

EUROPEAN FISCAL UNION

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CENTRALIZATION AND THE CAPITALIST MARKET ECONOMY IN HUNGARY

JÁNOS KORNAI*

Not long ago I was shown the quotas for admission that the faculty of economics at a provincial university had received from the Ministry for the ongoing academic year, which were derived from the national admittance threshold points: students on basic training 750, students on the masters' course 120, etc. I could hardly believe my eyes. Exactly 120 students on the masters' course? Not 119 or 121? I got in touch with people at other universities, who confirmed that they too had received similar detailed numerical quotas from the higher authorities. None of these university staff members could tell me quite how the figures had been calculated, but they suspected that someone above had produced aggregate national quotas for the each major field that had been broken down to an institutional level.

I had a flashback to 55 years previously. Back in 1956 I was working on my dissertation and holding regular discussions with enterprise managers in light industry. They spoke scornfully of the meticulous plan directives they received from the ministry, laying down for the following year, fabric by fabric and width by width, how many square metres of woollen or cotton material they had to weave. How, they exclaimed, did 'the powers that be' arrive at these exact figures given all the uncertainties of production and sales? Based on my research I finished my dissertation, which after some upsets appeared in 1957 as *Overcentralization in Economic Administration*. Over half a century has passed since then, and not for decades did it occur to me, even in my wildest dreams, that the subject of my first book, overcentralization, would ever become opportune again. Yet this is now the case. The subject of this

article is the centralizing tendency strongly apparent over the last twenty months.

My article 'Taking Stock', published in *Népszabadság* on 6 January 2011, reflected on the events of the Orbán government's first eight months and the public debate over them. It tried to explain how a radical change had occurred in the political structure: Hungary was no longer a democracy, but an autocracy. In close relation to this development, the article reviewed the damage done to legal security and human rights, and the detrimental features of the economic policy pursued by the government. Another twelve months have gone by, in which the critics of the Fidesz regime have produced numerous in-depth analyses and vehement political statements. Broad agreement on the situation has emerged amongst thinkers committed to democracy, human rights and the rule of law.

This article does not call for any changes of emphasis. I am still convinced that the main problem lies in the replacement of democracy by autocracy. What I set out to do here is to add to the conclusions already drawn, by reviewing the events of the last twenty months from a *different angle*: that of the centralizing tendency.

Examples

I will begin with examples rather than definitions, not grouped in order of importance, but presented sector by sector of society and the economy. The examples will illustrate what is meant here by a 'centralizing tendency'.

(a) Ministries

The government replaced in 2010 had twelve ministries. This number under the new government has been reduced to eight.

(b) National Bank of Hungary

The new act on the central bank was passed by Parliament in a whirlwind of year-end activity. At first sight, this new piece of cardinal legislation pre-



* Collegium Budapest – Institute for Advanced Study. This is an English translation of the article 'KÖZPONTOSÍTÁS ÉS KAPITALISTA PIACGAZDASÁG' published in the 28 January 2012 issue of NÉPSZABADSÁG.

scribes only formal changes, but in political practice, it allows strategic direction of the National Bank of Hungary to be assumed by the Fidesz regime, whose will also prevails over the government's actions, the president of the republic, and through its two-thirds majority, the legislature. The decision-making powers of the Monetary Council have been boosted. The prime minister may recommend a further National Bank deputy president alongside the two existing ones; his recommendation will undoubtedly be accepted by the head of state. Four new members have already joined the Monetary Council under the Orbán government; now two further appointments can be made. This put the members appointed by the Fidesz regime in a numerical majority, which may become stronger still, in a body where decisions are taken by majority vote. The position of the president of the National Bank is insecure. The transition rules associated with the country's new Basic Law allow the National Bank and the Hungarian Financial Supervisory Authority to be merged. Whether or not such a merger will be useful, it provides an opportunity to create a new united institution, a 'superstructure' to which a new leader can be appointed, thus demoting the president of the National Bank. Nobody knows whether the new legislation on the central bank will be long-lasting or not. This article does not engage in guesswork. Nonetheless, the mere fact that these very important pieces of legislation have been passed, despite protests at home and abroad, shows the force of the centralizing tendency, in other words of the determination of the top leadership to concentrate all powers into its own hands.

(c) Supervisory and regulatory bodies

Before the change of government the Budgetary Council had a significant staff working *in parallel* with the Finance Ministry. They made similar calculations to those of the government machine, but independently of them. The parallelism has ceased; the Budgetary Council will have no staff of analysts of its own in future.

There used to be four ombudsmen (parliamentary commissioners) working in parallel. Under the new regime there will be one. They used to speak as the conscience of Hungary's citizens – now this activity is to be part of the machine of the state.

There was a Health Insurance Inspectorate set up under the previous government, with tasks differentiated from those of the National Public Health and Medical Officer Service and the Health Ministry of

the day. The Inspectorate has now been abolished, and its tasks passed over to other authorities or left unassigned.

(d) Armed forces

The Customs and Finance Guard has been merged with the Taxation and Financial Control Office to form the National Taxation and Customs Office.

A Counter-Terrorism Centre has been established that combines the functions of several hitherto separate organizations. A former chief bodyguard of Prime Minister Viktor Orbán has been appointed to command it.

The Hungarian Corps for the Protection of Order will be established in a curious, semi-state-controlled, 'corporatist' form. All members of law and order bodies will be obliged to enter the Corps, which will act as an interest-protecting body. This mission will, to some extent, squeeze the trade unions out of the representation process.

