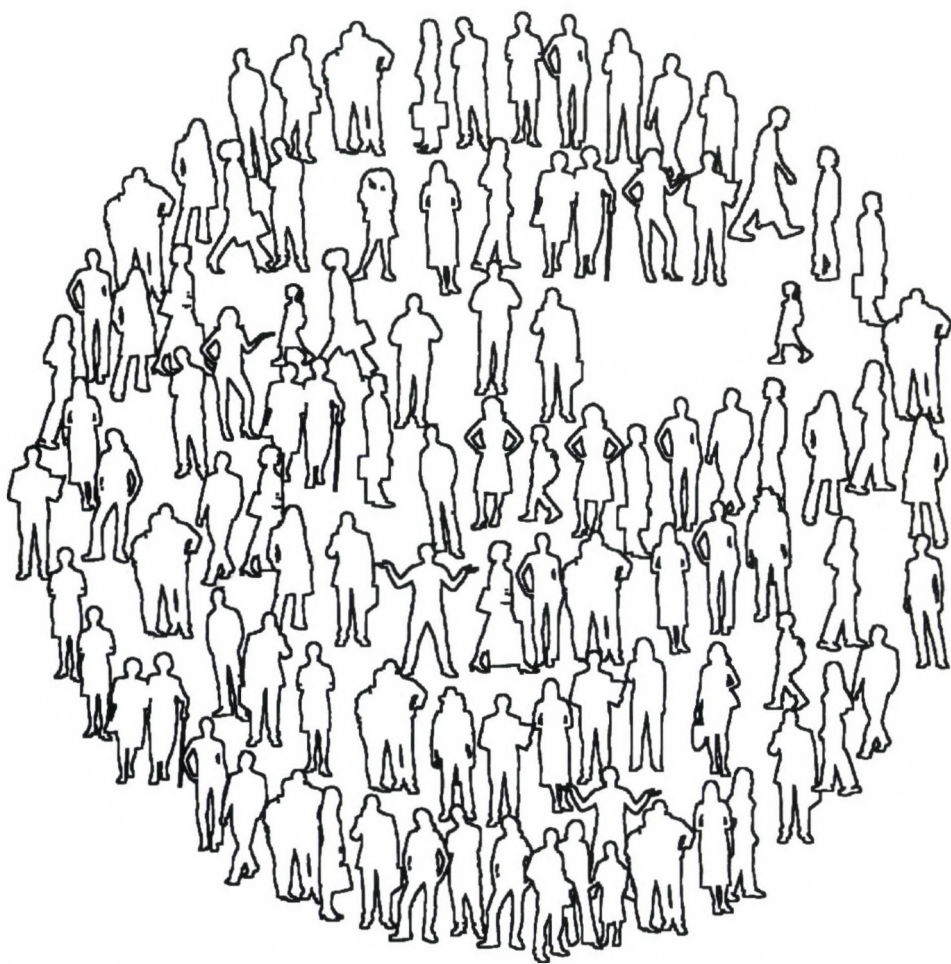


1-2'2012

ИНСТИТУТ  
ЗА ИЗСЛЕДВАНЕ  
НА НАСЕЛЕНИЕТО  
И ЧОВЕКА



НАСЕЛЕНИЕ

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**БЪЛГАРСКА АКАДЕМИЯ НА НАУКИТЕ**

**ИНСТИТУТ ЗА ИЗСЛЕДВАНЕ НА НАСЕЛЕНИЕТО И ЧОВЕКА**



# **НАСЕЛЕНИЕ**

**КНИЖКА 1–2/2012**

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**NUMBER 1–2/2012**

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**INSTITUTE FOR POPULATION AND HUMAN STUDIES**





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## CENTRALIZATION AND THE CAPITALIST MARKET ECONOMY<sup>1</sup>

