not included in the social expenditure was 6% of Hungarian GDP in 1988 (László [1994] pp. 46-47) and was 6.4% at the beginning of the nineties (Tóth [1994] p. 316).

If we add educational expenditure to the previously discussed social expenditure we get 34.1% for 1993, which is more than one-third of GDP and more than 55% of budgetary expenditure. The examination of public expenditure after the change of the political system confirms from varied perspectives the fact that alongside the decrease in the previously dominant economic expenditure, welfare expenditure has become the determining factor in the Hungarian budget. The financing of all these costs on the income side resulted in higher taxes, which particularly increased labour costs, which decreased international competitiveness. In 1989 social security contributions and taxes were 89.7% of net wages, while in 1993 they were 125%.

In the period of reform socialism – as we have already seen – the level of Hungary’s budgetary centralisation was one of the highest at 60% of GDP. In parallel with the radical decrease in economic expenditure in the second half of the 1980s – despite the expectations – the similarly radical reduction in Hungarian budgetary centralisation did not happen. What is more, public expenditure with respect to GDP increased once again from the 54% nadir of 1991 to 60% in 1993-94.

If we compare the Hungarian budgetary expenditure internationally, in 1994 we see that as a proportion of GDP it is still higher than those of the middle-developed capitalist countries, but it also exceeds that of the other post-socialist countries. This – together with the internal structural changes – can be considered a difficult legacy of the previous period. The rise of the ‘premature welfare state’ and the related system of illusions, promises and exceptions are present everywhere in society and this represents, or could represent one of the most difficult problems for Hungary in the construction of a new society.

The change of the political system and continuity

One of the most important results of the first years of the transition in Hungary was that the government consistently, decisively and speedily established the legal and institutional framework of the market economy. Doing so, it continued and completed the transition started in the second half of the 1980s. It brought the strict bankruptcy law into effect with the help of which it tried to prevent financial regulation from being paralysed by go-round debt. The accountancy law which guaranteed transparency was also passed and the commercial banks were obliged to hold reserves.

The 'market clearing' effect of the introduction of this package of laws had a shock-effect on the companies and banks, an effect which possibly legislators and parliamentarians did not expect. In Hungary the 'preliminary' events of the seventies and eighties, even if they alone did not lead to the change of the political system, greatly contributed to it, both in theory and politically. This enabled a peaceful transition; the calm change of the political system (Csaba [1994] p. 186). As a result of these precedents it was not necessary to use shock therapy in Hungary, unlike in other post socialist countries.

The fact that a shock therapy was unnecessary does not mean that it was not necessary to take advantage of the historical moment to stabilise the economy. A stabilisation package should have been put together and budgetary expenditure and imports should have been decreased by fiscal action and methods. Furthermore the population should have been told in clear terms that all this was the price they had to pay for the mistakes of the past. However, the Antall government was afraid to take unpopular measures and did not stabilise the fiscal balance by a comprehensive macroeconomic stabilisation.

As a result of the above-mentioned important preliminaries, Hungary was in a much more favourable situation than the other countries in transition, the other post socialist countries where there was a change of the political system. Unfortunately the Antall government could not manage the political legacy and a suitable strategy and political courage were missing. How can we explain why the Antall government could not use the advantage the previous Hungarian development offered, and by postponing or not even recognising the necessity of unpopular measures contributed to the growth of tension and the worsening of the economic situation in Hungary? The failure of the transformational crisis was inevitable, but its dimensions could have been moderated and the prerequisites of permanent growth could have been created.

One of the answers might be that this government was addicted to the illusions concerning the immediate creation of a social market economy and the transition from 'Goulash-communism' to welfare capitalism. On the other hand, the answer may be the extraordinary nature of the circumstances. Among others things, the recognition of continuity and a consideration of history may have helped in the formulation of a correct strategy. The lack of a concrete strategy and decisiveness is explained by János Kornai who says, "There was a special continuity in the priorities stimulating the Hungarian economic policy and it lasted throughout the big political turning point of 1989-90. The same orientation prevailed for 25-30 years." (Kornai [1995] pp. 1100-1101). The essence of this continuity is the revolution in 1956 followed by the security of political quietude which penetrated into Hungarian political life and economic policy with the calm at the beginning of the sixties, the fear of great changes, the prevention and avoidance of conflicts, and in the interest of all these, the provision of the material welfare for the population, the maintenance of a strong caring state, the reforms, and the maintenance of graduality and continuity in the changes.

Of course, the transformation of the political system brought about by history, meant significant changes, but the above mentioned phenomenon also appeared in the transformation, since it brought a calm, peaceful transition. As has been mentioned, the sense of continuity in economic policy and in the change of economic system was very strong. Shock therapy was correctly avoided, but in a less justified way, the necessary stabilisation was not carried out either. The economic policy of 'survival' continued and it was followed by the neglect of a long-term economic strategy and by the lack of the necessary political courage to create it and make it accepted and practicable.

In this tradition, in this system of norms, the moment, the present, has absolute priority. The preservation and maintenance of present power is the greatest motivation for the creators of policy. A basic method to achieve this is the maximisation of the present and near-future consumption of the population, which would not be a problem in itself, if were not that to achieve it future resources have to be given up, increasing the debt which the next generation will have to pay.

A part of the above mentioned trap is that we try to imagine the future, and to have it imagined for us, in a form which is much better than, for example communism or a social market economy or welfare capitalism, or at least better than the present, and to achieve this we expect and/or promise a high growth rate. This 'growth expectancy' is a very strong phenomenon which, unlike the inflationary expectation, does not come

to pass, but on the contrary is counter-productive because among other things it may result in over-distribution and it can decrease real growth.

Of course, the above mentioned or similar tendencies do not appear only in Hungary. In general, countries which are trying to catch up or countries which are in crisis have a lot in common. The politics that favours the present is not something unknown in the developed democratic countries, especially in the face of forthcoming elections. All this does not provide excuses for Hungarian politicians and decision-makers and it does not make the country's situation any easier. As an inheritance of the previous period we have to come to terms with the handing down of this mentality and politics to the present and future generations with all its attendant consequences.

Traditional 'growth' crisis – extraordinary stabilisation

The Antall government emphasised or would have emphasised growth from the beginning and it underestimated the size of recession. It tried to ease the tensions with an expansive fiscal policy. At the beginning of the nineties the National Bank had a restrictive monetary policy which led to the increase of interest rates. This greatly contributed to the increasing savings of the population. However, the National Bank used the exchange rate policy as an anti-inflationary measure and the forint was overvalued. From the autumn of 1992 this monetary policy became less strict and it significantly decreased the interest rates to decrease the interest burdens of the state budget and to stimulate company borrowing. Until the autumn of 1993 there was a negative real interest rate which decreased the savings of the population on the one hand, and on the other contributed to the dramatic increase in domestic demand. In 1992 the government overspending and the up to 6% deficit of the GDP was greatly counterbalanced by the significantly increasing propensity of the population to save. In 1989 the savings of the general population was 7.5% of GDP. This rate increased to 14.9% by 1991 as a result of the uncertainty caused by the change of the political system, the shocking effect of increasing unemployment and the stimulation of high interest rates. Even in 1992 it was 12.4% of the GDP and was able to finance the increasing deficit of the state budget.

In 1993 the effect of a loose fiscal policy together with a loose monetary policy was evident. GDP had already decreased by 0.8%, investment had increased by 1.7% and consumption by 1.3%. Among other things, as a result of the negative real interest rate in 1993, the savings of the population decreased to the level of the eighties. However,

the accumulation of companies increased, so the deficit of the state budget could not be financed from domestic resources. The overspending of the government, the increase in investment and the increase in domestic demand generated by rising consumption, increased imports by 20.9% by 1993. However, exports rose by only 13.1%. Despite the significant influx of capital the current account deficit soared to 9% of GDP and the external debt significantly increased (Bokros [1997] p. 20). In 1993 the state budget deficit was 6.5% of GDP, and the current account deficit was 9%; a significant twin-deficit was formed.