(e) Local government organizations

The new local government act deprives local government organizations of four main groups of tasks. Let me emphasize here that, in future, education, the health service and disaster protection will be wholly the responsibility of the central government.

Most of the state administration local services have been merged into the county-level government offices. This applies to land offices, pension institutions, and the consumer protection authority too. The county officials heading these offices are to be appointed by the prime minister.

(f) The judiciary

Hungary's courts of law were previously directed by an independent body with a specific form of self-governance. This has been replaced by a National Judicial Office, whose head is chosen by Parliament (in other words, the leadership of the party in power at the time). At present, this function happens to be performed by the wife of one of the most influential men in Fidesz. She decides personally on the appointment and promotion of judges. She also determines which cases shall be tried by which court.

(g) The media

The Media Authority (National Media and Telecommunications Authority), as the paramount state body for media matters, resulted from the merger of

several organizations. Its province extends from the content of television and radio services to the allocation of frequencies. Alongside the Media Authority, a so-called Media Council exists, whose members are drawn exclusively from political forces in the government.

Previously the state-owned, publicly financed radio and television channels operated separately, as did the state news agency. Now these entities have been merged into a giant centre called the Media Service Support and Asset Management Fund. This centralizes financing, and no less importantly, has the power to choose, hire and fire staff. Before the merger, the public radio and television departments could choose their own news sources. Now they are all obliged to use the material disgorged by the central news office.

(h) Insurance

Reforms in the 1990s produced a pension system that rested on three 'pillars', namely compulsory state insurance, compulsory private insurance, and voluntary private insurance. In 2010–2011 most of the second pillar's assets were seized and much of the funds were spent by the government, while its obligations to the insured are theoretically transferred to the first pillar, the state pension system.

The commercial banks set up and funded their own insurance body, the National Deposit Protection Fund, to guarantee repayment of deposits in times of disturbance in the banking sector. Government pressure has obliged the banks to hand over the management of these assets to a state body, the Government Debt Management Agency.

(i) Services

Seven previously separate companies in Budapest running the medical spas, street cleaning, funerals, etc. have been merged under a holding company, which also represents the capital city on the boards of the private and semi-private utility companies (gas, water, etc.).

Trade in tobacco products is being nationalized. The number of retail outlets will fall from 40,000 to 5,000.

It has already been mentioned that the county hospitals will pass from the control of the county self-governance authorities to central government. These changes of ownership can be expected to coincide

with mergers and closures that reduce the number of institutions, while providing chances to appoint new chief executives.

Disposal of sewage in parts of Budapest without sewage mains has been conducted by private sewage-tanker operators. This will be taken over by a firm owned by the capital city. The changeover is being accelerated by a financial disincentive: those using private operators will pay twice – namely, the full price to the private operator and the full price again to the city-owned company.

(j) Education, the arts, science and scholarship, entertainment

As mentioned earlier, primary and secondary schools in local government ownership are being transferred to central government. Control over *gymnasia* (academically-oriented secondary schools) owned by the capital city has already been centralized under a new Economic Organization for Gymnasia. Previously the appointment of teachers was the principal's right; now the Economic Organization has to agree to appointments. Each gymnasium previously had control over its own funds. Now it may spend nothing over a few thousand forints without the approval of the Economic Organization. By the time the gymnasia get used to these rules there will be further centralization, as they pass into central government ownership.

According to the cardinal act on public education, we are hurrying towards a uniform, central curriculum. Teacher independence will largely cease: 90 percent of what is taught will be compulsory curriculum and only 10 percent optional. Previously, local government-owned schools had greater freedom to adapt their curricula to local conditions; now they will all be inflexibly standardised.

The universities did not have full autonomy before, but now their quasi-autonomy is being strongly curtailed. The appointment of a rector was a two-stage process in which the university senate chose one candidate from several and s/he was then appointed by the government. No rector could be appointed unless recommended by the senate, although the government had a scarcely exercised right to veto a candidate. From now on this process will be different. The rector will be picked and appointed by the government. University bodies will only have the right to express an opinion, not exercise a veto, even if they disagree. As before, the seal will be placed on the document of

appointment by the president of the republic. In other words, the essential aspect in the selection process has passed from the hands of the university into those of the central government.

There is a wave of centralization engulfing the Hungarian Academy of Sciences network of research institutes. Various institutes of natural and social sciences with strong reputations that have worked separately and independently for several decades are being herded into groups and subordinated into newly created centres.

Mergers and centralization are occurring in vocational training and integrated training centres are also to emerge.

To date the public funding for several arts and science-related activities and social welfare tasks was distributed by public foundations, some of which amassed considerable assets. They embodied a specific form of professional autonomy and self-governance; boards of trustees consisted of representatives of the art or science concerned, or of experts involved in welfare activity; and the subsidies awarded were decided in line with their professional consciences. Most of the public foundations – 24 in number – have been abolished and their assets and decision-making functions transferred to state authorities.

The 1956 Institute, a previously independent body, has been annexed to the National Széchenyi Library. The Lukács Archives have similarly lost their independence, by being subsumed into the library of the Hungarian Academy of Sciences.

The Budapest State Opera is being run by a government commissioner appointed not by the minister of culture, but personally by the prime minister. The Museum of Fine Arts and the Hungarian National Gallery are being merged. So is the Mikroszkóp, a cabaret theatre, with the Thália, a theatre devoted usually to serious drama.

The Budapest Assembly has resolved to merge Petőfi Hall with the Trafó House of Contemporary Arts. The Budapest Gallery will merge into the Budapest History Museum.

