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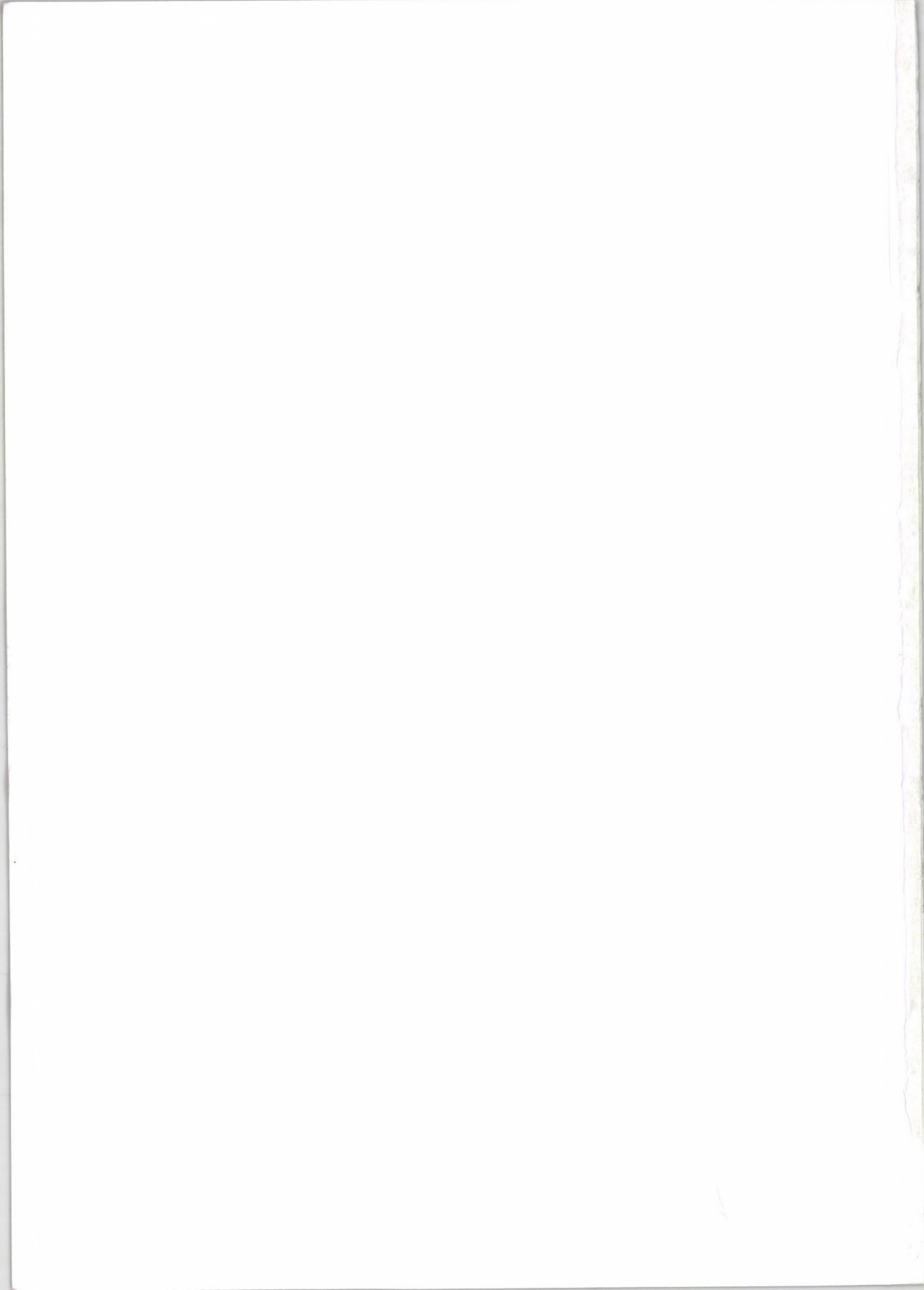
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ИЗДАТЕЛЬСТВО
ИНСТИТУТА
ГАЙДАРА



АЛЬМАНАХ

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Breaking promises: Hungarian experience

JÁNOS KORNAI

JEL: D7, P5

KEYWORDS
*promises, reputation,
capitalism, Hungary*

The paper is dedicated to the theoretical investigation of the phenomenon of promise and its different types: producers' promises to users, about what product or service is being offered, when, and under what conditions; users' promises to producers, about how much, when, and under what conditions they will pay the producer for the goods or services received; debtors' promises to lenders (usually a bank or other financial institution), about when and under what conditions the debt will be repaid; government (central or local) promises to citizens—all citizens or a certain group of them—about what services they will provide for them and under what conditions; political promises (by individual politicians, parties or movements) to electors, about the program they will implement if they are elected. Motives and effects of breaching promises are examined with a particular reference to the Hungarian economy.

JÁNOS KORNAI. Professor of Economics Emeritus, Harvard University and Corvinus University Budapest.

INTRODUCTION¹

I was still in high school when I first read that harrowing ballad by Friedrich Schiller, "Die Bürgschaft," the guarantor (Schiller [1794], 2004)².

1. I am grateful for their help in the research and their useful advice to the following colleagues: Zsuzsa Dániel, Tamás Keller, János Köllő, Sylvie Lupton, Boglárka Molnár, Mária Móra and István György Tóth. Let me thank the translators, Brian McLean and László Tóth. The attentive and efficient contribution of my assistants, Rita Fancsovits, Klára Gurzó and Andrea Reményi, means a lot to me. And my thanks go to Corvinus University of Budapest for the inspirative environment and the support for my research.
2. Schiller's poem has been translated to English several times. Below I quote Scott Horton's translation, published in 2007. Horton translates the Ger-

In the ballad, a man named Damon sneaks into the court of the ancient Greek city of Syracuse with a dagger under his toga, intent on stabbing the tyrant Dionysus, but he is arrested by the guards and brought before the tyrant, who condemns him to be crucified. Damon does not plead for mercy, but asks for three days' parole, so that he can give away his sister in marriage. He will leave a friend as a guarantor, who may be executed in his stead if he fails to return. The tyrant agrees and the friend steps in. Damon dashes away to the wedding, and tries to return just as fast.

But the weather is against him. There is a fearful storm, causing the river to flood and washing away the bridge. Damon manages to swim across, but then meets with a band of robbers whom he has to fight off. Eventually he reaches the edge of the city, only to hear that the friend he left as a guarantor is being raised up on the cross. People advise him at least to save himself, but he bursts through the crowd to embrace his friend. The news reaches the tyrant, who relents of what Damon has been through and what self-sacrifice Damon's friend has shown, feeling certain that Damon would not break his promise. The tyrant turns to the pair and says:

In truth, fidelity is no idle delusion,
So accept me also as your friend,
I would be—grant me this request —
The third in your band!

And now let us turn from the realm of poetry to that of reality, from ancient Greece to present-day Hungary. I often go to a retreat for scholars, where I've come to know the kind waitresses in the dining room well. One of them, Éva, took out a bank loan to buy a flat and a car, and the bank's terms required the signatures of two guarantors. She asked Vera and Klára, colleagues of long standing and personal friends, who agreed to act as guarantors³. Éva promised the bank and her two friends that she would service the loan properly. But in the end she let everyone down. She did not pay the installments and fled from her obligations. The bank is charging the debt on the two guarantors.

In the ballad it is a matter of life and death. The promiser goes through fearful vicissitudes to keep his word. The guarantor is set free. In the real case, the breach of contract by the promiser did not spell death for the two guarantors, but it means that two women with financial problems of their own are left to wrestle bitterly

man *Bürgschaft* to 'hostage' in the title and in the text at a point, though the latter rather means *Giesel* in German. In the context of my study the English *guarantor* is a better match, which also happens to appear in Horton's translation.

3. The story is real, but I have changed the names.

with the debt, because their colleague and friend broke her promise and failed to meet her obligations.

What significance does keeping promises bear? Why do so many people break their promises? What consequences ensue from this flood of promise-breaking? These are questions this study sets out to address. Though this paper is illustrated mainly by Hungarian examples, I assume that the problems brought up here are present also elsewhere, and my argumentation can be used to analyze this complex issue also beyond the Hungarian borders.