The Antall government 'walked into' the dead-end of growth without foundation, experienced several times in the previous decades, and based on the stimulation of domestic demand. This particular experiment was necessarily followed by the imbalance of the opened-up Hungarian economy, and eventually was financed by foreign countries. The price we had to pay was the increase of debts and deteriorating balances.

On 12th March 1995 on the basis of the programme of Lajos Bokros, the new finance minister, and György Surányi, the president of the Hungarian National Bank, a macroeconomic adjustment and stabilisation programme was started in Hungary. Such radical measures meant the abandonment of the previous survival policy, and they generated great social resistance and resentment. This sense of rejection was increased by the fact that the aim of the programme was not to tackle the outbreak of a crisis, but to prevent it, and "the people in the street do not consider the prevention of a disaster not yet experienced as a sense of achievement." (Kornai [1996] p. 592)

The greatest achievement of the programme was to combine the traditional orthodox stabilisation elements with growth stimulating measures. Therefore we consider it heterodox. However, it is important to emphasise that it fortunately harmonised the international stabilisation programmes using the features of the Hungarian economy and the relevant measures from the experience of previous decades. Lajos Bokros and György Surányi had lived through and several times analysed (Antal et al [1987], Bokros [1987]) the previous struggles of the Hungarian economy. The programme introduced in March 1995 built on the achievement of the change of political system, for the first time in decades showed how to tackle the problem of growth/balances and the maintenance of permanent growth.

A permanent solution was to set up a modern production system and use excellent technology and, based on all this, produce a competitive export performance, with exports increasing faster than imports. Considering the size and characteristics of the Hungarian economy only

successful export-led growth could solve the dilemma of balance and growth which has burdened our modern economic history. In all other cases, although it has been possible to stabilise the economy in some way and for sometime, the problem itself returns in a stronger form. If we close the economy and divert it from the main stream of development, as before World War II or for a long time after 1948, in the end the historical price is high.

As we know and as we have seen the technological backwardness and the obsolete economic structure were the result of the socialist economic system. Therefore there is no chance of finding a solution in the period of the planned economy. We saw it very clearly in the seventies and during the restriction period which lasted from 1978 to 1985, when in these seven years we wanted to set up a modern competitive economic system. But the new attempt for growth again after 1985 led the economy into a classical Hungarian 'growth crisis' and as a result, the debt of the country doubled.

In 1995 there were recurring symptoms and in part the therapy was familiar from the previous period. But so far a cure had not yet been found. What was the difference between this and the previous periods? The process of the nineties showed that the patient had significantly changed. There was a change of the political system and the change of the economic system was well underway.

The basic framework of the capitalist economy was more or less built up and private property became dominant. There was an integrated, basically liberalised economy, which fitted into the globalising world economy and its regional environment. During the crisis of transformation, and after it, there was a significant structural change and selection. Significant operating capital came into the country, which helped in the adoption of the most developed technology.

The above mentioned points enabled the Bokros package to carry out not only a stabilisation – which of course cannot be undervalued – and to carry out orthodox measures following a recession based on general restrictions, but to achieve a fundamental economic turnaround. The importance of the aimed turnaround was to put the Hungarian economy on an export-led path instead of growth driven by domestic demand, and based on the priority of increasing domestic consumption, which sooner or later leads to external imbalances for well-known reasons. It recognised that the Hungarian economy is permanent and its development can be maintained and its balance path can be based on export-led growth.

We must emphasise that the creation of the capitalist economic policy and the setting up of its institutional framework only provided an

opportunity to realise the above mentioned sustainable growth path, but not the guarantee that it would happen. In other words: capitalism is a necessary but not a sufficient condition for such an economic strategy. We see, and we have seen in the past, many capitalist economies, which – similar to the well-known periods of the economic history of Hungary – do not follow this path. In Latin-America there are several examples. It is also important to emphasise that it is not a one-off step, but implies the continuous application of such an economic strategy. “The macrostabilisation is not a single battle, but a never ending war.” (Kornai [2000] p. 658)

The programme-makers originally thought that the temporary effect of the short term income-increasing and austerity measures would be followed by the permanent decrease of expenditure which had been created by the restructuring and reduction of the system of the premature welfare state. There were symbolic but striking measures in this direction. Such measures include of the introduction of the priority principle in case of family allowance and child-care allowance, the appearance of partial financing of certain health-care provision, for example in dental services, and the introduction of a symbolic tuition fee.

These measures were symbolic but they were not part of a state budget reform. Now, the aim was stabilisation and the export-led programme, the decrease in expenditure, the increase in income, and the improvement of the balance. On the other hand, it showed that the carrying out of the state budget reform might be a clue to the financial stability of the country. The decrease of state expenditure could provide significant resources for economic growth.

Fading chances for sustainable growth

The stabilisation of 1995 was only a starting point and an opportunity. It was a chance for the creation of the balance to ease the situation of the Hungarian economy, not just for a few hours, but as an aid to start the export-oriented turnaround to be completed and consolidated and to allow the temporary income increasing – and expenditure decreasing – budgetary measures to be followed by the reform of the ‘premature welfare state’ and a significant decrease in government budget centralisation.

In Hungary after the final decision to introduce the plan there were only a few months for its introduction, so many details were not correctly worked out. From 1st January 1998 the complete divisional-imposing system was changed to a mixed construction. There remained a divisional-imposing part as a main pillar and a new capitalised private pension system

was attached to this. The divisional-imposing pension system virtually remained unchanged⁶ together with its attendant errors and the legislators postponed the adjustments to the period around 2010. At the time of its introduction the redistributed contributions showed 75:25 ratios in favour of the divisional-imposing system.

The reform – as usual – did not decrease government expenditure in the short run, but increased it as a result of the loss of private pension contributions. On the other hand the original decrees were adjusted several times which is decidedly harmful in the case of such a long-term system. These generally increased the burden on the pension funds and on would-be pensioners i.e. the future. Here the government of the present acted against the future again.

An important measure of the 1998 pension reform was the setting up of a capitalised private pension system. However, most of the basic problems of the social security pension system remained unsolved or in many cases the law postponed their solution until after 2010. In the case of the other welfare elements, during the restructuring of the health-care system there were no reforms, not even after the introduction of the Bokros-programme.

All in all we can say that out of the comprehensive reforms of the welfare system only that of the pension system was realised, although it was not problem-free as far as the future was concerned. However the reform of the other major systems was not carried out. After the Bokros package there was no development in this field, although this would have been the most desirable way to decrease government expenditure in the long run, and would have moderated public consumption, and would have given resources for sustainable growth. This strategy is justified by the lessons of international examples. (Lindbeck [2001] p. 171)

According to the executors of the programme the balance generated by the stabilisation was an inevitable prerequisite for the creation of the background of the reforms, however the reforms themselves would have created a long-term stabilisation.

Not only did the lack of long-term stabilisation reforms cause a problem, but the usual political reflexes also endangered the short-term balance. As the sense of danger started to fade, the instinct among politicians to offer handouts increased. Obviously it was stimulated by the coming general elections. From the autumn of 1997 the fiscal policy gradually started to weaken again and the balance was once more pushed to the background. Slowly at first, then faster the budget began to decline, to be followed

⁶ Unlike for example Poland, where this was changed ([Fultz 2002] p. 465-466)

by the decline of the current account. The Orbán government – citing the good old times – put the high growth rate, the catching up and the closing up at the centre of its economic policy. Its ideas were those of the previously mentioned growth- and closing up illusions, and of course, it was not unprecedented in the region. In the election campaign they promised a 7% GDP growth rate, a promise which appeared later very often.