The state funding for film production is being centralized. Andy Vajna, the government commissioner, is demanding the 'right of final cut' on the films mainly funded by the state.

What the examples have in common

It would be easy to add to the list of the thirty-three examples that I have given, which purposely ranges from the massive transformations involved in winding up the second pillar of the pension system, or the powerful new central office jeopardizing the independence of the judicial system, or the new law on the National Bank, to the smaller changes of amalgamating two galleries or amusement venues, although the latter will also bring radical changes for those involved. The range of examples includes some tiny or even bizarre instances to demonstrate how centralization has turned into a widespread merger mania. Wherever a problem is perceived, the panacea is to centralize and amalgamate. I would like to convey how the accustomed operation of countless organisms in society has been upset by the accelerating waves of transformations. In fact, a sudden reorganization is taking place in so many areas at once that it is justified to cite the Hegelian formula: quantitative change has become qualitative; the changes taken together have radically altered the system of control. Notable ingenuity has gone into this process: the legal form of the changes varies from case to case. In some cases whole institutions are united, in others the procedure for appointing heads has been modified, sometimes executive boards are packed to increase central control, sometimes statutes are altered. So what 'pattern' emerges from all thirty-three cases?

All state bodies are necessarily centralized, but the centralization *within* the machinery of state will strengthen if (i) the superior has fewer subordinates, so that his/her capacity for direction and inspection allows him to control them more firmly. Centralization will strengthen if (ii) there are fewer levels of superiority and subordination and if (iii) the commands become more detailed. It helps if (iv) the top political leadership is able to appoint its own people to all important positions. In terms of society as a whole, centralization grows if (v) previously autonomous activities operating *outside* the machinery of state can be brought, partly or wholly, under state control. Finally, centralization grows if (vi) state inspection and intervention can take place in processes previously not subject to such control.

In each of the examples at least one of the changes (i) to (vi) can be shown to have occurred. There are some cases in which two or more of the changes appear. This in itself backs my assertion that we are not facing a random collection of changes here. All the

changes listed point in a clearly perceptible *direction*: they reinforce centralization. I term this strong, radical, clearly observable and dizzyingly rapid process of transformation as a *centralizing tendency*.

I introduce here a neutral term free of value judgement, in line with a positive, scientific approach. Normative analysis and value judgements will follow later in the article. Even those who approve of the changes surely cannot deny the existence of such a centralizing tendency.

Some of the new formations, legal stipulations and forms of organization can be found under western democracies, but there they do not attack the foundations of democracy *as such*. The specificity of Hungary's twenty-month transformation is that this government has introduced *a great number of concurrent moves* towards excessive centralization and the destruction of autonomous mechanisms, and these very varied, mutually reinforcing changes have combined to form a trend.

Arguments for and against

The official initiators and implementers of these changes tend to claim that the previous form of organization or mechanism was inefficient and wasteful, and led to sluggish handling of affairs. There is no denying that problems of this kind could be found in almost every case. They go on to argue that there is one universal remedy for low efficiency and tardiness: merging units, eliminating overlaps, pruning out excess capacities – in a word, strengthening centralization.

There is an age-old debate over the advantages and drawbacks of centralization and decentralization. Names such as Adam Smith, Marx, Hayek and Lenin spring to mind, along with those of the great figures in mathematical economics, the Nobel Prize winners Arrow and Hurwicz. I thought, naively, that such debates could only recur in Hungary in university seminars on the history of economic theory, as intellectual titbits. Sadly, I have been proved wrong: the debate over centralization has become highly topical once again. Remaining on the fine, smooth plane of theoretical analysis, I will try to contrast the arguments for and against centralisation.

The multiplicity of human activity has to be coordinated, with the assistance of various mechanisms.

One such mechanism is that of *vertical coordination*. Let us imagine a pyramid. At the top is the Supreme Chief, who gives orders, let us say, to ten Chiefs beneath him. Under them lies a wider level of Deputy Chiefs. Each Chief has several subordinate Deputy Chiefs, while each Deputy Chief is subordinate to only one Chief above him. As we go down the pyramid, past the Deputy-Deputy and Deputy-Deputy-Deputy Chiefs, the levels become wider and wider and the number of participants increases. Finally, we reach the base of the pyramid. Here stand all the many people who receive orders from above, yet do not, in turn, direct anyone beneath them. This formation is termed in theory a 'perfect hierarchy'. (How devotees of centralization must sigh to think of it!) It is supposedly perfect because the relations of superiority and subordination are unambiguous: there are no double or multiple lines of dependence.

Another model is the mechanism of *horizontal coordination*. This operates on a flat plane; nobody is subordinate to anybody from the outset. The participants have to agree amongst each other. The first model is a pure case of centralization, the second one of decentralization. In the first model the hands are visible: the chief's order is a warning, and if need be, a threat. In the second, to use Adam Smith's apposite phrase, the coordination is effected by an 'invisible hand'. A formation similar to the first model is embodied in the state (although never in such a pure form as the model describes). Two spheres resemble the second. One is the market, where the coordination is motivated by discernible material interest through agreements between buyer and seller. The other horizontally coordinated sphere encompasses non-profit organizations, the various free partnerships and associations, the groupings of 'civil society'. Here the motivations are a mixture of material and non-material incentives.

Let us contrast the characteristics of centralization and decentralization.

