

Presidential Address

**INDIVIDUAL FREEDOM
AND REFORM OF THE SOCIALIST ECONOMY***

János KORNAI

*Hungarian Academy of Sciences, 1051 Budapest, Hungary and Harvard University, Cambridge,
MA 02138, USA*

1. Introduction

There is a vast and constantly growing literature on the reform of socialist economies. Worldwide interest has increased rapidly now that the two giants, first China and more recently the Soviet Union, have followed the two pioneering, smaller countries – Yugoslavia and Hungary – in taking the first steps along the road of reform. Most analyses of the reform process adopt a narrow economic or technological point of view, and concern themselves solely with issues such as efficiency, growth, material welfare, and adjustment to the world market.

This paper discusses something quite different. The questions it raises are prompted by moral and political philosophy, and they revolve around the issue of individual freedom. The basic question is: what is the relationship between the reform of a socialist system and the liberty of the individual?

The topics chosen reflect a value judgement. I am not presenting a normative theory here; most of the paper in fact, will offer positive, descriptive observations. Nevertheless, let me state my credo right at the beginning. I have a deep regard for individual liberty, and for the right to self fulfillment and the right to choose one's own way of life. In my value system, individual liberty is one of the fundamental, primary goods.¹ I regard the

*Several people were kind enough to offer valuable suggestions for improving the paper, including T. Bauer, J.S. Berliner, Z. Dániel, M. Ellman, R.I. Gábor, D. Hausman, Z. Kapitány, M. Laki, R. Nozick, A. Sen, A. Simonovits and J.W. Weibull, in particular. Special thanks are due to M. Kovács for her devoted research assistance and to B. McLean and S. Mehta for help in improving the English of the paper. The support of the Hungarian Academy of Sciences' Institute of Economics, and of Harvard University is gratefully acknowledged. Of course, responsibility for the views expressed in the paper is entirely the author's.

¹Rawls traces the value attached to liberty back to the high value placed on self-respect, which is ... 'perhaps the most important primary good It includes a person's sense of his own value, his secure conviction that his conception of his good, his plan of life, is worth carrying out Self-respect implies a confidence in one's ability, so far as it is within one's power, to fulfil one's intentions Without it nothing may seem worth doing ... we sink into apathy and cynicism'. See J. Rawls (1971, p. 440).

significant expansion of economic freedom as one of the major achievements of the Hungarian reform. By the same token, I consider its failure to go far enough in this direction as one of the gravest shortcomings of the Hungarian reform. One of the purposes of this paper is to establish a new standard for the measurement of the progress of the reform movement, to be applied in conjunction with the usual measures of efficiency. Applying this standard, the paper will report both on the successes and on the failures of the Hungarian reform.

The choice of Hungary is quite natural; it is the country I know best. But I am confident that the issues, problems, concepts and relationships discussed in this paper can be applied to the study of other socialist countries as well. Therefore, while Hungary will be used as a demonstrative example, the discussion of observations and propositions must be construed to have a more general validity.

The larger part of the audience at the Copenhagen Congress, and also the larger part of the readership of *European Economic Review*, consists of Western economists. This audience and readership cannot expect much novelty in this paper concerning the general discussion of individual freedom. Nevertheless, it might be interested in what is going on in this respect in the socialist system.

I hope, however, that the message of this paper will be heard in socialist countries as well. The discussion of individual freedom was an ideological taboo for decades; notions such as 'individualism' or 'liberalism' had strong pejorative connotations. But, I am convinced that respect for individual freedom is not only compatible with the original aims of many socialist thinkers but should become a fundamental ingredient of the socialist programme everywhere.

Freedom is a recurring topic in philosophy, in economics and in political theory, and not a single issue relating to it escapes being the subject of wide, and often heated, controversy. I am not embarking on any enquiry that touches upon the intricacies of modern analytical philosophy. This paper will remain at a modest, pragmatic, down-to-earth level and will try to keep close to the realities of life under socialist systems today.

2. Clarifying the concepts

Even an ordinary dictionary lists several meanings under the entries for 'liberty' and 'freedom', and it is small wonder, then, that every school of philosophy applies different interpretations to them. We do not aspire to provide a comprehensive, all-encompassing characterization. All we need here is a partial interpretation that embraces the elements in the composite category 'freedom' relevant to our context.² We hope nobody will dispute,

²For a more detailed discussion of these concepts (especially with regard to an instrumental role for freedom as opposed to the intrinsic value of freedom, and with regard to positive and negative freedom) see A. Sen's (1987) Marshall Lecture in this volume.

that the attributes we are going to examine, are indeed components of freedom.