Aware of the overspending of 1998 and its negative effects, in 1999 the government while emphasising growth to the outside world carried out a very strict consistent ‘cold’ stabilisation from inside with a basically hidden cut in expenditure, counterbalancing the overspending of the election year. One of the means used was the restriction of state investment, the postponement of the promised infrastructure development (e. g. motorway construction, etc.) and its ‘verbal construction’⁷ which has become very common since.

The government, being in the first part of its election cycle, was of course restrained in 2000. However, the lower than predicted level of inflation helped to moderate wage increases and caused a big inflationary income growth, which could be distributed by the government. That is how the majority of the increase of the ‘achieved’ nominal wages managed to be inflated in 2000, moderating the previous increases in consumption.

In 2000 the Hungarian economy reached the highest growth rate, 5.2%, since the change of the political system. After the Bokros-package – between 1997 and 2000 – we meet the ‘golden age’ of Hungarian economic growth. However there were already external and internal factors in 2000 indicating that some severe changes were on the way.

A “Post-Keynesian” turn – inwards

The importance of the paradigm change of the 1995 stabilisation and export orientation cannot be over-emphasised. However, as has been mentioned before it did not solve the century-old problems of the Hungarian economy, but gave a chance, a direction. In addition, to the fact that the decrease of the government budget centralisation did not happen in the following years as a means to increase long-term competitiveness

⁷ György Matolcsy said the following about the length of the motorways built in summer 2002: “the length of motorways is not as much as it would follow from the six hundred kilometres planned to be built in the next five years. It is 20-25 kilometres. Next year there is a real plan to build a 60-70 km motorway. It is certain that in the next 2 years there will not be built a 120 km long motorway and road, but later it may be.” (Matolcsy [2000a] p. 79)

and decrease public expenditure and that the inclination to domestic overspending took root once again, we also have to emphasise that the success of the programme was due to one-off possibilities and temporary methods in 1995.

The general world economic boom provided a definite background and reason for growth after the stabilisation of 1995. It was proved by the luckily short, sudden, direct and indirect negative impact of the 1997-98 international financial crises on Hungary. (Antal [2000] p. 12)

Between the period 1997-2000 the real question, the big issue, was how we could establish the conditions of permanent growth, how we could substitute temporary effects with permanent ones and how we could renew the forward forces in the Hungarian economy. Unfortunately, as we have seen, we could not seize the opportunity.

The Orbán government, temporarily putting aside the ideas of its election programme, managed to stabilise the Hungarian economy in 1998-2000 and pushed it towards a balance after the weakening fiscal policy of 1997-98. As we know and we saw in 2000, the majority, including the government itself felt that the Hungarian economy was on a course of permanent development and 5% growth was sustainable. This was reinforced by the fact that the growth became even faster from 1999 to 2000.⁸

However the dominant voices in the government thought that this pace was slow. Catching up as fast as possible with other countries, approaching the standard of living of the European Union, the expansion of distributable wealth and the guaranteeing of political power all required a faster tempo. The Irish example, the vision of the Celtic tiger, inspired the Pannonian tiger. And the Orbán government “dared to dream big”.

The ideas show a return to the election programme. Eventually the Széchenyi-programme came to symbolise this strategy. This programme was based on the New Deal, the internal demand-led growth through infrastructural development in a late Keynesian manner – and it was certain that these investments had relatively low import demand. At the centre was housing, the aim of which was to build twenty thousand flats and with this bring an expected 1.5% GDP increase, whereas it expected a 0.5% GDP increase from the 50-60 kilometres of motorway. And if we add this 2% to the expected 5%, than we arrive at the 7% growth promised by the Fidesz programme. According to the expectations of the government, private capital would have carried out the extra developments and the

⁸ As we have seen this was due to the end of the international financial crisis.

government itself would have acquired greater wealth from their extra revenues. (Matolcsy [2000b] p. 76)

Besides many other factors, one big difference between the Széchenyi-programme and the New Deal which inspired it is that the latter helped an enormous economy to come out of a crisis, and the former wanted to 'top-up' growth in a slightly open economy. Of course, 70 years have passed between the two and the changed world and world economy are not secondary factors either.

Of course, this concept based on the increase of the internal tools is absolutely against the idea of the previous export-led economic growth and practice. It is hard to imagine an economy which steadily and successfully combines a balance-deteriorating and balance-improving economic strategy, which both logically and temporally appear as the alternatives of each other during the development of the Hungarian economy. The new 'Hungarian model' (Mádi [2001] p. 14) which would deny traditional economic theory did not really prove to be successful.

By 2002 we had come a long way from the expected 7% growth increase. Experiencing the decline of the world economic boom, the Orbán government increasingly expected growth from an increase in internal demand and with the help of this tried to counterbalance the impact of the world economy. As the minister of the economy put it, "we are intensifying because we have already found the new structure of the healthy two-pillar economic growth. In this framework the infrastructural investments and the expansion of internal demand serve as a growth engine besides the global push. We are already able to strengthen the second if the first weakens. What is more, the strengthening of the internal economic engines means making up for the decade long backwardness in every case ranging from the motorway construction to housing, from the increase of the minimum wage to the investment subsidies given to enterprises." (Matolcsy [2001] p. 24)

As the figures showed the second pillar did not help very much. Among the less favourable, external circumstances, besides the 3.8% GDP increase in 2001, the increase in exports fell to less than half, 9%, and showed a worsening tendency. In the last quarter of the year exports were lower than the previous year. This was accompanied by a significant increase in the value of the forint at the time of the change of the exchange rate in spring. Investments in the market had already decreased in absolute terms. After a long time, for the first time since the Bokros-programme, consumption grew faster than investments and was higher than GDP growth.

In 2002 the slow development and the changes of the structure of

domestic use in favour of the consumption continued. Besides the 3.3% GDP growth domestic consumption rose dramatically with respect to the relatively high level of the previous years and was primarily connected to the revenue outflow which was higher than ever before. The truth is that this was the result of the combined and unanimous efforts of the two governments.

In 1999 and 2000 the increase in real wages was 2.5% and 1.5% respectively, substantially below the GDP growth rate. The turnaround appears in 2001, the year before the general election. Real wages rose by 6.4%, whereas GDP grew only by 3.8%. In 2001-2002 the wages of public servants were increased by 70% and from January 1st 2002 the minimal wage rose to 50,000 Ft. To the already increased base of 2001 was added the 13.6% real wage increase of the election year, which was more than four times the decreasing growth rate of the GDP (KSH [2003a] p. 117, 303).

The strict monetary policy made the situation for domestic exporters difficult. As usual the pre-election wage and salary increases, especially the increase in the minimal wage, made Hungarian labour more expensive and by doing so it made Hungary less competitive. The tough monetary policy and the loose incomes policy weakened the chances for exports, and increased the import pressure. This was also accompanied by – taking into consideration all the tools used – a loose fiscal policy. All this pushed the Hungarian economy onto a path characterised by a decreasing growth rate and declining exports. The introduction of preferential housing loans further decreased internal savings and even strengthened the need for external financing.

In 2002 the growth rate of investments moderated, but an even more unfavourable sign was the continuation of the internal structural shift. In the market and in the industries serving exports and economic growth directly, investments decreased in absolute terms. However, the substantially government-subsidised housing construction went on intensively in the non-market related field. Public administration and defence again led the growth of investments, and the increase was 74% in the first half of the year.

In the second half of the 1990s the influx of operating capital played a significant part in financing the current account deficit, and it did not increase the national debt. With the exception of 1988⁹ the influx of

⁹ This happened because the often mentioned international financial crisis and the Russian crisis had an unfavourable effect on Hungary owing to the risk of “regionalisation”.

operating capital increased every year, as did the current account deficit. This tendency reversed in 2000. In this year the influx of foreign operating capital slightly decreased, however, the Hungarian capital outflow increased, so the resources which did not increase the debt covered only 8% of the deficit. This rate was 41% in 2001 and 32% in 2002. As a result of the above-mentioned factors the gross foreign debt significantly increased. In the same period the net indebtedness grew even more quickly and it increased from €10,1 billion to €15,7 billion (KSH [2003b] pp. 56-57).