1. *Short-term efficiency*. Decentralization is obviously accompanied by wastage. There are parallel organizations whose activities overlap. A marked proportion of the capacities remain unused. So merging several bodies under central control produces instant savings in administrative costs; some personnel can be dismissed straight away. (An example is the administrative costs of decentralized private insurance, which are certainly higher than those of a centralized state insurance system.) This argument always rings out triumphantly. Yet the beneficial

effect cannot always be counted upon, because the centralizing measures are usually pushed through hastily, at a forced pace, without the benefit of sound expert advice. Eliminating overlaps, cutting administrative costs, and a *short-term* increase in efficiency add up to a weak argument, even though they produce results, because other arguments for and against must be considered carefully.

2. *Competition.* Centralization involves cutting out competition wherever possible, whereas rivalry is vital to decentralization, although competition involves great costs. Competing sellers have to advertise and convince buyers to purchase their product or service, and not those of another. They have to keep free capacity available to meet buyer demand at any time. This ties down huge resources superfluous to a centralized economy; but competition generates a huge driving force. It makes it desirable, and even essential, to launch new products before competitors, which is the engine of the innovation process that transforms our lives. All the major innovations in the last century have been made by decentralized, competitive economies.

Competition is necessary not only in the narrow sphere of economic activity, but in education, science and the arts. One very talented economist graduating from Harvard University wanted very much to teach there, but he was turned down. He then applied to the nearby Massachusetts Institute of Technology (MIT), where economics had not been taught before, and offered to set about organizing a teaching programme for it. He was given the chance. (He was lucky not to be dealing with Hungary's Ministry of National Resources, which knows beforehand precisely how many students it wishes to see in how many departments of how many universities.) The economist's name was Paul A. Samuelson, who would later become the most famous economist in his country and the first American economist to be awarded a Nobel Prize. Today MIT is one of the world's best-known workshops for teaching economics. Since then, the economics departments of the two neighbouring universities have rivalled each other ('overlapped'), vying to be the department with the best students and the most valuable research results, and frequently poaching each other's staff. Despite the rivalry, there is nevertheless cooperation between them in the form of joint seminars, for instance.

3. *Adaptation and selection.* Hungary's centralizers think it is possible to plan accurately within the four

walls of an official building: to lay down future structures in legislation and other inflexible regulations, freed of overlap and multiple administrative costs. It becomes possible to gauge the huge advantages of decentralization only by observing the *movement* of society. New organizations are continually appearing, some merge, others split, while others are wound up. Small, medium-sized and large organizations appear and thrive side by side. Some grow, others shrink. This all resembles in many respects the evolution and natural selection found in the biological world.

The birth and massive growth of Google or Apple did not result from a position taken by some jury assigned to assess tenders. No ministry decided whether or not the Metropolitan and the Guggenheim Museum, situated a couple of hundred metres apart in New York, should amalgamate or remain separate institutions.

Viable products, technologies, management methods, teaching principles, forms of organization, and organizations themselves stay alive. Those incapable of adapting and improving themselves fall away sooner or later. What arrogant self-confidence, what belief in one's own infallibility it takes to think that an office or a chief should decide on matters of life and death! Decisive, irreversible transformations are decreed, not gradually, experimenting along the way, as evolutionary processes take place, but at breakneck speed, to be accomplished in a matter of days or even hours.

4. *Information.* One condition for centralized coordination to work flawlessly is for the decision-maker to predict just how events will develop. In that case a flawless decision can be reached, and all that need happen is for the decision to be vigorously imposed. Real life, however, is full of uncertainties and inaccurate information which is not necessarily fortuitous; there may be intentional distortion at work. It may suit subordinates to deny that there are problems (or exaggerate them if it serves their interests). They may report that there is spare capacity, or on the contrary, complain that there is excessively tight utilization of capacity, depending on which is to their advantage. The Chief will be unable to correct faulty decisions because subordinates dare not tell him he has erred.

Here decentralization has a big advantage. Those collecting information are often the same as those who apply it, so that there is a personal interest in making it accurate. (This, in a very brief, rather simplified

form, is Friedrich von Hayek's main argument for decentralization.) Those acting on faulty information pay the price: they drop out of the running, they are deselected. Those who stay in the system are open to information, criticism and self-correction.

To sum up the arguments under points 2, 3 and 4, it can be stated that horizontally coordinated decentralization is much more *efficient in the long-term* than centralized, vertical coordination. If these arguments (presented in much more detail in the vast body of literature on the subject, of course) are considered objectively, it will be seen that the statement is true on a straight *logical* basis. However, there is also more cogent and succinct practical evidence available to support this statement too. The socialist system in its classic, Stalinist form is the historical structure that moved closest to a 'perfect hierarchy', to the model of utterly vertical coordination. Lenin stated that the Soviet system could be seen as one gigantic factory. The system initially, in the short-term, brought spectacular results indeed, but in the end it failed! In its long-term efficiency (in terms of innovation, productivity and continual expansion of production), it fell far short of the performance of the decentralized capitalist system.

The efficiency of a system is essential to increasing material welfare, but there are other values to be considered as well.

5. *The value of independence, self-determination and autonomy.* Let me take education and training as an example. It is clearly important for supply and demand for labour to harmonize, and so for the recruits emerging from training to match the structure required by their likely workplaces, in terms of level and type of training, etc. I once heard the following line of argument put forward at a conference in Sweden. Mozart's father might have learnt from the fact that Salzburg was full of musicians. Nannerl, the elder daughter, had become an accomplished pianist. Perhaps little Wolfgang should be a skilled craftsman instead: there was shortage of those too.