CONCEPTUAL CLARIFICATION

The term *promise* is clear: someone, the *promiser* or maker of the promise—one person or a group or an organization (e. g. a firm, a state agency, a party, or a government)—undertakes an obligation to the *promised*, the beneficiary of the promise. Again the latter may be one person or a group (e. g. the population of a city or a country) or an organization. In the Schiller ballad Damon was the promiser and the tyrant and the friend were the promised; in the Hungarian story Éva, the debtor was the promiser and the bank plus the two colleagues serving as guarantors were the promised.

A promise may be unilateral, so that the promiser expects no recompense from the promised, or it may be bilateral, so that a pair of reciprocal promises appears: promiser A stipulates at the time of formulation and utterance of the promise that B, to whom the promise is made, will simultaneously make a promise of which A is the beneficiary. Both make a promise contingent on reciprocity. Such a promise contingent on reciprocity is known as a *contract* (Sharp 1934, p. 27). I fulfill my promise on the understanding that you will fulfill yours.

This study considers both types simultaneously in the main. I allude to the distinction between them only where my argument requires it.

A promise is often made in an *informal* way. If I order lunch in a restaurant, we do not draw up a contract, but I promise implicitly to pay the bill after eating the lunch. Other promises have a *formal* framework, e. g. a solemn oath is taken in the presence of witnesses according to a traditional ceremony. It is very common for a detailed contract to be drawn up in writing, where the contracting parties describe their obligations precisely.

There is no clear dividing line between informal and formal promises; there are many transitional cases. The possibility of enforcing fulfillment depends among other things on whether the promise has been formalized. This study disregards in several places the distinctions with regard to formalization.

To forestall misunderstandings, let me point out that the *fulfillment of promise/breach of promise* pair of opposites do not co-

incide with another pair of opposites to which great attention is paid: *whether a statement is true or false*. Both contrast words with reality, but this study examines a special form of contrast. The question of *truth/falsehood* contrasts words uttered at a given time with the reality of that time or a past time, or perhaps with a reality quite independent of the speaker. The question of *fulfillment/breach of promise* contrasts the words being uttered now with the subsequent conduct of the speaker and final result after a period.

DEFINING THE SUBJECT-MATTER

My main aim is to present the phenomena related to fulfillment and breach of promises and the economic, political and ethical problems arising from these. I discuss questions that we all meet with in daily life and see mentioned in the press, other forums of public discourse, gatherings of friends, or sessions of Parliament. There are some who complain that a building contractor has not done a renovation job properly according to contract. Economists argue over the outcome of late repayments on loans advanced for purchasing real estate. Opposition meetings chide the governing party over unfulfilled campaign promises. I am seeking what is common among these seemingly different cases. Can we see identical or similar behavior patterns and social mechanisms in them? Do they lead to similar decision-making dilemmas and reactions?

I do not set out to report on the general state of promise fulfillment. I cannot say if the world, or even Hungary, has improved or deteriorated in this respect. Although I deal here with observable and in many cases even objectively measurable events, unfortunately there are only sporadic data available.

The study mentions tasks—what should be done to make promise fulfillment more frequent. But I have not sought to devise an action program to this end.

The paper draws on experience in Hungary. Hungary's experience serves solely for illustrating certain phenomena and not as evidence for proving general statements.

AN INITIAL LOOK: FIVE TYPES OF PROMISE

It would be an interesting subject for research to examine breaches of promises between individuals in private life, for example by those who dangle a prospect of marriage and fail to fulfill it. This study does not deal with private life, concentrating instead on promises closely connected to economic and political life. I see five basic types:

- A. *Producers' promises to users*, about what product or service is being offered, when, and under what conditions.
- B. *Users' promises to producers*, about how much, when, and under what conditions they will pay the producer for the goods or services received.

Types A and B are usually reciprocal and laid down in a formal or informal contract of purchase and sale. However, it is easier to discuss them separately and postpone examining the tie between them.

- C. *Debtors' promises to lenders* (usually a bank or other financial institution), about when and under what conditions the debt will be repaid.
- D. *Government (central or local) promises to citizens*—all citizens or a certain group of them—about what services they will provide for them and under what conditions.
- E. *Political promises* (by individual politicians, parties or movements) to electors, about the program they will implement if they are elected.

These five basic types do not include all types of promise made in the economic and political spheres, but they suffice to exemplify the interrelations and problems discussed in this study.

A. PRODUCERS' PROMISES TO USERS

Daily occurrences in all our lives: the electrician promised to be here by ten, I did not go to work so as to be here to receive him, but he failed to come; the roofer undertook to insulate the floor of the terrace, but the room beneath got soaked the first time it rained.

In each example the promiser is an artisan and the promised a household. In subsequent examinations households remain the recipient of the promise, but the sphere of promisers extends to all who provide any kind of product or service to them, from hairdresser to taxi driver, dentist to cable TV provider. A "producer" may be a one-person firm, or a small, medium-sized or large company.

Consumers in Hungary have several kinds of body they can turn to with a complaint. *Figure 1* shows four lines of data, in all of which the numbers of complaint tend upwards. We do not know whether grievances actually became commoner or the propensity to lodge an official complaint increased. The data certainly do not include all breaches of contract, as in most cases the injured do not turn to the authorities for legal redress.

Looking at such events from the consumers' angle, breaking a promise may have several kinds of consequences. It may damage the consumer's material surroundings: the light still does not go

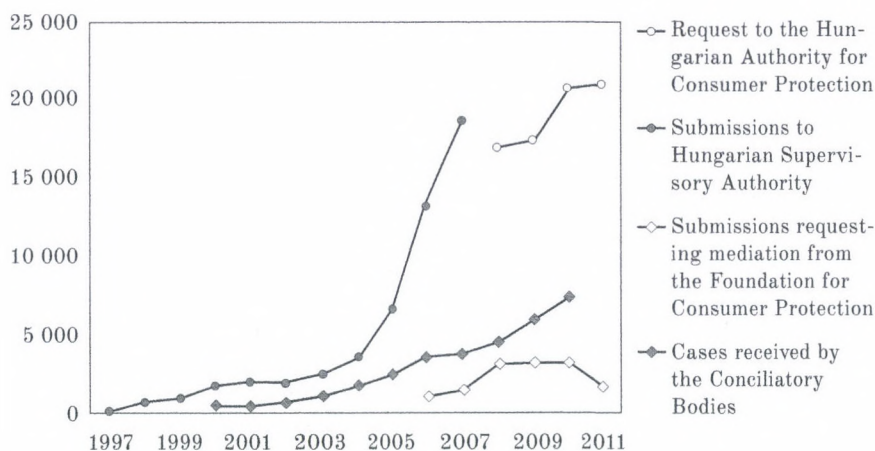


FIGURE 1. Number of consumer complaints, 1997–2011

NOTES. The *Hungarian Authority for Consumer Protection* is a central state agency. The *Hungarian Financial Supervisory Authority* is a central state agency, its general task being to monitor banks, insurance companies and other financial institutions. Its activities include the investigation of complaints received from the clients of financial institutions. The *Foundation for Consumer Protection* is a non-governmental organization, giving advice and forwarding complaints to the state agency in charge, but having no state authority. *Conciliatory Bodies* are independent state organizations, mediating between parties on the basis of written requests they receive.

SOURCES. Nemzeti Fogyasztóvédelmi Tanács [Hungarian Authority for Consumer Protection] (2012a, b, c, d), Pénzügyi Szervezetek Állami Felügyelete [Hungarian Financial Supervisory Authority] (2012a, b, c) and Fogyasztóvédelmi Alapítvány [Foundation for Consumer Protection] (2012). The latter source yielded the data on the Conciliatory Bodies.

on in the cellar; repainting the ceiling is costly. Beyond the material loss there is damage to the well-being of the aggrieved, who may be outraged in a serious case.

The recipient of a promise may be another producer, so that breaking it will cause disruption to input-output flows between firms or organizations. A component manufacturer which fails to meet the promised deadline for delivery upsets the user company's production plan. Various kinds of loss ensue: a whole line has to be stopped, causing disruption in sales; employees stand idle. If

the delay is often repeated, the user firm will become cautious and build up a greater inventory, which ties down capital. Often the problem is not the arrival date, but the quality of the consignment. If the user fails to notice the fault in the input and incorporates it into its product, it will damage the quality of its own output, which will cause sales losses sooner or later. All these eventualities ultimately reduce the efficiency of the user firm or other organization.