The state within the state(budget) – and outside it

When examining the major tendencies it is worth studying how the economic strategy of the government influenced the 'mirror' of the soul of economic policy – the government budget. What was the fate of the decades-long 'overweight' state of the Hungarian economy following the turn of the millennium?

As we have seen, when the Orbán government came into office it creatively adjusted the government budget in 1999 using internal austerity and in 2000 it underestimated inflation. This was helped by the significant increase in GDP especially in 2000. By 2001 it managed to decrease government expenditure to 45.6% of GDP and the deficit was decreased to 2.9% of GDP (KSH [2003a] p. 306, p. 362).

This meant that the public finance deficit officially decreased below the benchmark of the European Union. This raised hopes, since the deficit and the budget were roughly in order, so only inflation had to be decreased and we could meet the most important criteria. The other important hope was connected to the fact that the state budget centralisation might be further moderated systematically to approach 40% of GDP.

On the other hand, the supervising role of the parliament significantly decreased by the 'innovation' of the Orbán government i.e. by the introduction of the two-year-budget. The two-year-budget accepted for the year 2001-2002 provided a relaxed background for the government one and a half years before the general election. As we have originally seen the start of the planning was 'favourably' influenced by the higher inflation rate, which was higher than the planned one and this effect was carried through the whole base. The inflation was still higher – 9.2% – than expected (KSH [2003a] p. 117) and certain inflationary taxes were forecast. The accepted 2001 budget had already predicted that the fiscal policy shifted from its previous restrictive direction to an expansive direction on the basis of the new strategy.

From 2001 the Hungarian Development Bank (HDB) was given a more and more important role besides the state budget. The restrictions on acting as guarantor applied to the HDB were not the same as those applied to the government and they made use of this possibility. The expansion in guarantee-taking meant or may mean liabilities for the future and they are difficult to trace.

Outside the budget another important field of government strategy was the privatisation policy. As we have seen privatisation accelerated after the Bokros-programme and was not a pivotal issue in 1998 any longer compared with the previous years. After 1998 the Orbán government followed the scenario of the previous government in many respects. After the change of government privatisation became slower, the government centralised power and wealth and changed key individuals both at the governing authorities and at the enterprises.

A novelty was that the power of the central privatisation and trustee company did not decrease but continuously expanded. It is true for the whole period that government-generated redistribution was the determining factor in the activity of the privatisation company rather than privatisation. It is well-demonstrated by the fact that the State Privatisation and Trustee Company did not raise but spent public money between the period 1998-2000, because the expenditure was higher than the revenue. The majority of the expenditure included company subsidies reminiscent of the 'good old times'.

The Orbán government expanded the role of the government in a creative and rather non-transparent way outside the government budget and public administration as well. This way "the State Privatisation and Trustee Company and the Hungarian Development Bank may become the budget-evading hidden redistribution channel. The trustee holding company already previously supported its own companies from its own revenues and reserves and it saved the central budget from that expenditure. The novelty here is that the resources are allocated by the budget – with the help of various transfers – and the aim of the investment and sometimes its beneficiary remains outside the overview of parliament and the public." (Voszka [2001] p. 737) The strategy of 'the state outside the state', which included a more intensive utilisation of the hidden and less hidden channels and opportunities in previously existing or similar institutions and their creative development, accompanied the activities of the Orbán government and they became more and more significant and sophisticated.

A decreasing 'welfare' state – increasing tensions

Research shows that the cutting back of the “premature welfare state” was successfully achieved in Hungary in 1990s. During the decade after the change of the political system the decrease in welfare expenditure of the government budget was significant in Hungary. The recession of the first half of the 1990s, the restrictive measures in the social system of the Bokros-programme, the restriction of the ‘premature welfare state’ characteristic of all governments and the big inflation of the decade all encouraged this tendency.

In 1990 the overall welfare expenditure of the budget was 30.6% of GDP whereas in 2000 it was 26.2%. Within this education accounted for 6.9% of GDP in 1990 and 5.4% in 2002. Health expenditure was 4.9% of GDP in 1990 and 4.4% in 2002. Social security and welfare expenditure including housing was 18.8% of GDP in 1990 and 15.8% in 2002 (KSH [2001] p. 292, p. 230; KSH [2003a] p. 306, p. 362; Muraközy [1992] p. 1064).

The decrease in expenditure did not really mean the real reform of the welfare systems and the solution of their problems. Basic problems are still unsolved. Now I would like to emphasise just three of them. The first is that the welfare expenditure of the government budget is still very high. The second is that the reform and the systematic change of the big allocation systems, except for the partial reform of the pension system, were not carried out. The third is that the citizens feel – most of the time correctly – that the services they get are getting worse and worse despite the high costs (the volume of which they do not really realise). The welfare system cannot really help to solve the worsening social and income problems following the change of the political system. In brief we can say that today the Hungarian welfare system costs a lot, is not effective, is not directed and is the subject of general public dissatisfaction.

This is one of the most difficult questions of contemporary Hungarian society. The term ‘premature welfare state’ exactly refers to the size of the inherited liabilities that are relatively too large with respect to the burden-carrying ability of the population. It is absolutely true if we consider the fact that Hungary only reached the same GDP level at the change of the political system at the end of the decade, and that the combined GDP output between the period 1989-1999 was only 8.87 times higher than in 1989. (Kolodko [2001] p. 36) Another way of looking at the problem is that even though the economy stagnated for ten years we lost more than a full year's GDP i.e. 113% of GDP in 1989, which equals the total welfare expenditure of approximately four years.

The previous 'premature welfare state' cannot be sustained in its present state. In several elements the new market model is inadequate, the coat is too loose for the present Hungarian economy. It makes the chance of long term competitiveness worse. The restrictions to a level of 'a minimal state' is unacceptable for Hungarian society because of its historical background, European traditions and the enormous social problems it would cause. "The ongoing decivilisational processes make the quality of our society worse and within a short period of time they weaken the fundamentals of modern democracy and the modern economy." (Ferge [1998] p. 565, p. 569)

The real reform of government expenditure would involve a temporary solution from a certain point of view to create a 'sustainable welfare state' with welfare services markedly different from both the inherited 'premature welfare state' and the 'minimal state'. It can be imagined as a substantially tighter and targeted service, relying on multi-channel financing and strengthening the motivation of individual care, which could evolve relatively slowly and consequently. Its social cost would be somewhere between the previously mentioned two alternatives. Its source can be only the permanent growth of the economy, in other words the capacity of the Hungarian economy should grow up to its level.

The decrease of welfare expenditure shows a cyclical tendency of different governments. This was realised by the fact that the new problems of the transition and the operational problems of the old system generated many needs in the past. In the last decade the political forces had no other choice than to resist the pressure since their majority was dissatisfied during the transition period for very good reasons. What society did was to express its dissatisfaction by the 'resignation' of the given government every four years as a result of the unsolved problems.

"If the meeting of urgent needs becomes a primary political issue and an economic policy task then there is a straight line leading to the short run populist democracy and economic chaos. These needs have to be eliminated from the problems considered to be open for discussion in a democratic polity. With a slight exaggeration, the Hungarian political system had to fulfil both the political integrational role of the new democracies and the excluding functions of the crisis-managing, reformist totalitarian systems. The Hungarian system was suitable for both roles and it was consolidated in this controversial state in the last decade both as a democracy but above all as a "dual democracy" which excluded many of us." (Greskovits [1998] pp. 50-51) For the above mentioned reasons it is easier to understand why the parties – except for the short period of the Bokros-programme – favoured and favour those welfare and social

systems and measures which apparently reward the middle classes or are at least favourable to them. These layers and groups have much greater opportunities to enforce their rights and they have a much greater influence on the orientation of public opinion and the voters than the poorer layers of the society whose problems can not be solved at present. However facing these problems in the long run cannot be avoided.