What moral grounds are there for rigid defining what young people study? What happens to the sovereignty of the individual and the family in such cases? It may be that regional or professional autonomous bodies make many mistakes. It may also be that a super-clever state office can reach better decisions. However, there is an *immanent* value for many in allowing a village, a town, a profession, a branch of art, or any

other community to decide for itself. István Bibó wrote of the 'little circles of freedom' when he argued for self-governance.

6. *Paternalism and self-care.* The more the centralized state coordination embraces society as a whole, the more the state receives the task of taking care of all its citizens in every respect. Centralization and paternalism are twins, as are decentralization and self-help. This is an argument in favour of centralization in the eyes of those who like to depend on the state, but not everyone does. There are those who distrust the caring state, and many more have become uncertain about it in the light of recent developments. What if the state does not keep its promises? What if it turns out to be a father who does not look after his children well? Furthermore, many of us dislike being treated as children. We want to be responsible for ourselves. We want to provide for ourselves and our families, though it may involve greater expense. It brings to the fore private insurance, credit possibilities for paying education costs, and other decentralized mechanisms. There is no need for an unnecessarily sharp contrast: the demand for solidarity calls for the state to play a big part in assisting the sick and the old, disadvantaged and destitute. Nonetheless, the value of self-help, responsibility for oneself, is a sound argument for a requisite measure of decentralization and against an excessive degree of centralization.

7. *Diversity.* There was a huge saving for the Chinese economy when it became compulsory for all to wear a 'Mao suit'. How light-industrial costs must have jumped when multicoloured garments reappeared! Since then, the Chinese have shown by their purchases that diversity is a luxury for which they are willing to pay extra.

Turning to a broader definition, our diversity is one of the beauties of life. There is no need to shepherd several research stations or several schools into one pen, even if they cost more separately. Each has its own history, its own tradition and its own collective memory. They have been through lean times together and developed a sense of community. These cold-blooded, technocratic reorganizations break such communities up, rob organizations of their past, and place them artificially in new, alien surroundings.

8. *The political criterion.* So far I have considered criteria of efficiency and of ethics. I have left the political criterion to last. Let us lay aside points 1-7 for a moment and assume there is a well-oiled, smooth-

running mechanism in operation. The question is who stands at the top of it? This is a question customarily asked in theoretical literature on the subject, and answered with the assumption that a 'benevolent dictator' stands at the top of the pyramid.

Yet what happens if this benevolent person is fallible and prone to making frequent mistakes? If his or her intentions are not so good, and s/he tyrannizes, welcomes flattery, rejects criticism, shows obstinacy, and proves incapable of requisite adaptation? That may be the worst problem with the centralized model. The more efficiently it works, the greater the danger of it becoming the tool of a tyrant. Mechanisms based on decentralization, on the other hand, contain 'checks and balances' against such an all-powerful centre. The more decentralized mechanisms there are and the livelier their activity is, the more firmly they offset the centralized peak of the pyramid. The politicians and pundits who aim for a strong state for the sake of fairer distribution and redistribution in favour of those in need should bear this in mind! Beware: leadership of a strong state can fall into the wrong hands!

Power and centralization

Evaluating arguments for and against centralization based on the eight criteria mentioned belongs to the field of *normative* analysis. We have weighed up in various contexts whether the centralizing tendency is 'good' or 'bad'. Let us now turn to a *positive* approach of considering the observable phenomena of reality and their causes and consequences.

The main ambition of the government led by Viktor Orbán has been to grasp power as firmly as possible, and having done so, keep hold of it as long as possible. Power is the *end* and all *means* are subordinate to it. If we have understood this Machiavellian relation of end and means correctly, this is most important causal explanation of the centralizing tendency. The power motive provides sufficient cause to make the Orbánite pyramid as comprehensive and effective as possible. The true motive for the changes is to bring about the following conditions as much as possible:

- Let the chain of command from the top downwards be as short as possible.
- Let every Chief, Deputy Chief and Deputy-Deputy Chief be one of our trusty people. The reorganization of all organizations is justified by the opportunity provided to appoint our people to

head the new Centres or Sub-Centres. Nor need we stop at posts traditionally reserved in the practice of democracies for 'political appointees'. The further down the pyramid we insert our trusted employees, the better.

- The main appointment criterion is loyalty to the top of the pyramid. Of course, expertise is useful as well, but unconditional loyalty and obedience are paramount.
- Whatever level of superiority/subordination pair it is, let the dependence be *strong*. Orders must be obeyed without question. In fact, subordinates need not wait for orders. They will know from the party line what superiors expect and act on their own initiative.
- Bosses need not have long discussions with subordinates. As in the military, the pattern for vertical coordination, the essence lies in the downward flow of information, the orders, not in the upward flow of suggestions or advice, let alone criticism.
- The condition for the operation of centralized vertical coordination is discipline. This must be imposed by administrative means. The disobedient must be dismissed. Nor is there any harm in clean-outs of workplaces where nobody was considering disobedience. (Examples are the mass dismissals from the public media and from the ombudsmen's offices.) I have even heard of cases where the regime has followed up by preventing dismissed officials from finding new jobs. Fear of dismissal leads many to humiliate themselves, preferring to smother their protests rather than to risk their jobs.
- Naturally, vertical coordination rewards its people as well as punishing and threatening them. Loyal service brings high pay, end-year bonuses and special non-monetary concessions.

The power motive does not simply apply at the top. Going down the pyramid, the new nomenclature of 'our people' reaches to deeper and deeper levels. Its members – Chiefs, Deputy Chiefs, Deputy-Deputy Chiefs – have themselves attained power. They must comply with those above them, but can command those below; and having attained power, they hold onto it. The Supreme Chief at the top of the pyramid is not alone: he has shared interests with the high, medium and low-level powers beneath him, in maintaining and retaining power.