This paper is concerned only with *individual* freedom. Important though the freedom of communities (and we have in mind the freedom of firms, of associations, of towns, and of nations) may be, they will not be discussed in this paper. We shall concentrate on *economic* freedom, in other words, on the right of the individual to dispose freely of wealth, of income, of time and of effort. Political or intellectual freedoms will not be studied here, and the discussion will be confined to the economic aspects of liberty even though we are fully aware of the strong links between political, intellectual and economic freedoms.³

Freedom has an instrumental value; it helps the individual in his choice between alternative actions. In addition, the author joins all those who attribute an important *intrinsic value* to individual economic freedom, as a value in its own right.

This judgement must be made clear especially in the context of the discussion of socialist economies. Even if the paternalistic state were to allot me the same bundle of commodities which I would have chosen freely from a set of alternative bundles, it does not have the same meaning for me. It gives me some additional value, to make the choice myself, freely and without interference. In addition, in most cases the outcome of paternalistic interventions leads to large deviations from the bench mark autonomous choice of the individual.⁴ As for paternalism, I agree with I. Berlin's (1969) words: 'For if the essence of men is that they are autonomous beings – authors of values, of ends in themselves, the authority of which consists precisely in the fact that they are willed freely – then nothing is worse than to treat them as if they were not autonomous, but natural objects, ..., whose choices can be manipulated by their rulers... "Nobody may compel me to be happy in his own way", said Kant, "Paternalism is the greatest despotism imaginable"... Paternalism is despotic, not because it is more oppressive than naked, brutal, unenlightened tyranny, ... but because it is an insult to my conception of myself as a human being'.

Since we attribute an intrinsic value to individual economic freedom, we do not regard it simply as an instrument to achieve welfare or utility. I am

³There is a growing awareness of these relations among Hungarian authors; particularly among political scientists and sociologists, and recently in papers by economists advocating radical reform as well. Special attention of Hungarian scholars was drawn to the issue by the publication of the late I. Bibó's collected papers (1986), republishing his (1935) essay, *Coercion, Law, Freedom*. From the more recent literature we mention the remarkable studies by Antal et al. (1987), Bihari (1986), Bruszt (1987), Fricz (1987), Gombár (1984), Hankiss (1987). An outstanding contribution to political-moral philosophy is J. Kiss (1986); his work is an analysis of the theoretical foundations of human rights. Unfortunately, most of this literature is not yet available in English.

⁴In the apt phrase of Fehér, Heller and Márkus (1983): this is 'dictatorship over needs'.

aware that methodological objections can be raised by those who espouse a strictly monistic approach. I prefer a pluralistic framework, to separately handle incommensurables like ultimate moral principles, because this framework spells out potential conflicts and trade-offs.⁵ 'Hamlet' could have been a very short story indeed, and hesitation would have been ruled out if only the protagonist had formulated and solved in a straightforward way a simple problem of maximizing utility. This paper will discuss conflicting ethical values later. Notwithstanding the methodological distinction, the ideas in it can, of course, be transposed into a monistic framework. But whoever wants to do so must decide and adequately defend his *single*, ultimate, primary good. It might be liberty interpreted in the most general way. In that case welfare must be just one of its components. Or it might be utility. In that case freedom ought to be an argument in the utility function, itself.⁶

We shall not aim for a complete analysis covering all aspects of individual economic freedom in a socialist economy. Rather, we shall single out two important classes of constraints on free choice, and disregard many other constraints whatever their relevance might be.

To the first class to be discussed in more detail belong the *bureaucratic constraints*. In this category we include both formal legislative orders or prohibitions and informal imperatives enforced by pressures or threats imposed upon the individual by the bureaucracy. To sharpen our sense of the nature of bureaucratic constraints it seems convenient to examine the effect of a change in the constraints. How might the constraint change to allow an increase in freedom? Here are a few illustrative situations; the list of situations is, of course, not exhaustive.