Monetary policy – with question marks

At the turn of the millennium there were significant changes in the monetary policy, which is considered to be an important pillar of economic policy. When György Surányi's term of office ended the management of the Hungarian National Bank was taken over by Zsigmond Járai, previously finance minister of the Orbán government. Shortly afterwards the 4.5% exchange rate band of the crawling peg devaluation introduced in 1995 was changed to 30% and the crawling peg devaluation itself was done away with in autumn 2001 "driving the last nail into the coffin of the Bokros-programme".

Inflation in Hungary 'got stuck' around 10% in the period between 1999-2000. Even at the time of the introduction of the crawling peg devaluation it was clear that it would not be easy to achieve low inflation, but the peg worked effectively with inflation at 10%. According to some, 2001 was too early to do away with the currency peg management system – inflation was still higher than that of the neighbouring partner countries. On the other hand it was a big advantage because the broadened band gave significantly greater possibilities and room for manoeuvre for the interest rate policy of the National Bank.

After the change of the exchange rate mechanism the forint was revalued by at least 10% which made the situation of exporters more difficult and encouraged imports. The National Bank tried to decrease inflation by a monetary restriction using nominal and real exchange rate revaluation. The monetary policy based on the inflation-decreasing effect of the revaluing currency was not unprecedented, since we had seen it in the first half of the 1990s.

The 2001-2002 period saw that the carry-over of the exchange rate into prices after the revaluation became slower and weaker than was expected at the time of the introduction of the inflation-following system, and therefore it did not prove to be an effective tool. On the other hand the revaluation further restrained the already weakening exports and this was a bigger problem.

The experience of 2001–2002 showed that the Hungarian economy needed significant structural changes from its present state to become competitive in the European Union. That is why originally a higher inflation is calculated than the more developed countries. Higher inflation can however be accompanied by faster growth. Therefore reducing inflation in the present state of development is very important but it is not something to strive for at all costs. We have to harmonise sustainable growth with the requirements of the changes.

The Hungarian National Bank changed to an inflation-led programme after the abolition of the crawling peg devaluation. The central bank aimed to decrease inflation substantially, therefore it applied a restrictive monetary policy. It one-sidedly concentrated on the decrease of inflation and did not properly take the aspects of growth and balance into consideration. On the other hand as we have seen the Orbán government had an expansive fiscal policy in 2001-2002 and it had a loose incomes policy before the general election. The two elements of the economic policy moved in opposite directions, something which obviously undermines credibility over the long-term.

***After a ‘post-Keynesian’ economic policy, a ‘post-socialist’
economic policy (as well)***

In spring 2002 following the Hungarian traditions after the political changes a new government came into power. The strong election campaign made the parties even ‘bigger story-tellers’ and there was bigger bait on the hook.

The winning socialist party characterised its promises based on illusions as a ‘social change of the political system’. We have already mentioned the illusions and the promises which burden the future and the dangers which accompanied the change of the political system.

The adjective ‘socialist’ may lead one to stop and reflect, especially in the light of what has been said above. If the government had learnt from the retreat after the Bokros-programme and its negative consequences, and had aimed to create an ‘effective and sustainable’ welfare state with a feasible strategy in its hands and had written its name in Hungarian history in the first half of its government by carrying out a breakthrough, then this slogan would have been worthy of Hungary’s fourth democratic government.

In fact, as the measures of the new government showed, all this was primarily about ‘simple’ wage- and salary-increasing promises. Without any reforms or performance-based motivation they increased the salaries

of public servants and these were followed by further increases in other fields.

This burdened the already oversized budget in an economic situation with slowing growth, and in which the previous government had conducted election-related overspending for one and a half or two years. Furthermore money was already tight in 2002 when the new government took over. In brief, all this happened in a situation where things were already looking difficult. The previous government obviously knew this and would have stabilised the situation right after the elections as it had already done in 1999-2000.

The Medgyessy government should have done so. Instead it carried out enormous baseless and unresourced wage increases which directly increased the disposable income of the population. This created a permanent burden and liability on the budget. This recalled the profoundly disturbing socialist practice of the 1970s and 1980s of not bothering about the direct consequences and this is the reason why we consider it a 'post-socialist economic policy'. This is absolutely anachronistic and life-threatening for an economy open in all senses in today's globalised world.

What made things even worse was that the government accepted, indeed outbid the 'post-Keynesian' trend of the previous government. It continued the subsidy of domestic wealth accumulation through the preferential housing loans and together with government overspending managed to further decrease the savings of the population which may have acted against this. What is more the population became a negative saver in an absurd way. The government promised too much concerning the motorway construction programme and followed the fine tradition of the verbal motorway construction. This was a further burden on the budget.

The problems and dangers of the 'post-Keynesian' economic policy of the Orbán government were already discussed in detail, however the distribution after the change of the government seems to be even worse. The previous strategy at least encouraged investments and the development of the infrastructure which may have resulted in an increase of national wealth and improved conditions. Its need for imports is not so large either. The wage increases of the new government however increase the current consumption and they lead to indirect strong import pressure. The decreasing of savings on the other hand makes the financing of investments more difficult.

The previous government tried to reconcile the export-led, balance-maintaining strategy with the internal investment-increasing strategy. These

two cannot go together for a long time and be successful. Unfortunately the Medgyessy government combined its 'post-socialist' economic policy of 2002 with the "post-Keynesian" strategy of its predecessor. These two theoretically do not exclude each other – what is more they are similar – because both are based on the encouragement of domestic demand, and each is worse than the other and the combined negative effects can be fatal. This may be particularly true for those OECD-countries that are not used to this. Both incentivise at the cost of foreign resources which the international financial world does not tend to recompense. In all it is not surprising that the Hungarian economy had a bad year in 2002 and that the problems continued in 2003.

According to the preliminary figures of the Finance Ministry, together with the 3.5% increase in GDP, domestic use increased by 5.3% within which the domestic consumption and the gross fixed asset accumulation increased by 9.2% and 7.2% respectively. The per-earner real wage increased by 13.6% (!) in 2002 after the 6.4% rise in 2001. In 2001 exports rose faster than imports, by 8.8% compared to 6.1%. In 2002 this tendency reversed – exports increased by only 3.8% but imports increased by 6.1%. This change happened in the second half of the year because in the first half of 2002 exports were still increasing by 5.3%, but imports increased by only 4.6%.

The current account deficit increased to 4% of GDP. However the budget deficit reached 10% of GDP (Pénzügyminisztérium [2003] table I, 2, 3). This is a sad record in modern Hungarian economic history. There was not such a high deficit even in 'peace time' and it was below this level even during the most difficult times of the 1990s. In the critical situation before the Bokros-programme the budget deficit was only 8.4% of GDP in 1994. The high budget deficit is a tradition of election years. In 1994, when the deficit was much higher than that of the previous years, in the year of the elections the new government tried to put everything in the annual 8%+ deficit, for which it was only partially responsible. Similar reasons account for the 6% budget deficit in 1998. In both previous cases an open or covered stabilisation followed the year of the elections, unlike in 2003.

Less attention is paid to the fact that the budget expenditure soared to 50.8% of GDP in 2002 which may cause even more serious problems than the high budgetary deficit in the long run and which represents the reversal of the decreasing process of the budgetary centralisation started by the Bokros-package. As we have seen, in 1995-1996 the expenditure was successfully decreased from over 60% to 50% with respect to GDP.

Then by 2000/2001 this slowly moderated to around 45%. Further moderation would have been desirable and expected. Compared to this the year 2002 brought a very dangerous turnaround.