Life for the new nomenclature on the upper levels of the Orbánite pyramid is eased because they do not

have to philosophise or rethink complex dilemmas repeatedly. They have to do their part as the party and government orders and expects. If there is trouble, the medium and low-level bosses have a ready excuse: 'we can't help it, the decision taken higher up was faulty'. (How familiar is the line, 'I was carrying out orders'.) The reassuring technocratic ideology is also at hand (see criterion 1 in the previous section): 'we are building and strengthening centralization for the sake of efficiency, and not for power's sake'.

Vertical coordination – the hierarchical system of command – has never worked satisfactorily anywhere. It is a squeaky machine. If troubles arise, the inner logic of the mechanism calls for more centralization. If detailed instructions are evaded, the numbers are broken down further. 'Hand-piloting' is not exceptional, so that each boss himself decides, instead of giving general guidelines to his underlings.

According to the logic of a centralized system, the greater the troubles, the more administrative measures must be applied. Once upon a time it was termed 'sabotage' for an enterprise to miss its plan target and the penalty in the Soviet Union could be death or merciless forced labour. The byword now is 'fraudulent misuse of funds', and in rare cases where this has been proved conclusively in the courts, the sentence, so far as I can judge, has remained within the bounds of a civilized judicial system. However, there is no guarantee that repressive measures will stop there. Further curbs on the legal rights of witnesses or suspects reinforce concerns on that score. Arbitrary accusations and false charges are becoming more common. It must be feared that public officials and business figures will be enveloped by a threatening atmosphere. Against this backdrop, we must place our hopes in the legal sense and professional honesty of the judges. Punishment must come to those who break the law, but only to those who really do so. Pressure is being applied to the judiciary; judges face a great test; but conscientious judges will not pass falsified or prejudiced sentences and judgements.

All I have said here about the attributes and inner logic of centralized vertical coordination will come as no surprise to those familiar with the socialist system. The problem is that the Fidesz regime has mistaken its period. Strong centralization was able, for better or for worse, operate and survive in the Soviet Union for seventy years and in Eastern Europe for forty years, only because there was a socialist system in power

throughout the entire region. Private property scarcely existed, the market mechanism was all but excluded, and the socialist world was cut off from its capitalist counterpart. The situation is very different now. How can the Fidesz regime coexist with the clear fact that the centralizing tendency has strengthened, but there is no socialist system surrounding it? How can the system of state commands coincide with the capitalist economy?

'Coexistence' that undermines trust

There is no sign of the Orbán regime preparing for mass nationalization or collectivization – not even its angriest critics would suspect that. The regime has accepted that private ownership is Hungary's dominant form. (Even so, its significance is not emphasized in the new constitution and the state's acknowledged obligation to protect it has been left out. Indeed the expression 'private ownership' does not appear anywhere – perhaps a Freudian omission.)

There is no capitalist country in the world where a centralized state and a decentralized market do not coexist in some form; nor does the latter operate in an uncontrolled manner, as so-called neo-liberals are alleged to demand. (In fact, no sane economist has ever described anything of the kind.) The state everywhere exerts some supervision over the economy, intervenes in the economy to some extent, provides some free services, performs a measure of redistribution and influences demand through its procurements. Everywhere there are frictions, indeed conflicts in the coexistence of state and market, around the points of contact between them. The worldwide financial crisis has brought to the surface some dangerous phenomena. For instance, some developed countries that went too far in deregulating their financial sectors are now re-imposing regulation and making their systems more effective.

Coexistence between the state and the capitalist market economy is in an at least tolerable condition in most countries. In fact, the relation is positively fruitful in some, despite a certain degree of friction. On the one hand, state intervention cushions the market's failures and makes income distribution fairer. On the other, the market flexibly and effectively corrects the government's mistakes. However, these fortunate cases do not refute the general observation that state and market are two different kinds of organism alien to each other: their coexistence is not easy.

It is a mistake to think the various elements of state activity and the various elements of market activity can be combined in any desired proportion. The governmental measures of the last twenty months have whimsically alternated between elements of socialism and capitalism, centralization and decentralization, and state and market activity. Parliament has hastily adopted more than one proposal in which one measure has a 'socialist' feel to it and the next a 'capitalist' one. The resulting system is no unique 'Hungarian model' of which we can be proud, or to which we can draw the attention of a benighted world. The socio-economic structure under which we are living is incoherent and replete with inconsistencies. Nor has it sought to reconcile the advantageous traits of socialism and capitalism; it assumes in the main the least attractive traits of both.

In the light of these facts, let us look at the individual features of the processes that have taken place over the last twenty months. Strong words are used against bankers, speculators and adventurers – formulae borrowed from the current worldwide wave of antipathy towards capitalism – mainly when a wider domestic public is being addressed. The twilight of the West is nigh. Yet there have been cases where the head of government or a minister meeting with Hungarian and foreign business people, investors or leading bankers has addressed them in objective tones. If we only had words to go by, it would be hard to say whether the regime was a friend or an enemy of capitalism.

Words might be tolerated, but there have also been deeds unacceptable to sincere believers in the capitalist system. It has been cited a hundred times, but it remains the gravest iniquity in this respect, that the government confiscated the private savings that had built up in the pensions funds. The defenceless citizens sought protection and a remedy for their grievances from the Constitutional Court, but it let them down. That grave injury cannot be healed; this above all has undermined citizens' trust in the legislature, executive and judiciary, from which they had expected protection of their property, not an attack upon it.