Here as in households the damage is not just material. All troubles caused by suppliers breaking promises annoy users, from workers to managers, and create a bad atmosphere. This psychological effect must also be added to the direct consequences of promise-breaking.

Especially serious is the damage to producer/user relations that is protracted in time. This applies to all longer-term investment projects, including all building construction. When the project commences, its input suppliers all shoulder to contractual obligations. All participants should fulfill those obligations in consort, in a disciplined way. Any failing or breach of contract disrupts all the other participants as well. The more of them breach contract discipline, the graver the shortcomings, the more completion is delayed, and the lower the efficiency of the construction and investment becomes.

Users build up self-defense mechanisms. These can be seen also in households. It is easy to find the names of artisans or firms on the internet, but many people prefer to use a producer or service provider tried out and recommended by a friend or acquaintance. One of the most important criteria in such cases is reliability: keeping promises.

This applies still more in relations between firms. The procurement department of a user firm does not always seek out all possible sources or in every case ask for multiple estimates. It may simply place the order with a supplier it already trusts. There emerge networks of producers and users that trust each other. Selection by networking has its advantages, but also its risks (Woodruff 2004). Such rigid networks reduce competition and may rule out in advance potentially advantageous offers. Not infrequently corruption creeps into relations between exclusive partners: strictly commercial conditions are watered down by mutual favors; firms may begin to look more leniently on breaches of contract.

B. USERS' PROMISES TO PRODUCERS

It may appear self-evident in a market economy that users will pay for products and services received. Those buying in a store, or procuring a service in a hairdresser's or fast shoe-repair outlet, naturally fulfill the informal contract behind the transaction straight away, by paying. There is a different situation when events are nor-

mally protracted: on one side supply of the good or performance of the service, and on the other payment for it. This is typical in relations between firms, especially on construction or other types of investment projects. If the contract so prescribes, part of the price has to be paid in advance. Another installment must be met within a given period after arrival of the consignment (say 30 or 60 days). A further part may be withheld until the purchaser has tested the article supplied (for instance a piece of technical equipment or a building).

There are, unfortunately, only very few aggregate data available for breaches of Type B promises.

Let us begin with households as consumers. I know of no aggregate and detailed figures for the debt of households to private producers, but their debt to utility companies is reported regularly (Sík 2011, Bernát 2012)⁴. In 2011 20 per cent, in 2012 22 per cent of the households were late with their utility bills. This is three to four times the 6 per cent European average. (More on this is in *Ingtalan és befektetés, 2012*.)

If the utility companies were to press consistently for punctual settlement of their bills, households breaking their contracts would be in deep trouble, as these service providers have a natural monopoly. Electric current and running water are practically indispensable. At first sight one would think that this dependency would enforce strong payment discipline. In fact, under the political, social and cultural conditions of Hungary, the situation unfolds in a different, controversial and confusing, way, and the effect is in the opposite direction. Cutting off the electricity or water supply has such dramatic effects that all compassionate people would sympathize with the ones who have broken their contracts by failing to pay, so that the utilities dare not do it in most cases even in cases when the regulations would allow, and social aspects and the consideration of need would not go against the harsh measure either. This encourages contract-breaking in others who might be capable of repaying their debt, at least in part. (At the same time it is not uncommon that families in utter destitution, needing social solidarity the most, are left without utility services.)

The proportion of firms that fail to make payments when due and break their contracts is very high. Missing deadlines is common. It is worth noting that many of the organizations behind with their payment obligations are state agencies or publicly or municipally owned institutions, such as hospitals, schools and universities⁵.

4. Keller (2012) shows interesting figures about household indebtedness in Visegrád countries. Data based on the Eurostat (2011) report, up to 2009, indicate the highest increase of household indebtedness in Hungary.

5. In May 2012 overdue bills of public institutions reached the substantial amount of 42.2 billion forints (*Népszava* 2012).

The victims of the contract-breaking in these cases are producing or service-providing firms. If they are short of liquidity and do not have an adequate credit rating, late or lost revenue may threaten their very existence. Large numbers of them fail.

Bankruptcy of firms is on the increase. They may have hit trouble because they failed to find buyers in a period of general decline in demand, or because buyers are not seeking their goods or services, since they regularly commit Type A breaches of promises by being late with their supplies to buyers or sending faulty goods. It may also be because they have fallen victim to Type B breaches of promises: they as sellers regularly fulfilled their obligations, but users did not pay⁶.

Sellers try to cover themselves by laying down in contracts that part of the purchase price must be paid in advance (Raiser, Rouse and Steves 2004.), but this only provides partial protection. It may eliminate the crude cases of contract breaching where buyers pay nothing at all, but it does not prevent them being late with the rest or not paying the residual at all.

The loss of revenue that rightly belongs to a firm damages its owners, endangers the jobs provided by the firm in financial difficulties, and if failure ensues, leads to employees being pushed out into the street.

As with Type A breaches discussed above, this is not just a question of material losses. For the victims of the breaches, they mean an end to peace of mind and a sense of security. People become embittered and angry. Protests by entrepreneurs being in trouble because unpaid bills are frequent.

C. DEBTORS' PROMISES TO LENDERS

A producing or service-providing firm provides a *commercial loan* to a user firm if it does not insist on prompt payment of the sale price. This is established practice in market economies: customary contracts of purchase and sale lay down the allowed period of payment postponement. However, when buyers have exceeded that, *forced* lending begins: the seller is obliged by this breach of contract to increase the amount of commercial credit.

Let us turn to the other, greater component of the total amount of credit: *bank loans*. Here the bank, or a bank-like financial organization extends the loans and households, firms or other organiza-

6. An example was construction of the Megyer bridge over the Danube, where the government made a contract with a main contractor, which farmed out tasks to numerous subcontractors. The work was done properly but the government did not pay, and the main contractor could not meet its financial obligations. The subcontractors held several demonstrations in protest at this.

TABLE 1. Growth of non-performing loans,
2008–2011

Data in December 2008 = 100.

Types	December 2008	December 2009	December 2010	December 2011
All loans	100	134.8	164.6	194.3
Loans to households	100	145.8	188.3	228.6
Mortgage loans to households	100	168.1	232.1	310.6
Loans to other sectors	100	124.8	143	163.1

SOURCE. Pénzügyi Szervezetek Állami Szervezete [Hungarian Financial Supervisory Authority] (2012 d).

TABLE 2. Proportion of non-performing loans payment,
2008–2011 (per cent)

Types	December 2008	December 2009	December 2010	December 2011
All loans	12.3	17.5	20.9	25.2
Loans to households	16.7	24.5	28.3	34.7
Mortgage loans to households	12.5	20.2	24.5	32.4
Loans to other sectors	9.9	13.5	15.8	18.7

NOTE. 'Proportion' in relation to all loans in the category (e. g., non-performing loans to households were 16.7 per cent of all loans to households in December 2008).

SOURCE. Pénzügyi Szervezetek Állami Szervezete [Hungarian Financial Supervisory Authority] (2012 d).

tions (non-profits, state agencies, voluntary associations etc.) are the debtors. So in this respect the debtors are the promisers and the banks the promised.