János Kornai

*Янош Корнай е почетен професор по икономика в Харвардския университет и в университета „Корвинус“ в Будапеща. Той е член на Унгарската академия на науките и на Европейската академия (Academia Europaea) и чуждестранен член на Американската, Британската, Финландската, Руската, Шведската и Българската академии на науките. Бил е президент на Иконометричното общество, на Европейската икономическа асоциация и на Международната икономическа асоциация. Награждаван е с най-високите унгарски отличия за научна работа, както и с наградите „Ф. Сейдман“ (САЩ), „Хумболт“ (Германия) и медалите „Еразъм“ (Academia Europaea) и „Леонтиеф“ (Русия).*

*Изследванията на Янош Корнай са в областта на критичния анализ на социалистическата система и пост-социалистическия преход. През последните две десетилетия той се занимава с проблемите на икономическата политика и по-специално с макроикономически проблеми и реформирането на социалната държава. Най-известните му произведения са *Overcentralization in Economic Administration* (1957), *Anti-Equilibrium* (1971), *Economics of Shortage* (1980), *The Road to a Free Economy* (1990), *The Socialist System: The Political Economy of Communism* (1992), *Highway and Byways* (1995), *Struggle and Hope* (1997), *Welfare, Choice, and Solidarity in Transition* (co-author Karen Eggleston, 2001), *By Force of Thought: Irregular Memoirs of an Intellectual Journey* (2006), *From Socialism to Capitalism* (2008). Неговите книги са преведени на повече от двадесет езика.*

Not long ago, I was shown at a provincial university the quotas for admission that the faculty of economics had received from the ministry for this academic year, derived from the national admittance threshold points: “Students on basic training 750, students on the masters’ course 120,” and so on. I could hardly believe my eyes. Exactly 120 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 the university people could tell me quite how the figures had been calculated, but they suspect that someone above had

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<sup>1</sup> Статията е публикувана на унгарски език в *Népszabadság online* на 01.02.2012 г. и на английски език в *CESifo Forum*, vol. 13/1, 2012, 47-59.

produced aggregate national quotas for the each major field that were broken down to institution level.

Memories flashed before me of 55 years ago. Back in 1956 I was working on my dissertation, having regular discussions with enterprise managers in light industry. They spoke scornfully of the meticulous plan directives they got 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” come by those exact figures, what with all the uncertainties of production and sales? Based on my researches I finished my dissertation, which after some upsets appeared in 1957 as *Overcentralization in Economic Administration*.

Over half a century has passed since then. Not for decades did it occur to me even in my dreams that the subject of my first book, overcentralization, would ever become opportune again. Yet it has. 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 debates over them. It tried to explain how a radical change had occurred in the political structure: Hungary was no democracy any more, but an autocracy. In close relation to this, the article viewed the damage done to legal security and human rights, and the detrimental features of the economic policy that was being pursued. 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 piece does not call for any changes of emphasis. I am still convinced that the main trouble lies in the replacement of democracy by autocracy. What I set out to do here is to augment the conclusions made already, 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 make plain what is meant here by a “centralizing tendency”.

### *Ministries*

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

### *National Bank of Hungary*

The new act on the central bank was passed by Parliament in a whirlwind of end-year activity. At first sight, this new piece of cardinal legislation prescribes only formal changes, but in actual political practice it allows strategic direction of the National Bank of Hungary to be assumed by the Fidesz regime, whose will prevails equally in the actions of the government, the president of the republic, and through its two-thirds majority, the legislature. The decision-making



powers of the Monetary Council increase. 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 a chance for a new united institution to come into being, 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. The 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 hands.

#### *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 citizens – now this activity is to be part of the machine of 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, its tasks passed to other authorities or left unassigned.

#### *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.

#### *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 educa-

tion, the health service and disaster protection will be wholly the responsibility of the central government.

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

#### *The judiciary*

Hungary's courts of law were hitherto 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 determines which cases shall be tried by which court.

#### *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, 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 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.

#### *Insurance*

The reform of 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 have been seized and much of them spent by the government, while its obligations to the insured pass in theory 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.