There has luckily not been mass nationalization, but a slow, surreptitious expansion of the state sector is nevertheless occurring. The first episode, small but alarming, occurred in Pécs, when a new Fidesz mayor, still in the time of the last government, used his security men to chase out the staff of the French-owned waterworks and took charge of it. Later, by legal means, but for economically nonsensical reasons, the

government repurchased most of the shares of the oil giant MOL, i. e. it began to play the stock market, in this case sustaining an inordinate loss. It later obtained ownership rights of the vehicle company Rába. Economists remain puzzled as to the possible reasons for these moves.

It is well known that legally, economically and ethically dubious transactions took place in all the post-socialist countries during the huge process of privatization that followed the change of system. If it should emerge only now that some deal or other was illegal, an investigation might still be launched. However, confidence in the sanctity of private property will be seriously shaken if a wave of *generalized* suspicion begins, two decades after the change of system, and if there is a full, methodical criminal investigation of the whole privatization process. What is the purpose of this upheaval in property rights? 'Shake in your shoes, we're after you all'. Is that the kind of anxiety the government wants to spread in everyone who has acquired property in the last twenty years?

It is incompatible with the smooth working of the capitalist system for the state as buyer (the biggest buyer, excessively big, many say) to discriminate among potential sellers, not over business conditions, but on political grounds and in view of personal connections. There are generally known to be firms 'close to Fidesz' (just as there were those 'close to the Socialist Party' or 'close to the Alliance of Free Democrats'). Sometimes the discrimination can be detected even in the legislation, as with the exemption from 'crisis taxes' given to some domestically-owned chains of stores. The bias which exists, but is harder to detect, is that in adjudicating between tenders for state procurement orders. Furthermore, investigative journalists report the existence of 'shadow empires' in the economic background of Fidesz, receiving assistance from the political sphere and giving aid to politicians in return.

One foundation of the capitalist economic system is the respect of private contract. The government, parliament and the courts have an obligation to enforce contracts. But how can respect for private contracts be expected if the government itself, as a partner in many important agreements, sets such a bad example? When the 'crisis taxes' began to be levied, government promise after promise was heard during the negotiations, only to be broken at the next stage of talks. The banks are being trifled with; a kind of three-card trick is being played on them.

Even after tempers cool and the government side announces that this was the final move, the game resumes. This happened in several stages with the ostensibly 'final settlement' for individuals who had taken out bank loans in foreign currency.

The question of loans raised in foreign currency is hideously complicated and cannot be reviewed in this article, which will focus on just one aspect of it. To shed light on my contention, it is necessary to analyse only two pure cases, although in practice a broad range of cases exists that exhibit mixed features of the two extremes. One pure case is where a household was compelled to take out such a loan to improve its housing conditions: its members were not well enough informed to see their way through the web of conditions surrounding the loan. They have been trying to repay it, but they cannot, because their finances have deteriorated, for instance because the main wage-earner has lost his job. In such a case, the principle of solidarity warrants society giving assistance to the family.

The other pure case is where a borrower was hoping to make a profit out of buying a piece of real estate. S/he knew that raising a loan in any currency involved a risk. It is unacceptable to brand such a person as a 'speculator', for such transactions are part of the normal course of a capitalist market economy; the housing sector would never develop without them. If the transaction pays well, the borrower pockets the profit. If it does not, that is the borrower's problem. No pity is due and still less is s/he entitled to retrospective help of some kind. Yet the final version of the 'final settlement' has assisted just such cases of business investment. The state has forced banks to amend earlier private contracts retroactively, at their own expense, to the benefit of the borrowers. This procedure, and similar retroactive contract amendments made under state pressure, have caused perilous legal uncertainties. This is a classic example of what I termed in my earlier work as a 'soft budget constraint'. If there are mass bail-outs of profit-greedy individuals now in financial trouble, entrepreneurs, investors, local government organizations or ordinary citizens will be led to think that they do not need to hesitate about taking risks. They can safely take out loans for as much as they wish, because they will be bailed out if they get into trouble. Even if they signed a contract, what does a little signature matter?

Respect for private contract and the security of the law was also damaged by legally inadmissible legisla-

tion that retrospectively expropriated many severance payments to employees. Owners hold sway over their firms' affairs. They must abide by the valid laws of the state, but having done so they are sovereign decision-makers. Yet this government has repeatedly breached the basic market rules of capitalism in the past and continues to do so. Fidesz's people announced that private firms would have to compensate employees who lost by the introduction of single-rate flat income tax. 'Wage commandos' are being sent out to firms to check whether this has been done. There is even an open threat attached: firms that do not meet the requirement will not qualify for state procurement orders. The authorities are meddling in what can or cannot be sold at a filling station, in how many chemist's shops and how many tobacco outlets a town may have. The state is intervening with the force of law in whether shopping malls may be built.

'Profit' is a word with a pejorative ring for Marxist propagandists, but those who have studied economics know that profit and investment are closely tied on the macro level. On the micro level, most firms (including banks) cover a large part of their capital investments out of their own profits. Only part of those profits reach the owners as money that they are free to spend. If they want they can use profit-based funds for consumption or for personal capital investment. However, by clamping down on corporate profits, the state will deal a heavy blow to the investment process. Loss-making firms will try to ride out the storm for a time, usually by trimming back their activities, and many of them become insolvent sooner or later. Brutally high 'crisis taxes' cannot qualify as praiseworthy 'unorthodox' methods of relieving citizens that do credit to the administration's ingenuity. When the profit motive for firms and banks is seriously imperilled, the ultimate hope of finding funds for lasting growth is lessened. It is useless for propagandists to proclaim that the government's main aim is to produce growth, if its deeds drastically reduce the possibility of investment funded out of profits.