Looking first at debts of households, their indebtedness has proliferated in recent years. Large sections of the Hungarian public became addicted to buying on credit. More and more people in the previous decade took out larger volumes of credit to buy cars and purchase or build housing as well. A very high proportion of such mortgage loans were denominated in foreign currencies, notably the Swiss franc, which required much lower rates of inter-

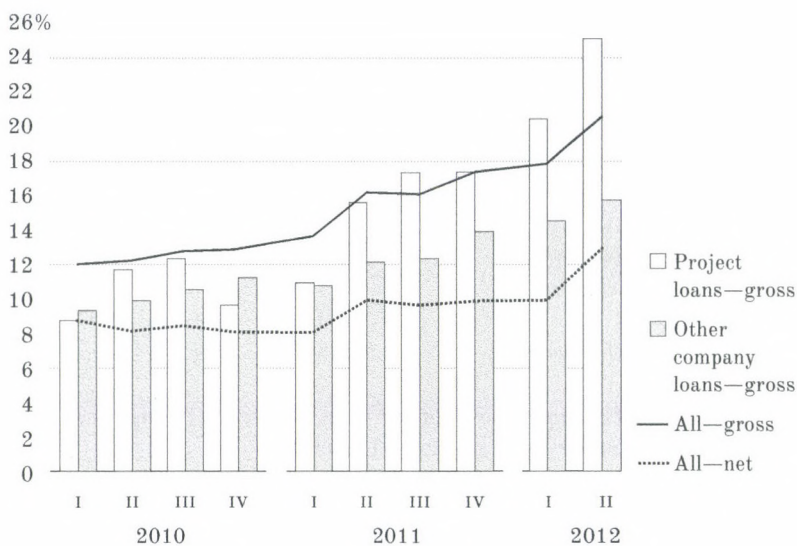


FIGURE 2. Proportion of overdue loans

NOTES. Loans late more than 90 days are called overdue loans by the Hungarian National Bank.

SOURCE. Magyar Nemzeti Bank [Hungarian National Bank] (2012), p. 33.

est at the time than did loans in the Hungarian national currency, the forint⁷.

Two changes ensued after the loans were taken out. Hungary became embroiled in the international financial crisis, so that some debtors lost their jobs or saw their income fall dramatically. Meanwhile the forint weakened fast against the Swiss franc and other foreign currencies. Repayment obligations that seemed tolerable to meet from original household incomes became unbearably high. The proportion of the personal debt in arrears rose suddenly. This alarming tendency is illustrated by the second and third lines in *Tables 1* and *2*.

To express this in the language of this study, a high proportion of such households have broken their promises to lenders. Many still pay in part or in arrears: they have half-broken their promises. Others have become irrevocably insolvent, so breaking their promises entirely. Here the intention is only to note the phenomenon without going into the detailed reasons behind it. Let me

7. The mounting personal indebtedness, including the problem of so-called foreign-exchange debtors, is covered in numerous studies. (See, for example, European Economic Advisory Group 2012, pp. 125–127, Hudecz, 2012.)

just add, however, that the blame for the situation by no means attaches wholly to the promisers, the households failing to meet their obligations. Banks in those years hoped for good returns, and virtually persuaded the future debtor to take the loan, often failing to verify the creditworthiness of the household. In other words, the recipients of the promises walked into a trap of their own making.

The economic stagnation and recession have also reduced the solvency of the corporate sector. The number of overdue loans to firms has increased alarmingly. This threatening tendency is illustrated by *Figure 2*, and the last lines of Tables 1 and 2. ('Other sectors' in the two tables mean the loans given to the sector of firms and the projects financed by the EU and the Hungarian state.) *Figure 2* shows that a quarter of all project loans falls into the non-performing category. This rate is seriously high.

The conceptual framework of this study gives a more explicit name to the trend in the figure and the two tables: the number of firms not keeping their payment promises to banks is increasing. The same applies to many LGOs, which borrowed sizeable sums that they cannot repay over the promised term.

D. GOVERNMENT (CENTRAL OR LOCAL) PROMISES TO CITIZENS

Some regulatory measures spell out obligations undertaken by the state, others make silent implicit promises. Let us look now at those where the state shouldered long-term obligations. The promised, the beneficiaries of the regulations, trusted in the state's promises and accordingly organized their lives, family budgets, and savings habits in the long term.

Let me take a single example, albeit a weighty one. The Hungarian government in 2010 and 2011 unexpectedly and radically altered the pension system. Hitherto a fixed proportion of the centrally collected pension contributions were allocated to private pension funds, called the 'second pillar' of the pension system. The new measures ended this important component of earlier practice. Since then the entire mandatory pension contributions go into the state pension fund. The capital accumulated in the private pensions funds were swiftly transferred to the state budget. Much has already gone on day-to-day public spending (Simonovits 2011, European Economic Advisory Board 2012, p. 128). This study does not set out to decide whether the new laws meet the requirements of constitutionalism and protection of rights. Reputed lawyers at home and abroad have responded with a resounding negative to these questions. Rather than commenting further on the legality of the decisions I will stick to my subject. The insured, understandably, viewed it as a state promise that the capi-

tal accumulated from setting aside those pension contributions in private pension funds would remain their own property. In their view the radical alteration of the system, that is, the elimination of the 'second pillar' means the state has broken its promise. It is still unsure what the change means for the future income of pensioners. Nobody will be able even in the future to give an appreciable estimate of the loss or gain, as there will be no basis for comparison. No one will be able to say with hindsight what the pension income received from the private pension funds would have been, had they not been abolished. Whatever the case, there is disillusionment, outrage due to the state's broken promise and anxiety for the future among those pressurized by the state into abandoning the expected income from the contributions paid into private pension funds.

E. POLITICAL PROMISES (BY INDIVIDUAL POLITICIANS, PARTIES OR MOVEMENTS) TO ELECTORS

Citizens of all parliamentary democracies often complain that politicians promise the earth during election campaigns, then fail to keep their promises. Vehement disenchantment with political parties and leading politicians has often been heard in Hungary since the multiparty system was reintroduced.

There is no space here to examine the relationship between political promises and their fulfillment rate in the last 22 years. Let us look just at the last elections in 2010. Party leaders and election candidates mouthed various promises. Fidesz, the party that won over the electorate, was cautious about making numerical promises for which it might be called to account later. One figure they gave, however, made a big impression on voters: they would create a million new jobs (Matolcsy 2010). (Hungary, incidentally, has a population of around 10 million.) They gave themselves ten years to fulfill the promise. Later, when Fidesz had formed a government, one leading economic politician put the promise more specifically. They would fulfill it evenly: 400,000 new jobs would appear over the four years of their present term of office (Varga 2010).

So far the government has not fulfilled the first part of the promise due in the first two-year period, the increase in the total employment rate is much slower than promised. And if we disaggregate the employment figures, it turns out that they were blown-up by the rapid increase of so-called public work, which replaces social benefits with mostly part-time jobs paid at starvation wages by the state. Job numbers in several sectors with actual employment in normal employment relationships fell.

The promise was addressed primarily to those who would gladly have taken a job. They suffered a big financial loss. Mention must also be made of the disillusionment. Unemployment gener-

ates fear among those who still have a job, but feel insucere because of the threat of unemployment. Many anxious people were filled with hope by the party seeking their vote. Now they are dismayed to find the promise has not been kept.

INTERACTIONS

SPILL-OVER EFFECTS IN PRODUCTION AND THE CREDIT SYSTEM

For each basic type of breach of promise discussed in the last section of the paper it was established that it caused not only material losses to the aggrieved but also effects on their mental state, mood and well-being. Each type of damage was examined separately. In actual fact there are many types of interaction between the thousands or hundred thousands of micro-events.

The best known is the interaction between belated or omitted payments, i. e. spill-over effects of breaches of Type B promises, in this paper's terminology. Firms G, H, and I should be paying firm M for products received, but they break their contracts and fail to pay. Firm M in turn owes money to firms X, Y and Z, but not having received its dues, it in turn, against its intention, breaches its promise and does not pay. Firms X, Y and Z are now unable to pay other obligations, and so on. The phenomenon is called *chain-indebtedness* in the Hungarian economic jargon. Each link in the chain means that there is a debtor in arrears and a forced creditor waiting for his money in vain. *Circular indebtedness* appears when the chains formed by overdue payments link together. The troubles form a spiral, a vicious circle, an accelerating, deepening whirlpool of indebtedness. For example, circular indebtedness is estimated to be 400 billion forints in the construction industry, which is approximately one quarter of the production value there. The situation is well described by a press-release on the topic: "No way out from the vicious circle of circular indebtedness?" (MTI—Stop, 2012. See also MTI—Figyelő, 2012).

One after the other, the indebted firms start to fail, and B and C-type breaches turn into type A. Producer or provider firms in deep financial straits cannot meet their obligations to produce or provide services. This too has spill-over effects well known from the economics of trade cycles. Production growth deceleration may switch into recession. Shrinkage of the real economy may hit back on the financial positions of firms, which accelerates the spiral of indebtedness.