- Freedom increases, when the right to make certain kinds of decision passes from the bureaucracy to the individual; for example when mandatory posting to a job after graduation gives way to the graduate choosing his first job himself.
- Freedom increases when a bureaucratic constraint on an individual's decision is lifted. For example, suppose an employee has the right to set about leaving his job and looking for another one, but needs the consent of

⁵For more detailed theoretical arguments against a simple-minded monistic approach see A. Sen (1985), especially the chapters on pluralism and incompleteness, and on pluralism, well-being and agency. Sen explains that in certain cases only a partial ordering of alternatives can be established in connection with ultimate moral principles. 'Assertive incompleteness' of the ordering may exist. 'There is - on this view - no additional moral criterion that can be used to rank the unranked pairs in terms of moral goodness ... Intelligent moral choice demands that we do not choose - explicitly or by default - an alternative that we can see is morally inferior to another feasible alternative. But this does not require that the chosen alternative be seen to be "best" in that set of feasible alternatives, since there may be no best alternative at all, given the incompleteness of our moral ranking'. See Sen (1985, pp. 180-181).

⁶For further criticism of an oversimplified 'welfarism' and for the discussion of moral theories in economics see S.-C. Kolm's (1987) paper presented at the Copenhagen meeting. (Abbreviated version in this volume.)

his superiors before he actually leaves; he becomes freer when he no longer needs that consent.

- Freedom increases when an existing bureaucratic constraint becomes quantitatively less stringent, for example if the maximum number of employees in a private firm allowable under an administrative order is raised from three to nine.

Freedom in the sense of not being constrained by another individual or by a group of individuals or by the state is often called ‘negative freedom’. (In shorthand this is called ‘freedom *from*’.)⁷ According to this interpretation the loosening or lifting of bureaucratic constraints undoubtedly enhances negative freedom.

It is an odd tradition of the socialist movement to belittle the relevance of negative freedom. This tradition points out the emptiness of the formal, ‘bourgeois’ rights, for example by citing the freedom of the rich and the poor alike to sleep under the bridge. In this view only ‘positive freedom’ matters, i.e., one must have the power to do what one wants to do. (In shorthand this is called ‘freedom *to*’.) However great the relevance of positive freedom, the issue of negative freedom cannot be ignored with a wave of the hand, since it plays an extremely important role in the life of the individual. Incidentally, the right to decide freely where one wants to spend the night, is not universally accepted, and we should not take it as self-evident. There have been times when the citizens of some socialist countries could not travel without written permission from the state, they had to report to the police immediately when they decided to spend more than one or two nights away from their place of permanent residence. We shall return to this issue and to other aspects of negative freedom in our subsequent discussion of the Hungarian situation.

The other class of constraints we want to focus on comprises of *limitations on choice imposed by shortages*. It is probably fair to say that we are dealing with an issue concerning ‘positive freedom’. The usual concept of positive freedom refers to the individual’s capabilities: his freedom increases, when his means to achieve his goals increase. This general concept leads to certain more specific ideas in our thinking. Imagine an hypothetical experiment in the free association of ideas. The first words which would come to the mind of a Western economist responding to the concept of positive freedom would probably be notions such as income, wealth, capital both physical and human. These are undoubtedly components of an individual’s capabilities and limits in their availability constrain his freedom of choice. If we use the metaphor of a show window displaying a variety of goods, then this show window is useless if one does not have the resources of income or wealth to buy what is available there.

⁷For the distinction between positive and negative freedom see I. Berlin (1969), G.G. MacCallum (1967), F. Oppenheim (1961, esp. pp. 109–135) and S. Gordon (1980, pp. 133–134).

If a similar experiment in the free association of ideas were to be carried out in Eastern Europe, the response of an Eastern economist would be a little different. Of course, he will think of poverty and the low level of development, and of resources such as income appropriate to his situation. But surely, another association would also cross his mind. Despite a well articulated demand and money income to back it up, the individual might not be able to get the good that he wants at the prevailing price, or indeed at any price. That is not less an obstacle in the fulfillment of his goals, than the limits of his budget.

The first type of constraint on positive freedom is general; we can find it in all systems, including socialist systems (though, of course the parameters of *distribution* vary from country to country for many reasons). The second type of constraint is more system-specific, and that is the motive for the special attention given to it in this paper. We are talking not about sporadic and occasional excess demand, but about an economy where shortages are chronic and caused by systemic factors.⁸ Shortage phenomena do occur here and there in all systems, but in a 'shortage economy' they are very frequent, they appear in all segments of the economy, and they are intensive and tormenting.