#### *Services*

Seven hitherto separate companies in Budapest running the medical spas, street cleaning, funerals, etc. have been merged under a holding compa-



ny, which represents the capital city also 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 5000.

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 done by private sewage-tanker operators. This will be taken over by a firm owned by the capital city. The changeover is speeded by a financial disincentive: those using private operators will pay twice: the full price to the private operator and again the full price to the city-owned company.

*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. Hitherto each gymnasium had control over its own funds. Now it may spend nothing over a few thousand forints without the Economic Organization's say-so. By the time the gymnasia get used to this 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 per cent of what is taught will be compulsory curriculum and only 10 per cent optional. Previously, local government-owned schools had greater freedom to adapt their curricula to local conditions; now they will all be inflexibly the same.

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 he or she 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. Now it 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 university's into the central government's hands.

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

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

Up to now the public funding for several arts and science-related activities and social welfare tasks was distributed through 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 hitherto 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 Petöfi 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

There would be no difficulty about adding to the list of thirty-three examples I have given, which purposely ranges from the huge changes 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 slighter ones of amalgamating two galleries or amusement venues, although the second too will bring radical changes for those involved in them. The spread of the examples to include some tiny or even bizarre instances is intended to demonstrate how centralization has turned into a kind of 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 there is sudden reorganization in so many places 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: the legal form of the changes varies from case to case. Sometimes whole institutions are united, sometimes the procedure for appointing heads changes, sometimes executive boards are packed to increase central control, sometimes statutes are altered. So what “pattern” emerges from all thirty-three cases?

All machines of state 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. Centralization will strengthen 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) hitherto autonomous activities operating *outside* the machinery of state can be brought, partly or wholly, under state control. Finally, it grows if (vi) state inspection and intervention can be made in processes hitherto occurring without 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 in which two or more of the changes appear. This in itself backs my assertion that we are not up against 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 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 for those who approve of the changes it is not worth denying 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 brought in *a great number of concurrent moves* towards excessive centralization and the destruction of autonomous mechanisms, and these very varied, mutually reinforcing changes have combined into a tendency.

#### ARGUMENTS FOR AND AGAINST

The official initiators and implementers of these changes are wont 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, with 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. Not a bit of it. The debate has become current again. As a warm-up, let me remain on the fine, smooth plane of theoretical analysis. I will try with a poker face to contrast the arguments for and against, as if this were some kind of duel that the one with better arguments could win.

The multiplicity of human activity has to be coordinated, with the assistance of various mechanisms. Let me pick out two of these.

One is the mechanism 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 perfect because the relations of superiority and subordination are unambiguous: there are no double or multiple lines of dependence.

The other 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 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. For other arguments for and against must be considered carefully.

2. *Competition*. Centralization involves cutting out competition wherever possible, whereas rivalry is vital to decentralization, though competition involves great costs. Competing sellers have to advertise and convince buyers to purchase their product or service, not another's. 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, indeed essential to bring in new products before competitors do: that 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 Har-



vard 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 become the most famous in his country, the first American economist to be awarded a Nobel Prize. Today MIT is one of the 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 one with the best students and the most valuable research results, and frequently poaching each other's staff. Despite the rivalry there is cooperation between them, for instance in the form of joint seminars.

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 in legislation and other inflexible regulations the future structures, 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, and still 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 flawless working of centralized coordination 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. True, but real life is full of uncertainties and inaccurate information. Nor are they necessarily fortuitous; there may be intentional distortion at work. It may suit subordinates to deny there are problems (or exaggerate them if it serves their interests). They may report there is spare capacity, or contrariwise, complain 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 are the ones open to information, criticism, and self-correction.

To sum up the arguments under points 2, 3 and 4, it can be stated that the 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 literature on the subject, of course) are considered objectively, it will be seen that the statement is true on a straight *logical* basis. But there is more cogent and succinct practical evidence as well. 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 the system is essential to the increase in 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 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.