The situation is worsened because the victim of the C-type breaches of promise (failures to service or make repayments of bank loans) is the banking sector. However much the banks them-

selves may be to blame for allowing the proportion of loans in arrears and non-performing loans to rise so high, the consequence is the serious deterioration of the state of affairs in the banking sector. This is one of the factors behind the alarming fall in the level of bank lending activity. This too holds back production growth and may contribute to a recession process. There then appears in the chain of cause and effect a further consequence mentioned before: liquidity in the household and corporate sectors is reduced, which produces further spirals of promise breaching.

Mass occurrences of broken *micro*-promises of types A, B, and C, through the mutually reinforcing interactions just detailed, eventually cause serious *macroeconomic* damage.

SPIRALS OF BAD MOOD AND BAD EXAMPLE

Economists, citing the well-known relevant theories, easily recognize the spirals engulfing production and the credit system, and the multiplier effects whose interactions turn a thousand little micro promise breaches into a macro-level crisis. However, it is more a task for social psychologists to describe how the annoyance and outrage at the breaches of promise pass from one person to the next. One person leaves his home angrily because the plumber failed to turn up yesterday and there was no hot water in the pipes this morning. Driving along he shouts insultingly at a pedestrian crossing the road, who also ends up in an upset mood and quarrels with colleagues at work. At the end of the day, all these people return home feeling nervous and irritated. They stick their own anger and bad mood on the members of the family. The bad temper and tensions spread like a disease from one person to the next.

Nor is the problem confined to mood. *Bad examples* also spread like an infection. Many people say to themselves, "If others keep breaking their promises, why should I be the fall guy who always keeps his word?" The more bad examples people see, the more they wonder why they should be the exception and take their promises seriously, to their own detriment. These spill-over effects from person to person cause the vicious circle to spread and worsen: promise-breaking breeds yet more promise-breaking.

The people in the political/government sphere and the business sphere are not isolated from each other. Talented and/or smart ones pass repeatedly through the revolving doors between them, holding political, administrative and commercial posts by turns. Once they have become accustomed to irresponsible promise and responsibility-breaking in one sphere they will take the behavior pattern with them into the other.

It is especially dangerous for the feeling to emerge among ordinary people that "those above," those at the pinnacle of political power, are not keeping their word. *Tables 3 and 4* show the find-

TABLE 3. Public opinion:
Do politicians keep their promises?

Country	Ratio of citizens who doubt the reliability of poli- ticians (per cent)
Italy	77.8
Latvia	67.4
Hungary	66.7
Russia	65.1
Japan	61.0
Spain	60.1
Israel (Jews)	59.2
Germany (East)	59.1
Slovenia	56.6
France	56.6
Ireland	55.0
Czech Republic	52.7
Poland	52.5
USA	51.1
Germany (West)	49.5
New Zealand	47.9
Sweden	46.5
Great Britain	46.4
Australia	44.8
Canada	42.4
Cyprus	35.4
Norway	33.9
Switzerland	32.8
Philippines	30.8
Bulgaria	23.7
Israel (Arabs)	18.2
TOTAL	49.0

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NOTE. The survey was conducted in the framework of the "International Social Survey Programme", in 1994-1995. Information on the data collection methodology is described in the cited source as follows.

The following question was asked:

"How much do you agree or disagree with the following statement.

People we elect as (MPs) try to keep the promises they have made during the election

1. Strongly agree; 2. Agree; 3. Neither agree nor disagree; 4. Disagree; 5. Strongly disagree; 6. Can't choose, don't know; 7. NA, refused.

The above percentages were arrived at by calculating the proportion of those choosing 4 or 5 to all answers, and countries were listed in the decreasing order of the proportions.

The table was compiled by Tamás Keller.

SOURCE. International Social Survey Programme (1996).

TABLE 4. Public opinion:
Do politicians keep their promises?

Country	Ratio of citizens who believe in politicians (per cent)
Izrael (Arabs)	44.2
Philippines	41.0
Cyprus	32.7
Bulgaria	31.7
Ireland	29.5
Australia	28.4
Norway	27.6
Canada	25.7
New-Zealand	24.5
USA	24.2
Switzerland	23.5
France	21.2
Great Britain	21.1
Germany (West)	19.7
Slovenia	18.5
Izrael (Jews)	16.5
Poland	14.8
Spain	14.8
Czech Republic	14.6
Germany (East)	14.3
Sweden	14.2
Japan	12.9
Italy	10.4
Russia	10.3
Hungary	10.2
Latvia	8.8

NOTE. Information on the survey is available in Table 3.

The above percentages were arrived at by calculating the proportion of those choosing 1 or 2 to all answers, and countries were listed in the descreasing order of the proportions.

The table was compiled by Tamás Keller.

SOURCE. International Social Survey Programme (1996).

ings of an international survey. Table 3 ranks the countries based on the share of those, who *strongly doubt* the trustworthiness of politicians. Hungary is among the first ones; two third of the population strongly or very strongly disagree with the optimistic statement according to which politicians keep their election promises. Table 4 presents the rankings based on the proportion of those *strongly believing* in the trustworthiness of politicians. In this ta-

ble Hungary is among the tail-enders: only every tenth Hungarian thinks (with strong or even with very strong conviction) that politicians fulfill their promises made during the election campaigns.

“If those up there can get away with not fulfilling their promises, then why should I, the little man, fulfill 100% of my promises?” It is distressing that this line of thought have probably crossed many people’s mind.

THE MORAL JUDGMENT OF FULFILLING AND BREACHING PROMISES

Many types of doubt might fill the heart of people. Still, I hope that most continue to believe that promises should be fulfilled. Why do they think that? The answer is not self-evident, since the promiser often benefits from breaking his or her word. Here, the topic of my paper leads to a much wider issue, to the moral judgment of people’s acts.

There is no agreement among philosophers about the answers to the fundamental questions of ethics⁸. I do not feel competent to comment on the debates between the various schools of philosophy. I would like to set out from a different approach. How do average people, the acting agents of the economy and politics, judge the breaching of promises?

A few pages earlier, when reviewing the main types of breaching promises a comment returned repeatedly: the victims of unfulfilled promises are annoyed and upset. Actually, they condemn even the mere fact of breaching of promises, since common decency would demand that everyone should keep his word. “I fulfill my promise—so I expect the same from you. Where would it lead to, if everyone offers promises and later does not care a rap for his own words?” Quite many think this way, perhaps the great majority of people. Even if we have never had a philosophy book in our hands, here we get close to the *Kantian* position, and to the *contractualists*, to the school of philosophy, which derives ethical principles from the idea of a social contract.

My paper, first when discussing the main types, and later when introducing the interaction between the acts of breaching promises, highlighted with great emphasis the adverse *consequences* of the phenomenon. People think along similar lines, when they recount: how much loss they suffered as a result of the other party’s breaching of promise. In these instances the argument gets close

8. The “Promises” entry of the Stanford Encyclopedia of Philosophy (2008) provides an extensive overview of the main alternative ethical theories. Also see Patterson’s (1992) paper, which comments on several important works from the literature dealing with the values of promises.

to the line of thinking of another school of philosophy, to the so called *consequentialists*. We need to behave ethically, among others we need to fulfill our promises, because unethical behavior has adverse consequences. This line of reasoning is almost obvious for economists.

When reading the literature of the issue in works written by philosophers, I got the impression that perhaps the above mentioned alternative approaches are theoretically not incompatible with each other⁹. In any case, they coexist, supplement and strengthen each other in the moral judgments of everyday people.

Let us see an example. The patient is angry, because the doctor, who treats him at a high cost in his private practice, promised that he will see him at a specific time—and yet he kept him waiting for a very long time. If following this he makes a judgment, then he sees this situation as the breach of common decency. “What would the doctor say, if next time he would be kept waiting for hours by his high charging lawyer or car mechanic?” And of course, he considers important the consequence he suffered by the breach of promise, the time wasted while waiting. He makes a comparison, he runs some kind of cost and benefit calculation in his mind: he would not have waited more than this either and he would have saved the fee, if he went to a government-financed, free clinic.