I have coined the term 'forced substitution' to describe a typical situation common in a shortage economy in order to contrast it with voluntary substitution. The latter provides a free choice: the individual substituted good *B* for good *A*, because his tastes or the relative prices have changed. In a case of forced substitution he would have preferred good *A* to good *B* at prevailing prices, but he has no choice other than to substitute *B* for *A*, because *A* is in short supply. In some cases forced substitution causes only a minor inconvenience. In others it leads to grave and lasting suffering, for example to people forced to share an apartment for decades or even a lifetime against their will, or unable to have a telephone installed for years even though they are sick, immobilized or need a phone badly for some other reason. The victims of shortage suffer humiliation; they are at the mercy of the seller and of the bureaucrat.⁹

It might be surmised that the individual is not indifferent even towards the availability of goods which he actually does not choose right now. The wider the assortment of goods supplied, the larger the number of alternatives, and

⁸For a more detailed analysis of the causes and consequences of the shortage syndrome see the author's book (1980) *Economics of Shortage*.

⁹Assar Lindbeck in his Schumpeter Lecture (1988) published in the present volume talks about the loss in satisfaction when the consumer is prevented from achieving a better consumption bundle because of rationing or government decree. The term 'rationing' has a conventional narrow meaning in the sense of applying coupons or other forms of bureaucratic allotment. In recent disequilibrium analysis any kind of allocation procedure used on the shorter side of the market is called rationing, including queuing or even a completely random selection. Shortage-imposed constraints on free choice appear in all types of rationing.

consequently the safer the availability of goods demanded, the stronger is the buyer's conviction that there is genuine free choice. It follows from the intrinsic value of freedom, that the situation in which one chooses *C* while both *C* and *D* are at hand, is not identical with the situation in which one chooses *C* because it is the only possibility. In the latter case one is deprived of the elementary right of free choice; there was a loss of something valuable – although it was not a loss of 'welfare' or 'utility' since *C* would have been preferred to *D* anyway.

We might, therefore, conclude that an individual's economic freedom increases as the intensity and frequency of shortage phenomena decreases and the consumer is provided with greater opportunities for choice. The relationship is all the more immediate, and stronger, if the change for the better is not just provisional, but if it becomes permanent as a result of a reform of the economic mechanism.

The two sets of constraints on freedom, which will be at the heart of our discussion, namely bureaucratic constraints and curtailment of choice due to chronic shortages, are interrelated. Bureaucratic control is among the factors which explain why shortages occur; shortages induce bureaucratic rationing. Yet the two sets overlap only partially, and so it is analytically useful to consider them separately.

It follows that in our conceptual framework we regard freedom as a *multidimensional* category. All the restrictions on the individual's economic freedom mentioned so far can be observed. They can be represented either by a binary indicator (reflecting the presence or the absence of a certain constraint), or they can be represented by a scale ranging, e.g., from zero to one (reflecting the stringency of the restriction in question).¹⁰ Each indicator represents a specific well-defined dimension of freedom, which is not, when approached in this way, an intangible metaphysical entity. Are Hungarian individuals free with regard to their economic actions? One cannot give a simple 'yes' or 'no' answer. But one can give meaningful answers for each type of constraint which is relevant to our enquiry and consider the degree of freedom or lack of freedom in each particular dimension.

3. Yardsticks: The minimal and the maximal state

To appraise the changes in the degree of individual freedom one needs yardsticks. To consider the restrictions on freedom in a private market economy, the point of departure might be taken to be Locke's 'state of nature', i.e., the state of individuals living in *complete anarchy*.¹¹ In the

¹⁰Perhaps it is not a hopeless task to try to devise composite indices of individual economic freedom, based on several observable, partial indicators of freedom, in the same way that one might calculate a composite index of human intelligence or economic upswings and downswings.

¹¹See J. Locke (1690, 1967).

scheme presented in fig. 1 there is a vertical axis, representing the degree of state control over the economic spheres No. 1, 2, 3,....

Degree 0, or complete anarchy, is not sustainable. Going upwards from 0 one arrives at the points (denoted by Δ on the scheme) representing what political philosophers have called the 'minimal' or the 'night-watchman' state. The role of the state is limited to the protection of the citizen against violence and theft and to the enforcement of voluntary contracts.¹² (Here we disregard for the sake of brevity the role of the state in external affairs.) Any additional state activity, including measures designed for redistributive justice and the supply of public goods, goes beyond the minimal state.