Against such a backdrop the peaceful coexistence between state and market becomes almost impossible. The government seeks to bring the private economy under its sway, and notably its life-blood, the financial sector. The centralized state pyramid sees itself as all-powerful and tries to dictate through its available means, while the decentralized market around it is incapable of collective action to defend itself by similar means. Yet it too reacts, as explained in the next section.

Arbitrary state action and market reactions

One of the important features of capitalism is that it consists of millions or tens of millions of atomized players, each rivalling each other, often in greater or lesser conflicts with each other. This Marx saw pejoratively as the ‘anarchy’ of the market, as ungoverned administration, and that is what it is.

The market has its own parlance and sign-language, which has been well explored by science. Some information consists of price indicators, other of quantitative indicators of production, investment and capital flows. Let us look briefly at a few market indicators. A sizeable proportion of Hungary’s state debt consists of state bonds. When an issue of bonds matures, the state must pay it back with interest (its yield, in business parlance). Then new bonds must be issued to cover the repayment. If a state cannot make the repayment it becomes insolvent, the state goes bust and the investors’ money is lost. Thus buying Hungarian bonds entails a risk. What do the buyers of Hungarian state bonds think of that risk? It is superfluous to ask them in words. The answer appears in various indicators, of which two will be taken as examples here.

One is the risk premium. Investors can insure themselves against the risk of default: the bigger the risk of trouble, the higher the premium. The country risk premium for Hungarian state bonds has been climbing. Before the Fidesz government took power, in May 2010, it was around 250 basis points. In October it rose above 550 basis points on several occasions. In January 2012 it exceeded 700 basis points. Another significant indicator concerns the yield on ten-year state bonds. Before the 2010 elections the expectation was 6–7 percent per annum. These days investors are only prepared to buy such bonds if the Hungarian state offers an annual rate of interest of 9–10 percent. This is an unprecedented cost. It is unpayable by any economy presently stagnating or possibly shrinking, with a prospect of growth one day, but likely to be slow for some time. If Hungary’s financial policy-makers accept it by floating more bonds, the country will find itself in a debt spiral, or worse still, in an accelerating whirlwind of debt.

It is unclear to the government, judging by official statements, that the investment experts at home and abroad are not usually ‘speculating’ with their own money. Most are handling the money of insurance institutions, pension funds, and investment banks that

marshal the savings of private individuals. They attend to the views and advice of analysts and credit-rating institutions. Some investors – to safeguard their depositors, insurance clients and pension beneficiaries – are *obliged* to refrain from investing in junk bonds. It is a waste of breath to engage in polemics with them or with analysts or credit-rating agencies. Even if they err occasionally, what they do and decide is an economic *reality*.

There is a strong economic correlation between market movements for sovereign paper and exchange rates. Foreigners who sell bonds bought for forints hasten to exchange those forints into euros or dollars or another currency. Amidst the sharp fluctuations, the trend is clear: the forint has weakened perceptibly against all other currencies. Albert Hirschman, in his splendid book *Exit, Voice and Loyalty*, stressed a wonderful thing about the market: there is no need to say anything, no need to protest or threaten or shout. It is enough to exit. When the centre handling Hungary’s state debt announces an auction of new state paper and no buyers appear (as has happened several times), it shows that investors who would have gladly bought Hungarian state bonds earlier have silently left. Government spokesmen are scaring citizens by saying they will detect who is giving the forint a bad name and punish the rumour-mongers, but that will not stop the flow of deposits from Hungarian banks into foreign ones, which is reducing the funds available for real investments in Hungary.

Still clearer signals of exit are emitted by the figures for the decline in lending and in the propensity to invest. The threat here is not just to the financing of Hungary’s budget deficit – the *short-term* financial balance – but to the country’s *long-term* prospects of growth. There are many factors affecting the supply of credit. The mounting tax burden on the banking sector is certainly one contributor. The fall in lending to firms is conspicuous.

For a long time, one driving force behind growth in the Hungarian economy was the inflow of operating capital (foreign direct investment). This moved for many years within a band of an annual 3–10 percent of GDP. There is no figure available yet for the whole of 2011, but the figure for the first three quarters was saddening: for the first time foreign direct investment was negative, in other words more capital was taken out of the country than brought in. This was an alarming signal indeed of silent withdrawal. Another important figure: investment in the competitive

sphere stagnated. The volume in the first three quarters of 2011 was equal to the same period of the previous year.

The chain of cause and effect, impulse and reaction, is clear. The confidence of the business world has been undermined by the whimsicality and unpredictability of Hungarian economic policy, legal uncertainty, and repeated breaches of the rules of a capitalist market economy – including more than one grave and crude breach of fundamental principles. The destruction of trust leads to a worsening of the financial conditions for normal operation of the Hungarian economy, thus damaging the prospects for long-term, lasting growth.

This brings me to my final conclusion. The Orbán regime has attained its real goal: it has harshly seized power; by strengthening centralization and extending the power of the state it has gained the means of exerting unlimited power. However, autocratic rule, unbridled centralization and excessive expansion of state activity are incompatible with healthy running of a modern capitalist market economy. Following *this* road, it will be impossible to raise the Hungarian economy out of stagnation and onto a path of sustainable growth; and Hungary's present and future generations will suffer as a result.