When we get over the first annoyances or indignation caused by the breach of promise and we bring ourselves to make moral judgments, then—like in the case of the judgments made within the juridical system—we do not apply simple formulas, overly simplistic schemas. We cannot be satisfied with the statement: all breaches of promise should be morally condemned. We need to weigh the circumstances under which the events unfolded.

I have not found such works in the literature written by legal scholars, sociologists or philosophers, which reported on systematic observation or questionnaire based survey among the Hungarian population. However, there are relevant American studies available. It is possible of course that the distribution of the American reactions is different from the Hungarian in similar situations, but even in this case, it will be illuminating (at least from the perspective of the applied research methodology) to report about a few American studies.

The title of Shavell’s (2006) paper hits right into the middle of our topic: “Is Breach of Contract Immoral?” The author has conducted a small sample survey. For instance, he asked the following question from the interviewees. Suppose that a Renovator has made a contract to do a kitchen renovation for a Homeowner. The

9. In the philosophical literature there are such works that attempt partial, limited reconciliation. See for example: Nozick (1974).

Renovator then discovers that the job would cost him a lot more than he had anticipated. So the Renovator did not fulfill his promise. Question: Would the responder judge the breach of contract as unethical? The responders were able to answer on a five-point scale: beginning with the "Grade (1) definitely unethical" and ending with the "Grade (5) definitely ethical" answer. 38 answers out of the 41 responses spread between Grade (1) and Grade (3), and all together only three classified the situation "Grade (4) somewhat ethical." No one classified it "Grade (5) definitely ethical." However, the distribution of the answers significantly changed, when the original question was supplemented with other important details. For instance, it was included that: *Did they state in advance*, what to do, if the costs rise above the originally calculated costs? Did they state in advance that the contract is valid even if the costs are higher than originally expected? Did they agree in advance about the indemnity in an event of the Renovator not fulfilling his promise? The more the respondents understood that there may be "mitigating circumstances" the more carefully they judged the situation.

Wilkinson-Ryan and Baron's (2009) paper attempts to probe the moral judgments of people about the breaching of contracts through the help of similarly realistic examples. In relation to several kinds of hypothetical stories they asked questions, and to each story they surveyed the stances of different samples. For example, in one of the stories they offered for the interviewees to comment, the following problem arose. A couple rents out a restaurant for an anniversary party. However, the owner of the restaurant wants to waive the contract, because unexpectedly he received a much better offer. The story continues with two versions. In the first version the owner of the restaurant offers that they should sit down together, discuss the problem and come to an agreement about the amount of the indemnity payment. In the second version there is no direct negotiation, the owner asks for an outside mediator to help determining the amount of the indemnity payment. All experimental surveys prove that the knowledge of the terms of contract and the circumstances related to the breaching of the contract significantly influences those, who form a moral judgment about the situation.

What special "laboratory" conditions offered themselves during the past few years for Hungarian sociologists and legal experts, when about the half of the country was debating over the problems of helping out the "foreign currency debtors"! They could spare the application of artificially invented stories, because the real events produced those cases in which people could have been asked for moral judgments. It is a pity that the Hungarian social scientists did not seize the opportunity.

At this point, it is useful to summarize *in a general manner*: what are those circumstances, which needed to be weighed for

those attempting to form a moral judgment about any breach of promise.

1. Did the promiser commit himself in a *bona fide* manner? Or he had already known from the beginning that he would not fulfill the promise, yet in a deceitful way he still made the promise?
2. The *bona fide* manner is a necessary precondition of a correct promise—necessary, but not sufficient. Did he carefully think about whether the promise can really be fulfilled? Schiller's hero was ready for any struggle and daring endeavor to keep his word. But was he thoughtful enough, when he promised to return in three days? There would have been no problem with the three days, if there were no rain and floods, if robbers did not attack. The promise—and this is quite a common phenomenon—undertakes the tightest deadline possible, which works, if there are no unexpected setbacks. However, in fact it happens rather frequently that there are setbacks, and because of this the realistic deadline should always be set with a “margin,” with some “reserve time.” Poor Damon, who was just condemned by the tyrant to be crucified, did not think too much about the reserve time. Yet, in the case of others, in much calmer situations, we can expect more careful calculation indeed. And this is true not only for the promiser, but also for the promised. Returning to the example of the “foreign currency debtor,” both the debtor and the lender calculated negligently and irresponsibly, ignoring the risk of unforeseen difficulties.
3. In the case of a unilateral promise, did the promiser, or in the case of a bilateral agreement did both parties offer in advance careful terms safeguarding against an event of the promise becoming unfulfilled, and about what types of compensation the other party will receive in such case?
4. What motives induced the promiser to breach the promise? Does he breach his promise because of greater individual profit? Or external factors independent of him explain that the promise is only partially or not at all fulfilled?
5. Did the promiser do everything to fulfill or at least partially fulfill the promise in the case of unforeseen obstacles? We respect Schiller's hero among other things, because he struggled with a heroic effort to fulfill his promise.
6. Regardless of the obstacles—does the promiser seek with due diligence the fulfilling of his promise or he does not fulfill his promise because of negligence?
7. If the contract is broken, and the contract did not describe an exact compensation, does the promiser seek to reach an agreement with the aggrieved party? Or did he present the

other party with a *fait accompli* in this respect? Or perhaps he keeps aloof from the compensation?

Those who wish to form a moral judgment about the breach of promise must conscientiously weigh both the mitigating and aggravating factors. If the judgement is considered by the victim of the breach of promise, he must certainly face the question: to what extent is he also responsible. Those who committed the real breach, frequently apply the “blame the victim” tactics as a defense mechanism. This type of retort is of course often rightly rejected by the aggrieved party. But no matter how justified is in the given case the rejection of such kind of mean-spirited attack, it does not provide an automatic waiver for the aggrieved party from voluntarily examining: whether he is also responsible for what happened. Often he commits at least one mistake of which he can admit if to no one else to himself: that he is carrying at least a part of the responsibility. Two partners are needed to a deceptive commitment: the one who offers the false promise, and the other one who believes in it and allows to be taken for a ride.

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MOTIVES TO FULFILL OR TO BREACH PROMISES; ENFORCING FULFILLMENT

I do not wish to narrow down the next argumentation to the cases of the breach of promise. According to my impression, even though this I cannot prove through any systematic observations and statistical data, luckily the fulfillment of promise is more common than its breach. I will discuss the motives behind the two opposing phenomena side by side.

I wish to talk not only about the motives of the *promiser*, but also about the motives of the *promised*, the beneficiary of the promise. Moreover, besides the two actors in the promise relation, there will be a discussion about the actors outside of the relation, who influence or who *could* influence the course of events. The term “motivation” refers to voluntary acts. In parallel, we also discuss the phenomenon of the *enforcement* of fulfillment.

MORAL INCENTIVES

Here, we will actually follow the continuation of the train of thought, which began in the previous section of the paper. The great majority of the promisers are honest people, who make a *bona fide* commitment and bravely strive to fulfill their promise.

Let us take a look at the business world of the market economy. It would be a big mistake to think that every transaction is regulated by contracts legally formulated by lawyers. Many kinds

of input and output flows take place without any special promise, by the routine-like repetition of “business as usual.” Or even if the producer and the buyer signed a contract, it does not mean at all that everything is regulated down to the tiniest details. The parties, trusting in the honesty of the other party, leave many questions open in the contracts. Macaulay (1963), a professor of law, conducted a survey among American businessmen and he found that they consider this informality natural, and they do not even attempt to build their relationships on all encompassing contracts. Incidentally, “contract theory” developed in economics provides a strict mathematical proof for the impossibility of a “*perfect*” contract and it would not even be economical to strive for such contract (Hart, 1998a and 1998b, Bolton and Dewatripont, 2005).

The breach of promise could become less frequent, if the moral incentives motivating the fulfillment of promises would prevail stronger. I do not wish to start a moral preaching here, as it would obviously be received with an ironic smile. Evidently there is a need for an education that engraves in the brains of people the sanctity of the plighted word. Parents, all institutions of education, the managers of all work places and so on participate in process. Out of the plethora of tasks in moral educations I highlight two elements.