What moral grounds are there for setting rigid frames for what young people study? What is happening here to the sovereignty of the individual and the family?

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. But there is an *immanent* value for many in allowing a village, a town, a profession, a branch of art, or 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 of 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 there stands a “benevolent dictator” at the top of the pyramid.

And what is going to happen, if this benevolent person is fallible, often making mistakes? If his or her intentions are not so good, and he or she 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. May the politicians and pundits who aim for a strong state for the sake of fairer distribution and redistribution in favour of those in need think about this! Beware: leadership of a strong state can get into the wrong hands!

## POWER AND CENTRALIZATION

Evaluating arguments for and against based on the eight criteria mentioned belongs to the field of *normative* analysis. We have weighed 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 aright, this is most important causal explanation of the centralizing tendency. The power motive provides sufficient cause for making 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. It is sufficient reason for reorganizing all organizations that it provides a chance 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 trustees, 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*. The 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 do it on their own initiative.

- Bosses need not discuss much 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 to risking 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 that power, they stick to 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”!) Also at hand is the reassuring technocratic ideology (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 thicker 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 stayed within the bounds of a civilized judicial system. But there is no guarantee that repressive measures will stop there. Further curbs on the legal rights of witnesses or suspects reinforce the 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 an atmosphere of threat. Where we must place our hopes is 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 be known to those familiar with the socialist system. The problem is that the Fidesz regime has mistaken its period. Strong centralization could, for better or for worse, operate and survive in the Soviet Union for seventy years and in Eastern Europe for forty, but only because in the region there was a thoroughgoing socialist system in power. Private property scarcely existed, the market mechanism was all but excluded, and the socialist world cut off from the capitalist. Now there is a different situation. 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 – 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 uncontrolled, as the 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. And 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 went too far in deregulating their financial sectors; reimposing regulation and making it more effective have joined the agenda.

Coexistence between the state and the capitalist market economy is in at least tolerable condition in most countries. In fact the relation is positively fruitful in some, despite some frictions. 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. But these fortunate cases do not re-



fute 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 this, let us look one by one at the features of the processes taking place over the last twenty months.

Strong words are used against bankers, speculators and adventurers – formulae borrowed from the current worldwide wave of antipathy to capitalism – mainly when a wider domestic public is being addressed. The twilight of the West is nigh. Yet there are cases where the head of government or a minister meeting with Hungarian and foreign business people, investors or leading bankers addresses 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 to capitalism.

Words might be tolerated, but there have also been deeds unacceptable to sincere believers in the capitalism 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 there is nonetheless a slow, surreptitious expansion of the state sector 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 making an inordinate loss by it. Later it obtained ownership rights of the vehicle company Rába. Economists remain puzzled to know what could have induced 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. But confidence in the sanctity of private property will be seriously shaken if there begins a wave of *generalized* suspicion, two decades after the change of system, and 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 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. In existence, but harder to detect, is the bias 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 respect for 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 the worst 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, having a kind of three-card trick 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. I would like here only to pick one aspect of it. To shed light on what I have to say it is necessary to analyse only two pure cases, although in practice there is a broad medium band with mixed features of the two extremes.

One pure case is where the 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 the borrower was hoping to make a profit out of buying a piece of real estate. He or she 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 he or she 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 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 a "soft budget constraint". If there are now mass bail-outs of those in financial trouble, who got into it in the hope



of fat profits, there will appear in the minds of entrepreneurs, investors, local government organizations or ordinary citizens the expectation that they need not hesitate about risks. They can safely take out loans for as much as they wish, because they will be bailed out if they are in trouble. Even if they signed a contract, what matters a little signature?

Respect for private contract and the security of the law were also damaged by legally inadmissible legislation 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 repeatedly breaches the basic market rules of capitalism. 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 was 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 intervenes 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 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 they are free to spend. If they want they can use them for consumption or for personal capital investment. But if the state clamps down on corporate profits, it deals a heavy blow to the investment process. Loss-making firms will try for a time to ride out the storm, usually by trimming 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.