As the previous process and the figures for 2002 show, the competitiveness of the Hungarian economy significantly decreased. Calculating on the base of specific labour costs and with value added, the index improved by 2.6% in 1999 and by 1% in 2000. However competitiveness worsened by 7.9% in 2001 and by 11.2% in 2002 (Pénzügyminisztérium [2003] table 1, 2, 3).

The loose fiscal policy and the lack of structural changes had an impact on the external judgements made on the country. The problems became more severe because there was a visible opposition between the directors of fiscal and monetary policies. It resulted from the fact that besides loose fiscal and income policies the monetary policy was keen to remain tough. On the other hand the strategic and personal conflicts – which are unacceptable in countries with a civilised economic policy – could be felt both at home and abroad and they further worsened the trust in the Hungarian economy and further decreased the otherwise worsening credibility.

The increasing contradiction, starting in 2001, between the loose budgetary policy and incomes policy and the strict monetary policy was strikingly against the requirements of the Eurozone and what is even more serious against the maintenance of a course towards sustainable growth. It was and must have been clear for years that a consequently strict budgetary and incomes policy and a less strict monetary policy which takes aspects of growth into consideration might be the key to a balanced path. A very strict monetary policy cannot moderate inflation either and this has to take the permanent growth of the Hungarian economy into consideration.

The Medgyessy government continued its economic policy, leading to an increase in domestic demand despite the accumulating negative phenomena and the continuously deteriorating foreign judgement. The consequences of the contradictions and mistakes of the economic policy have already attacked the national currency as well. The uncertainty was further increased by the many mistakes of the directors of economic policy.

Of course it then seemed to be rather unfounded and incredible but certainly surprising when the government announced the planned introduction of the Euro on 1st January, 2008. However the announcement from the prime-minister, an economic expert himself, might suggest a turnaround in economic policy.

The indicated processes, the speculation around the forint, the extremely high interest rates, the budgetary deficit and the unfavourable macroeconomic indicators all demonstrated a kind of distancing from, rather than an approach towards, the convergence criteria. On the basis of all these it was clear to foreign and domestic experts that the introduction of the Euro can be realised only if there is a very tough turnaround of the fiscal and income policies and if there is a return to an export-oriented balance path, the danger of which might be that growth will significantly slow down.

Therefore there were different opinions, arguing that if we take the structural and adjustment problems of the Hungarian economy, the unrealised reforms of welfare expenditure of the budget and the aspects of suitable growth into consideration, then an early or slightly later introduction – as some of the candidate countries believed – would be optimal, say, in 2010. On the other hand the disciplinary power of the convergence criteria -knowing the Hungarian tradition – argued for the early introduction of the Euro.

However there were no changes in the economic policy in the second half of 2003 either. This was considered to be a negative phenomenon by the international world of finance. The international judgement on the Hungarian economy further worsened. The dismissal of the finance minister in January 2004 and his singling out as a scapegoat did not overshadow the responsibility of the whole government and that of the Prime Minister for being the most spendthrift since the change of the political system.

The lasting overspending, the unfounded wage and income-increasing measures of the Medgyessy government put the Hungarian economy into a very difficult situation. The governmental support of the middle classes has been considered the axiom of the social policy for a long time in Hungary. That is why subsidies through tax allowances and interest support are so popular because politics can certainly prevent these great sums being given to the poor layers of society 'unworthy' of them. In fact a means-based taxation system and free, targeted social support might be the basis of an effective and restricted social policy.

However, Lajos Bokros 'the Cassandra in wolf's clothes' is right when he says that such changes and reforms are the most difficult for governments aiming for short-term popularity. What a difficult situation the 'government of the millennium' and the 'present government' during the last three years brought our country into is shown by the fact that Lajos Bokros outlined his programme to save the country from drifting into a critical situation in about 25 points in 1995, and these were enough.

At the end of 2003 however the ex-finance minister put 130 points under the Christmas tree.

The analysis of the date for the introduction of the Euro carried out at the beginning of 2004 seems to be as thoughtless as the statement concerning the 2008 introduction of the Euro made in summer 2003. There has not been a country which would not have introduced the Euro according to the date originally set.

But besides the concrete problems, among other signs this announcement shows that unlike in other developed market economies, where credibility is the base of economic policy, in Hungary the tradition of making promises, rooted in previous decades, is still present. Although Hungarian public opinion socialised on this tradition should be lenient to such cases, outside observers in our globalised environment are not accustomed to this and they strictly compare reality with the promises and they judge and act on the basis of these. Not just the government, but the country will pay the price, before we enter the Eurozone.

It was not just the speculation against the currency and the overspending of the state which indicated the worsening of the problems, but other indices in 2003 as well. GDP growth became slower and possibly will not reach 3% in 2003. The domestic use grew by 5.5% which was higher than GDP growth. Within this the consumption of households grew by 7-8% and the gross fixed asset accumulation by 3-4%. Real wages grew by about 10%. As a result of the activities of the two governments the amount of housing credits rose from 324 billion forints in 2001 to more than fourfold – 1320 billion forints – in the third quarter of 2003. The government increased the interest support for housing loans, but more severely the savings of the population became negative because, besides the government, the population also overspent and is overspending.

The growth in exports was about 4-6%, the increase in imports was still significantly higher: about 8-10%. The current account deficit further increased to 6.2-6.5% of GDP. The worsening of competitiveness continued and the divided labour costs, valued-added, increased by another 4% in the first half of 2003 (Pénzügyminisztérium [2003] table 1,2,3.).

Foreign investment has slowed down. The reason for this is worsening competitiveness, the uncertainty surrounding Hungarian economic policy and the better opportunities offered by competitors in the region, including the expansion of privatisation possibilities in these countries. However the Hungarian regional capital exports strengthened after 2001 which is not a bad sign by all means except if it occurs for the same reason as the foreign capital flight. Both tendencies make the current account

worse. The overspending of the government and the population and the increasing current account deficit are both increasing the debt of the country. The total net debt was higher by 22% i.e. by 3.2 billion Euros at the end of September 2003 compared to the previous year. Out of this the liabilities of the government increased by 2.7 billion Euros, which is a 50% increase in a year.

Hungarian indebtedness is relatively lower now than in the middle or second half of the 1990s. Its growth however is a bad sign because we must not forget that “the deficit, which results in the increase of indebtedness, is absolutely against solidarity. All the debt of the country increases the burdens of the future generations and nobody asks *them* about taking these on... .With the increase of state debt it is not the future that starts but the pawning of the future.” (Bokros [2003] p. 3)

The ‘post socialist’ distribution-centred baseless economic policy which continued the ‘post-Keynesian’ trend of the Orbán government brought the Hungarian economy trying to merge with the developed world into a very difficult position. The unresourced increase in the domestic use intensified the balance problems of the Hungarian economy.

After careful work the overspending of the half-year or year preceding the general elections can be tackled without any big shocks. But now this has not happened. The three years between 2001-2003 show the signs of the irresponsible election overspending which lasts almost for a whole cycle and at the beginning of 2004 no significant changes can be felt. It is no excuse, indeed it is worrying that between spring 2002 and autumn 2006 there are basically 6 ‘elections’: two parliamentary, two local government elections, one referendum on EU membership and one European parliamentary election. Now we are halfway through this series, but this does not mean that we are half way – downwards – in economic terms.

The Orbán government openly dropped the traditional theorems of economics. The Medgyessy government did not declare it but did exactly that. The basic theorems of economics have been proved right concerning the present situation of the Hungarian economy. However those who do not believe the textbooks could learn all these from the Hungarian events during the past decades. Unfortunately we have received and still receive manifold illustrations of the results of ‘ignorance’ and what happens if we ignore the basic requirements of economics and if we do not learn from our past.

The Orbán government and then the Medgyessy government did not do what they should have done on the basis of the economic and historical circumstances and lessons. They knew – or might have known – but they

did not do it. The compass which always points in the direction of short-term popularity proved to be an unreliable instrument.