One is the role of the media. Rare is the day on which an anomaly or even a scandal around the fulfillment of a promise would not appear on the screens, in the sea of letters of the print media and on the internet. But almost never appears such analysis, which objectively and intensely scrutinizes the ethical side of the events and would be ready to offer a moral judgment. The flood of superficial news about the breach of promises gives birth to cynicism. “If so many are doing it—why should not I do the same as well?”

The other problem, which I wish to mention in regards to the discussion of moral incentives is related to the phenomenon, which I called in my works as the “the soft budget constraint syndrome.” In the first part of my study, when discussing the B and C types of breaches of promise, the case of those debtors (indebted households, firms, hospitals, local governments and other organization that are in financial trouble) have appeared, who do not meet their financial obligations. Should they be saved? Or should we leave them alone, and leave it to them how to get out of their difficult situation? When the topic arises in relation to a given episode, the commentators bring up numerous *economic* arguments in favor of saving them or against it: how would it influence production, employment, the state of the banking system and the government budget and so on. However, the *ethical* aspect of the question usually gets lost. The often occurring, almost certain “bail-out” has a *pedagogical effect*. It teaches the debtor to feel free to breach his promise; there is nothing to be ashamed of in doing that. But not

paying back a debt is indeed shameful—even if there are mitigating circumstances! I have never recommended that without exception everyone, who cannot get out of trouble on his own, should be let down. However, this should not be done in mass proportions, in a way that the question of the debtors' own responsibility hardly ever arises; very rarely is a single word spoken about the moral aspects of the breach of promise.

That is just what happened in Hungary when the government announced it would shoulder the full local-government debt of some 1500 small municipalities and much of what larger municipalities owed as well. In the second case the bailout proportion is not uniform; it would depend on how wealthy or poor each community is. Thus the scale of rescue did not depend on how far the debt had resulted from irresponsibility and wastefulness by local leaders. The idea of the moral responsibility of those who had contracted the debt was not even mentioned in the rescue announcement. "Why be thrifty if those who battle to cut expenditure and strive to keep their promises are treated just the same as those who are irresponsible and waste the community's money?" many local leaders grumbled.

I illustrate the idea with another peculiar, hardly believable episode of the long history of the "foreign currency debtors" mentioned already before. The episode, the wide-spread application of the so called "preferential full repayment" scheme early 2012, is worth a special mention. Let us think about two typical stories.

The person in the *first story* is a poor man, with little school education, who is the head of the family; he lived in depressing housing conditions, when he received the opportunity to get a better flat through the help of a loan. The bank practically fobbed the loan off on him, and it did not sufficiently warn him of the risks. The story continues in a sad manner. At the time of taking out the loan, he still had a job, but since that he has lost his employment. Because of the weakening of the forint his installments grew high. Now he has been unable to pay for some time. Since the apartment where he and his family is living, served as mortgage, perhaps soon he will be evicted. In his case indeed two ethical principles collide: the principle of solidarity, which obliges us to help those in trouble, and opposing that the principle of individual responsibility, according to which each individual is responsible for his own decisions, even for his bad borrowing decision. In this case, according to my own moral sense the first principle, the principle of solidarity weighs heavier; this man and his family should be saved from the tight situation.

The person in the *second story* is competent, knowledgeable, well paid, with an economic or legal education. Some of them are working as government officials. He lives in a nice flat. He took out a large loan, because home building seemed to be a good investment, since housing prices grew month by month. It turned out

that he made a bad decision; he has lost a lot on this business. He still has his job, he still makes good on his installments. Eviction does not threaten his usual life-style, since the place where he is actually living did not serve as mortgage. He bought or built another apartment or house. He will not become homeless, if this additional dwelling would be taken away from him. In his case I do not see a moral problem. If he made a profit on the investment, I would not envy him. If he lost—that should be his own problem¹⁰.

Well, the “preferential full repayment process,” which was legally enacted by the ruling political force, made it possible for the “foreign currency debtor” to repay his loan in a lump sum payment. The application of the procedure was tied to several conditions. According to Condition No. 1, the debtors had to properly make the installment payments due during the past six months. By this they have already excluded the person in the first story, who is in such a big trouble that he is unable to properly make the necessary installment payments. Condition No. 2 is this: the residual debt must be paid right away, by one single payment. How could our poor man gather so much money? In contrast, Conditions No. 1 and 2 can be easily fulfilled by the person in the second story. The second story represents well-to-do social strata, who are receiving special favors in exchange for their political support.

The preferential full repayment had to be paid in Hungarian forint, at an exchange rate imposed upon the banks by the government, exchanging at a significantly lower rate the arrears than the actual market rate. The people applying the “preferential full repayment” scheme, (most of them similar to the person figuring in our second story) altogether have won 370 billion forints with this opportunity, mainly at the expense of the banks, and at a smaller degree at the expense of the treasury (in other words of the tax payers) (Pénzügyi Szervezetek Állami Szervezete, 2012 e)¹¹. This is a staggeringly high sum, which, inexplicably, did not get much emphasis in political debates.

The ruling political group provided an extreme example of softening the budget constraint. Everyone can learn from this. It is worth breaking a promise—in this case: the commitment to repay the loan in a proper manner. If you took out a loan in order to make a profit and you belong to the well-to-do strata of socie-

10. The problem has been around for years, yet neither the government, nor the banks or the research institutes have organized large-scale surveys to figure out the social and economic distribution of the indebted households. No approximative estimations have been available to overview the proportion of those in need, ethically entitled to be supported, and those taking the loan for financing an investment.

11. In order to illustrate the magnitude of the amount I indicate: this is more than half of the planned state budget deficit of 2012.

ty favored by the government, you will not face any disgrace. You even may receive a bonus, a significant amount of your debt will be paid back by others.

Against this “pedagogy” the naive warning of the parent or the teacher (“Be careful my child, not to make irresponsible promises!) does not carry much weight.

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REPUTATION

In order to increase their reputation, the promisers are motivated to keep their word. The breaching of many small promises or even a spectacular defaulting on the fulfillment of one large commitment can destroy a reputation.

Firms have several kinds of motivations to increase their reputations. Recognition helps them selling their products and services. I have already mentioned that the buyers are gladly relying on familiar and highly esteemed suppliers. Better reputation is a significant advantage in the competition with rivals. To that extent, economic interests are connected to reputation as well. This is supplemented and even strengthened by psychological effects. “We are among the first ones;” “everyone has a high opinion of us”—this belief rightly flatters the company managers’ vanity.

The same can be said about the reputation of political parties and organizations. It is obvious that the voters do not base their choice only on the successes and failures of the days before the election, but reputation, which has developed over a long time, also plays a big role. Better reputation improves the chance of winning the elections and seizing power. But not only the fight for power motivates them to increase their reputation. The politician takes pleasure in his reputation, enjoys recognition and popularity—this is easy to understand psychologically.

The promiser fulfills his promise. Why? Is it because, this is what his conscience, his healthy moral sense tells him to do? Or is it because he knows that his honest behavior, the transforming of his words into actions will make a good impression on others and it will increase his reputation—and he can also leverage this into an advantage in economic competition or in the political arena? Difficult to separate the two; the two kinds of motivations jointly exert their effect.

The degree of reputation is not a continuous variable, which at times can be increased at an arbitrary rate, or at times its decline can be accepted without further due. Similarly to several other social phenomena, the speed of change—setting out from a given point—depends on the direction of the change. The reputation of a firm, a political party, an economic or political leader often increases slowly and gradually, as the numbers of the positive experiences grow among the people watching his work. But if it comes

into the open that he breached his word, his reputation may suddenly collapse.

The third factor that motivates the fulfillment of promises is the legal and juridical system that enforces the fulfillment. We will get to this point soon, but here I would already like to offer one remark ahead. In the business world the first and the second factors to a certain degree and under certain circumstances are able to replace the third (Macaulay, 1963; Kornhauser, 1983). The stronger the promiser's inner moral motivation to fulfill the promises and the contracts, and the more he is striving for increasing his reputation, the less frequently recourse will be required to sort out the consequences caused by the breaching of promise to legal recourse.