Here peaceful coexistence between state and market becomes almost impossible. The government seeks to bring the private economy under its sway, 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. The next section sets out to say how.

### **ARBITRARY STATE ACTION AND MARKET REACTIONS**

It would be a poor comparison to think of an American football game at this point: of two teams rushing at each other, one trying to crush the other's players mercilessly and grab the ball. One side in the battle between the Orbán government and the capitalist market economy is lined up ready for battle, with a team of leaders from the ruling political party. But what about the other side? Hungar-



ian capitalism has no united party, no Politburo, no chiefs of staff. Indeed the world's capitalists are not united either. There is no global united capitalist political party. There is no world government, no central planning office like Gosplan. So there is no other "team" to crush the opponents and grab the ball.

It is time to lay aside the sports comparison. One trouble with the government is its penchant for seeing the situation as a football game or a boxing match. So let us talk instead in the language of economics and social theory. 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 several times above 550 basis points. 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 per cent 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 per cent. 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, 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 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. Certainly the mounting tax burden on the banking sector is 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 per cent of GDP. There is no figure yet for the whole of 2011, but the one for the first three quarters was saddening: for the first time it 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 – more than one of them grave and crude breaches of fundamental principles. The destruction of trust leads to a worsening of the financial conditions for normal operation of the Hungarian economy, and so to 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. But 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 the trap, out of stagnation and onto a path of sustainable growth. And we will all be the sufferers by that, present and future generations.



## MY EXPECTATIONS OF THIS ARTICLE

Much of my message remains unsaid. It would be good to discuss the bad kind of coexistence between state and market that has arisen in Hungary, how it fails to draw all possible good out of the capitalist system: the propensity for innovation, dynamism, initiative and a spirit of enterprise. But sadly it brings out all the bad innate in capitalism as a genetic attribute. The government and the market work together to make the income distribution still more unjust; they operate side by side to produce and sustain mass unemployment. Unfortunately there is no space to explore these ideas here as my article is already too long.

I have addressed primarily readers who are themselves critical of the Fidesz regime. Already there is a wide circle who agree on the fundamental question: this country is under autocracy instead of democracy; the state of law has weakened; human rights are being infringed. I would like to augment this common recognition with my analysis here. I hope this will assist people in understanding the situation and formulating their own position on it.

I do not think *fanatics* can be convinced by analyses or by economic or moral arguments. I do not imagine that admirers of Viktor Orbán will read my piece, strike their foreheads and say the author is right and their opinion of capitalism, centralization and decentralization will be different in future.

But what if the ranks of Fidesz and the administrative apparatus include some who are not fanatics? People who, if they are not close to the top of the pyramid, find it important to retain their autonomy? What if they are capable of breaking out of a short-term, technocratic outlook of being impressed only by state discipline and a possible swift growth in efficiency and not concerning themselves enough with long-term interests? What if they are capable emotionally of appreciating the strong moral dilemmas mentioned in this article?

And I would add that many are uncertain: they like some things the government is doing but not all. Many people have become disillusioned with politics, backed away from public affairs and turned in on themselves, their families and their immediate environment. It may be that some of those who have become uncertain will be prepared to rethink their own experience in the light of the ideas in this article.

When I write or lecture, I normally have specific people before my eyes. It is as if I am addressing and seeking to convince them. This time I have been thinking of some former students of mine as I write. Perhaps there were not so few of them who once read my *Overcentralization* or *Economics of Shortage* or *Socialist System*, or studied from them in college and university. They know that as an author I dealt much with issues of centralization and decentralization, the state and the market, and socialism and capitalism. If they listened to my messages then, perhaps they will find it worth dwelling on my present words as well.

We shall see. Perhaps I will live to see some essential change in this country's favour.