What can be learnt from history and what cannot

In the previous chapters we examined – in broad terms of course – the Hungarian economy and the development of what I consider to be some of the important trends and characteristics in the economic policy of Hungary. The vast, separating currents of history can of course be seen from widely differing viewpoints, just like a great river itself. And this fact of being observed fortunately disturbs neither history, nor the flow of the river – both flow on as before. Now – from my point of view – for the first time in 15 years it is time to examine this period, driven by the change of system, from a contemporary perspective.

Historically speaking 15 years is a significant period in Hungary's history. The events, the economic policy, the critical judgements on certain governments cannot hide from the author or the reader the enormous changes that Hungary has undergone during this period, nor what a positive development it has been; how valuable has been the stabilisation of the democratic system, and what opportunities the accession to the European Union offers.

This study has concentrated on the facts, the trends and the failings rather than on the undoubted results of this process. In part this is because I feel that an accurate recording of the facts, an assessment of the various possible courses of action, a steering away from powerful but dangerous illusions, an evaluation of the lessons of history and a recognition of the mistakes and 'errors of ignorance' will help us to achieve better results in the future.

It is also because the detailed analysis clearly demonstrates to me that, considering the base from which Hungary embarked on the historical task following the change of system, the country would have gone much further if it had considered more carefully the prevailing conditions, had taken more seriously the difficult 'lessons' of history, had been better able to build more consistently on long term strategies, had created a consensus of experts on the basic questions, and if a short term perspective had not been so often dominant.

I have already noticed from various individuals and in various events, both explicitly and implicitly that many good and bad lessons have been taken into consideration.

Hungary's freedom of action

It is safe to say that during the period under examination – with a few exceptions – there have been three significant changes of governing system or regime in Hungary since the middle of the nineteenth century. The second half of the nineteenth century saw the transformation from a feudal to a capitalist society, after the Second World War the capitalist economy was transformed by communism/socialism, and last, but not least 'one more system change' occurred when the socialist system reverted to capitalism at the end of the twentieth century. (in addition to this of course, Hungarians took part in two world wars and suffered the Trianon Treaty).

In every case it is clear that it was fundamentally external conditions that decided these transformations, and the direction and methods of development. The only thing left for Hungary itself was to decide how to make the most of the positive, the negative, and the even more negative circumstances. It was always the position of Hungary's dominant economic partner in the world economy that determined the country's situation and activity. After the establishment of the Dual Monarchy it was the Austrian Crown, between the two world wars, it was Germany, after the Second World War, the Soviet Union, and after 1990 Germany, and in a wider sense the European Union.

The change of system that occurred in the 1990's was again driven by an outside force – this time much more favourable to Hungary – the European Union, and within the Union, primarily Germany. The model was already there to follow, and given the fulfilment of the requirements, the accession makes it possible and necessary for the first time, that Hungary becomes an organic part of the entire European market. If Hungary is not successful in its attempt to join the Union, it is sure to remain behind.

In its present stage the success or failure of the Hungarian economy is determined by the European Union and Hungary's ability to adapt to it. This will remain an opportunity in the future. At the same time, we must not forget that compared to the 19th century, Europe as a whole has dropped back behind the United States and Asia. This fact is indeed one of the driving forces behind the European Union's desire to expand and create a larger, more competitive market. The relatively closed market of the European Union and Hungary's none too successful attempts to connect with other regions in the world economy reinforces the one-sided dependence of the country on the EU.

Catching up and joining

For centuries one of the basic problems facing Hungary and the region has been – just like that facing many other parts of the world – how to catch up with the developed world. Communism, characterised as it was by a fundamentally modernising programme, attempted to maximise the speed of economic growth. The socialist model became more and more uncompetitive, the growth in quantity, the development of autarky and the isolation from the world market caused a terminal economic backwardness and collapse.

After the most recent change of system, although in a new form, the primary importance of catching up and joining remains. In the new world, the previously rival countries are now on the same side, and the Western European level of development, standard of living, welfare system and socio-economic structure are the models to aim for. As always, only the rich and/or successful examples have been fluttering before our eyes, and these have not been studied in depth, neither have their key features been adopted, nor have the failures of other examples been learnt from.

The often relatively unfounded illusion of catching up is not restricted to Hungary but can be observed all over the 'post-socialist' region. Kolodko, who played an important and extremely active role in the transformation process, states in his book, which first appeared in 2001, that in the best (fastest developing) growth scenario, it would take Poland 18 years, Hungary 16 years, the Czech Republic and Estonia 15 years, Romania 30 years, Albania 40 years and Tajikistan 50 years to reach the levels of the developed countries. (Kolodko [2002] p. 113)

In the context of the world-wide economic growth experienced during the 1990s, the crises related to the process of transformation in the post-socialist area, which grew at the turn of the millennium and meant that many countries did not reach the standards they achieved at the end of the 1980s, suggest that it will be difficult to turn the illusions into reality as everyone so earnestly desires.

The region has already witnessed hopes and calculations during an earlier period, half a century ago, and in fact in many senses we are further from the developed countries than we were then. It seems that the hopes will remain undiminished for the next fifty years, too.

Hungary was also the first democratic government to make the required 'leap' out of the social market system, and the crisis of the transformation occurred immediately. There was little time for the Horn government to do any dreaming – the Bokros package and the stabilisation followed in

rapid order. Following this successful move, the 3-4 year 'golden age of growth' further fanned the flames of hope.

The Orbán government, building on this, made an 'accelerated catching-up' the key point of their economic policy and would have liked to have achieved an even greater rate of growth. This acceleration, based on domestic demand, could not turn around the decelerating trend, but rather undermined the delicate economic balance. As we have seen from the experiences of the previous decade, the Hungarian economy always takes its own revenge on those who try to make faster growth the central aim of policy.

The social programme of the Medgyessy government in many ways matches the illusions mentioned above. The journey to the hoped for goal, as in many cases since the change of system, has encouraged the government to implement an economic policy which in the long run and in the end results not in an approach towards, but in a distancing from the 'better world'.

After the previous two governments' dreams of a 3-4 year 'golden age of growth', the country has experienced similar 3-4 year periods of 'ancient' imbalances, which threaten Hungary's long-term international position. At the same time Lajos Bokros himself, who saw clearly the dangers of these processes, and who, like Kolodko, is a financial expert recognised throughout the region, wants to see his own strategy for the catching-up process implemented. (Bokros [2003] p. 1)

Of course the plan drawn up by Lajos Bokros, and temporarily started at the end of the nineties, with its export-led, balance-maintaining growth, would be – could-be – the ideal course for the Hungarian economy. At the same time, the fact that we expect and want to catch up with other countries does not mean it will necessarily happen. Even if – departing from Hungarian tradition – sustained and sustainable growth is at the centre of Hungarian economic policy for a period of some decades, and fiscal, incomes and monetary policy remains subordinate to it.

Without this kind of plan for growth it is certain that the 'catching up' process will not be completed. A sustained period of balanced growth is a necessary condition for this process – necessary but not sufficient. To catch up quickly – and there are not many examples of this process in economic history – would require a kind of 'economic miracle', for which there is no recipe, and each case of which has had its own special characteristics. Catching up quickly is the result of a vast number of factors and is a process which no country sets out to create from the beginning. 'Expecting a miracle' has never been a realistic, fruitful economic policy.

The repeated illusions which we have believed in up to now are not self-fulfilling prophecies, indeed they usually have the opposite effect. Partly because they lead to an emphasis on unrealistic goals which in the long run makes them less achievable, and partly because they intensify the expectations of the population, which sooner or later turns against the process.