THE ENFORCEMENT OF CONTRACT FULFILLMENT BY LEGAL MEANS

Here, we can safely limit ourselves to the business contracts. The breaching of the irresponsible promises made in an election campaign is not prohibited by law. This type of breach of promise is punished by the voter—provided that he recognizes the offense committed against him and he wishes (and is able) to employ the possibility of punishment in the polling-booth.

The modern rule of law applies sophisticated legislation to punish the breaching of contracts. In private lawsuits they award compensation. For the deceitful false promises, and for the serious negligence leading to default on the fulfillment of a contract, the prosecutor can press charges and penalties may be imposed by the court. Special legislations regulate the bankruptcy proceedings, the sale of assets seized to pay off debts, the evictions as a result of mortgage foreclosures, and so on. The rigor of the law is not only meant to help compensating the aggrieved party as much as possible. At the same time, they expect a deterrent effect from it as well: the promiser should be afraid of the consequences of breaching the promise.

Even in the countries with the oldest tradition of the rule of law, the apparatus meant to enforce contract fulfillments does not work at one hundred percent efficiency. Unfortunately, in Hungary this machinery is much more creaking than in the more developed democratic countries. Many lawyers and corporate attorneys are less skillful than their counterparts in the West. Litigations are prolonged for long. Erroneous rulings are not uncommon.

The handling of bankrupt firms deserves special attention. If it comes to light that a firm is unable to repay all of its debt, then a bankruptcy procedure will ensue. This is in the jurisdiction of the courts; they will appoint a liquidator (a bankruptcy commissioner), who on the basis of the relevant legislation decides, among other things, about how to sell off the remaining properties of the firm,

and about which creditor should be indemnified and to what extent. Here, we are far from the complete fulfilling of the contracted payment obligations, rather the benefits of the partial fulfillment and the remaining assets of the firm have to be distributed among the aggrieved parties of creditors. Several factors complicate the rear-guard fights for the last partial fulfillment of the contracts.

One of the complicating factors is the well known institution of modern capitalism: the idea of *limited liability*. The owners of a corporation or an LLC are only responsible for the debt accrued by the company to the amount of the capital they invested. In the worst case this can be completely lost; the remaining assets will be transferred to the aggrieved creditors. However, the owner is not responsible with his own private wealth. Also, if the owners and the executives were clever, then—somewhere between legality and illegality—at the last moment they transferred out a good part of the wealth of the company and they left not much for the indemnification of the creditors. There are many legal loopholes, which facilitate this type of trickery—for the benefit of the breaching parties, and at the expense of the aggrieved parties. Smart attorneys, pettifoggers specialized in the knowledge of legal loopholes write the contracts from the outset in such a way, that their client—without breaking the letter of the law—can circumvent the *spirit* of the law, which would protect the interest of both parties in a fair manner.

It is still the lesser evil, if the company under bankruptcy proceedings even exists at all. Other companies simply disappear, if they have a gallows look. The Hungarian business jargon calls these peculiar firms “phantom companies.” They appear on the scene, they promise the moon, they utilize the products and services ordered—but by the time they have to pay, they disappear. There is no one to call to account for the debt.

We expect from the state to enforce with its own instruments the fulfillment of private contracts, and by doing so to strengthen the “sanctity” of respecting contracts. During the past years in Hungary just the opposite move happened several times. The government struck heavy blows at the prestige of private contracts. I present three examples; each caused a stir in the public.

In 2009, the “Budapest Transport Company” (BKV), owned by the capital city, paid out enormously large severance payments to many high ranking executives leaving the company. The payments were based on valid and legal labor contracts, the news created a public outrage. Fidesz, the current governing party, which was in opposition at that time, began a huge campaign—accompanied by the sympathy of the public—and demanded the repayment of these severance payments. Following the elections the parliament, now dominated by Fidesz hastily enacted a new legislation regulating severance payments *retroactively* (!) for several

years back. According to this, on severance payments over a certain threshold value granted after 2005 a 98% extra tax was imposed in the state sector (budgetary authorities, companies owned by the state, etc.)¹². Yes, but through this extra tax they not just regained for the treasury the immorally large severance payments of some transport executives, but they confiscated a part of, or the whole, compensations of such old teachers, doctors and other workers, who through a lifetime of diligent work acquired the right to a modest severance just in excess of the statutory limit set by the 98% confiscating legislation. The ruling political forces and the parliamentary majority dominated by them, abusing their legal opportunities, retroactively crushed the private labor contracts freely signed by the employers and the employees many years ago; contracts which included the provisions of the severance payments.

The other example is connected to that chain of events, which we have discussed already several times: the story of the “foreign currency debtors.” The bank and the debtor signed a proper contract. Today, it seems certain that significant portions of these contracts contained many such elements, which caused harm to one or the other or both parties, and the damages rippled through the other parts of the national economy. Mass revision of the contracts was fully justified. However, this should have been done *voluntarily* by the two contracting parties. The government can persuade them to do so, they can provide guidelines in regards to the content, and they can provide them with economic incentives to facilitate the changes. Also *courts* can annul the contracts and they can call upon the parties to sign a new contract. But under the rule of law the *executive and legislative branches of the government* cannot force *retroactively* the contracting parties to modify the contract against their own judgment. However, that is exactly what happened repeatedly, mainly at the expense of the banking sector. The executives of the banks protested, but eventually as a result of the governmental pressure they swallowed the bitter pill, and they were ready to apply the contractual changes being forced upon them. These tough state interventions certainly reduced dramatically the prestige of the “private contract.”

The third example is also drawn from the story of relations between the government and the banking sector. One important stage in the negotiations on foreign-currency lending was reached on 15 December 2011, when a “Minutes of Understanding” formulated in Hungarian and English was signed by Minister György Matolcsy and State Secretary Gyula Pleschinger on behalf of the government and Dr. Mihály Patai, president, and Dániel Gyuris, vice-

12. A detailed discussion of exceptions and parital exemptions is beyond the scope of this paper.

president of the Banking Federation. (For the statement issued see Bankszövetség 2011, pp. 5 and 9.) Point D) 1. stated, "The Government declares that the basis and the rate of the bank tax will remain unchanged in 2012 compared to the regulation in effect, while the rate will be decreased by 50% in 2013. The Government declares also that there be no bank tax levied on banks in 2014 higher than the bank tax defined by the legal framework of the European Union, or the average of the bases and the rates of bank taxes in effect in Member States." Yet the budget for 2013 submitted to Parliament in the fall of 2012 left the rate of special bank tax unchanged instead of reducing it by 50 percent. The government had not kept its promise.

CONCLUDING REMARKS

In a dictatorship the tyrant does not have to make promises to the people¹³. He does not rise time and time again to the top post of the country through the open competition of alternative political forces; rather this happens with the help of the machinery of repression and violence, i. e. the institutional system of the dictatorship serving him to hold onto his power. In contrast, in a democracy the promises of the competing parties play an especially important role. The voter—if he has good memory—can assess how much the ruling party fulfilled during the past term the promises made before the last election. If they fulfilled their promise, then it will strengthen them, if they breached it, then it will weaken the trust towards them. Of course, comparing the promise and the action is not the only criterion, according to which candidates are compared, but without a doubt it is one of the most important ones. Those who weaken the trust in the political promises, undermine *one of the foundations of democracy*.

The socialist command economy can do without promises. The vertical coordination is moved by commands, which are given by the superior body to a subordinate body. A command is a command—there is no need for promises, rather the command should be fulfilled. In contrast, in the capitalist market economy, the horizontal coordination primarily takes place according to voluntary private contracts between buyers and sellers. Of course, the fulfillment of private contracts, the fulfillment of promises made by the seller and the buyer, the creditor and the debtor, is only one kind of the various coordination processes, but without a doubt one of the most important one. Those who weaken the prestige of the pri-

13. It is not a coincidence that it is Napoleon to whom the following statement is attributed: "The best way to keep one's word is not to give it."

vate contracts, undermine *one of the foundations of the capitalist market economy*.

It is to be feared that in Hungary exactly this—the weakening of the foundations—takes place right in front of our (and outside world's) eyes. I do not know what others experience in their countries about the spread of the above detailed hideous phenomena—researchers there are expected to uncover and analyze them. I am certain, however, that the population of Hungary is suffering due to the almost everyday routine of broken promises.

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