It is particularly dangerous that in this way it is increasingly difficult to gain the appropriate support for the wiser strategy in the current Hungarian democracy. As a result governments are less willing to take the necessary decisive steps, often substituting fine words for action, which makes it more difficult to have a clear conception of the problem, to discuss it openly and to raise the required support among the population for the steps which have to be taken. It goes without saying that a consensus of various political actors concerning fundamental questions of economic strategy is necessary for this.

What must be placed at the centre of Hungary's economic policy is export-oriented, continuous growth, sustainable in the long term. If we stay firmly on this course, expansion will lead to a continuous increase in the standard of living which is the most important target of all growth. An expanding economy would allow us to carry out the reforms which are necessary, and to reduce the role of the state in the economy while making its influence more efficient.

The 'golden age' of growth in the 1990s was achieved in parallel with growth in Germany, and so the recent slowdown in that growth was also decisive for Hungary. We can speed up our growth if the 'target' countries improve their rates of growth but even if the rate of domestic growth is higher than that of the EU, reaching a target of fast growth is not so easy to achieve.

Maintaining an appropriate level of growth in exports is itself an incredibly hard task – we have to maintain our competitiveness on world markets on a daily basis, and to do this we must continually update and adapt to the latest technology. There must be continuous improvements in efficiency and productivity. This cannot happen without a significant capital investment, which is almost impossible to provide from domestic sources alone. Technological development and the increase in investment make the inflow of capital vital and consequently Hungary's ability to attract such capital is of crucial importance.

Hungary and the European Union

Accession to the EU and the introduction of the Euro are not ends in themselves, but means to achieve sustained export-led growth, and our strategy and evaluation of them must be carried out on this basis. Neither accession nor the introduction of the single currency can guarantee Hungary stable growth, on the contrary, they can only be beneficial tools if the domestic Hungarian economy advances on a balanced course. If the opposite occurs – a programme based on illusions, divisions, low competitiveness and problems with the budget – the EU and the Euro will simply make the effects of Hungarian economic problems more visible and more damaging.

We would like to sample the kind of success that Ireland has achieved – one of our favourite hopes for the future – but less mention is made of the ‘Celtic Tiger’s’ more miserable previous experiences, even when it was already in the EU, when it faced fundamental problems of competitiveness and adaptability. It took many years before a national consensus and a common will were created as the result of many different factors, which led to lasting export-led growth.

Being on the threshold of accession to the EU brings advantages and disadvantages. The short term viewpoint and the earlier illusions deluded governments preparing for accession and they have not adequately prepared the business community or the general population for the coming situation and its attendant pitfalls. The significance of the move has not really been fully understood in Hungary.

The population awaits this historic moment of entry into the Union in a rather indifferent frame of mind. From the government, in order to get the support of the country for accession, the population has received a rosy picture of the advantages that lie around the corner, the approaching ‘paradise’, while in the short term interests of political popularity the responsibility for every difficult, unpleasant initiative has been placed round the neck of the EU, even if it was necessary anyway, or even just unpleasant. On the basis of centuries of experience, the public perceptions in Hungary view with some scepticism every connection to a ‘big brother’.

The essence of the European Union is that it is not a supra-national, charitable, paternalistic state. Of course, it does have some of these characteristics. Over the past decades however, Hungarian public opinion, accustomed to promises and hand-outs, has only wanted to believe this aspect of the EU. For years the fundamental question has been how much

we will get from the great common treasure chest, how many grants will come our way.

At the same time the Union is a common market, defended from the outside world, but within the Union fiercely competitive in terms of all the factors of production. From a certain geo-political perspective the expansion of this market has been not a charitable initiative, but a response to the increasing backwardness of the European economy compared to the United States and Asia. The Hungarian economy can expect to face a much more competitive situation than the present, with more developed and practised actors, who in some areas, such as for example agriculture, have totally different basic business conditions.

The points made above have been easy to predict for many years, and it is therefore particularly unfortunate, indeed dangerous, that in the years immediately preceding the accession it was not the competitiveness of the national economy, the implementation of the necessary reforms and export-led balanced growth that were characteristic of the Hungarian situation, but precisely a move away from these goals. In May the Hungarian economy will take the field in a weakened condition for the professional European match.

With the introduction of the Euro too, the Hungarian economy must keep its eyes on a sustained period of export-oriented growth. In the long term this requires as strict budgetary and incomes policy preconditions as the introduction of the Euro itself. Because, as we have already seen, the timing of the introduction of the Euro is very important, and this is the decisive influence on inflation in Hungary. The structural reforms and the maintenance of sustained growth will possibly bring higher inflation than the convergence criteria envisage for a long period.

Sustained export-led growth, as we outlined earlier, requires a strict fiscal and incomes policy, and a relatively relaxed monetary policy. As a consequence of this, in the long term, the credibility of the economic policy requires the synthesis and co-operation of fiscal and monetary policy. Accession at the wrong time – a time when there is an unfavourable exchange rate, and the criteria force a reversal of growth in an economy with disrupted balances – is a risky undertaking. The Hungarian economy should first aim for long-term growth, which will lead to a safe introduction of the Euro, which will add a further push to growth.

The best route is not easy, and we are certainly not on it at the moment. According to the decades long tradition in Hungarian politics, only in forced circumstances are governments willing to implement more difficult decisions rather than simply muddling through in the short term.

It is to be feared that the errors of recent years will be felt in the first years following accession.

The Union will act as a warning influence in Hungarian fiscal and monetary policy, and many hope that the sooner the Euro is introduced the more secure will be the faith in the convergence criteria, rather than relying on the independent devices of the politicians. At the same time, given what has been said above, it is important to remember the risks of introducing the currency too early. For Hungary the path of long-term growth will lead to the appropriate route to the Euro, and so we must return to this path as soon as possible.

The present is the future of the past

Considering the last 150 years of the Hungarian economy and the relationship between Hungary and the world economy in the contemporary period, we get a very interesting and informative picture. What we have seen so far has of course been drawn in general terms, particularly for the past, from where however we can see the main tendencies and the clear examples from experience. While the details of the recent past are much clearer, we still do not know how the pieces fit together and whether they are of crucial importance or inconsequential for the bigger picture.

The situation is the same when we look out from the top of a mountain. From a distance we can clearly see the hills, rivers and the outlines of the towns. The individual houses and people are however invisible. Close up the density of the leaves and the branches prevent us from seeing the tree we are standing next to, and only from the pattern of the leaves can we deduce which species it is.

The many details, motives, words and plans from the past, as well as the contradictions of the events that occurred do not always allow us to see clearly. As Frigyes Karinthy the great Hungarian writer said, "the present is the future of the past", and a certain distance allows us to understand better the context of the course of present events.

The history of the Hungarian economy is inseparable from and incomprehensible without an understanding of the past and present of Central and Eastern Europe, Europe and the world as a whole – whether we are thinking of the present, the past or the future. The development of Hungary and the opportunities open to her are always connected by a thousand visible and invisible threads to our narrower and wider environment. The future will be no different.

Studying the course of history, the passage of decades, the coming and passing years, we hope that we can draw lessons that are worth

studying and keeping before our eyes, and that we can at least make sure we understand the consequences of the mistakes we have made before. All this helps to guide our future actions.

All of us feel that it would be wonderful to know what the future brings. And of course we often think that it would be better if we did not know. The future cannot be studied because it has not yet occurred. But the events and decisions of the present and the past have a huge influence on what will happen, and what form the future will take.

One of the main points to come out of the present study is that in history, continuity is perhaps much stronger than many of us often think. The past centuries and decades are the past and the roots not just of the present but of the future as well. What happened and what did not happen in the past will affect generations to come, whether they are aware of it or not.

However, the continuity of history and the study of the past does not absolve a generation from its own responsibility as to how it acts in the present and, since 'the present is the future of the past' what kind of opportunities the present generation leaves for the future. The events that will occur in Hungary over the next decades – the shape of the future – are, to a large extent, in our hands.

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