Turning to the upper end of the axis, degree 1 represents complete state control of all spheres of the economy, with nothing left to private initiative or choice.¹³ This Orwellian situation is entirely hypothetical and without any

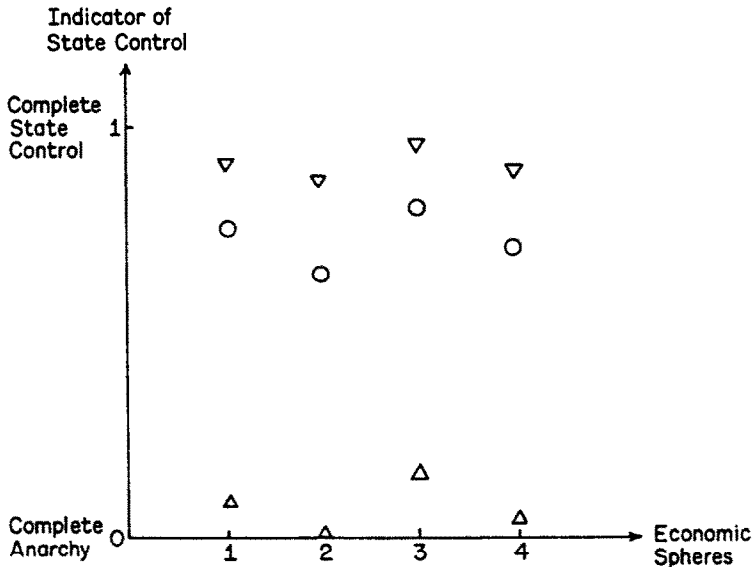


Fig. 1. Illustration of the yardsticks: From complete anarchy to complete state control. *Legend:* ∇ maximal state, \circ actual state, Δ minimal state. (*Note:* The figure is used only as a simple schematic illustration of the points made in the text. Our train of thought does not require the assumption of cardinal comparability between different spheres of the economy.)

¹²R. Nozick (1974) introduced the notion of an 'ultramiminal' state completely free from any redistributive function, in contradistinction to the classical definition of the minimal state which implies a certain degree of coerced redistribution; that is, even individuals who do not want protection, receive it and pay for it.

¹³Imre Madách's 19th century Hungarian drama 'The Tragedy of Man' contains a prophetic anti-Utopian scene of a society called the *Phalanster*. (This name was adopted from the work of the eminent Utopian socialist, Fourier.) Here everybody has a mandatory, assigned job and must work in the collective enterprise. Plato is a shepherd, Luther a stoker, and Michelangelo a cabinet-maker carving the legs of chairs. See Madách (1861, 1953, pp. 127-145).

historical precedent; it has never existed at any time. Let us introduce by way of contrast to the notion of the minimal state, a new notion, that of the *maximal* state (represented by the symbols ∇ on the scheme).¹⁴ This is a lower degree of 'etatization'¹⁵ than the terminal point of the scale, i.e., the point of complete state control. The maximal state is not an abstract theoretical notion, but an historical concept; this is the highest *feasible* degree of bureaucratic power, where feasibility depends on the practical conditions for enforcing centralization. Among such conditions are the technology of information gathering and processing and of communication between the officials in the hierarchical bureaucracy; the organizational abilities of the bureaucracy; the art of mass-manipulation; the ultimate limits of tolerance of repression, and so on. So the maximal state, of necessity, allows certain minor concessions to be made with regard to individual freedom, one typical concession being a limited degree of individual choice on the market for consumer goods. Such arrangements are tolerated, but only provisionally, and the proviso always remains that further steps in the direction of complete state control would be desirable should they ever become feasible.

Looking at the actual historical record we find that all socialist countries have come close to the maximal state for at least a period of time in their evolution – the Soviet Union after the collectivization of agriculture under Stalin, China after the establishment of the communes under Mao, and Eastern Europe during the period 1949–1953. There are substantial differences among the different spheres of the economy in terms of how close they have come to the maximal state in each country during the peak periods of etatization. We have no space here to elaborate in detail; with a degree of simplification needed for a general analysis one can, however, say the maximal state has been the historical point of departure for the reform process in socialist countries. As a consequence of the reform, the degree of central control in the *actual* state (represented by symbols \circ on the scheme) is lower than in the maximal state.

It is quite understandable for scholars and politicians discussing the problems of a welfare state to think in terms of: how close to or how far from the minimal state are they and how close should they be. It is no less understandable, for scholars and politicians considering the problems of reform in socialist countries to think in diametrically opposite terms: how close to or how far from the maximal state are they and how close should they be.

¹⁴Here and in the rest of the paper we shall not discuss the role of the Party separately. The functioning of the Party is thoroughly entwined with that of governmental agencies, the Party being the dominant force in this joint activity. Throughout the paper, concepts like 'state', 'government' and 'bureaucracy' embrace the institutions of the Party.

¹⁵The practice and the ideology of 'etatism' is analysed in B. Horvat (1982).

4. Changes in Hungary

We now turn to a survey of the changes in Hungary. It would take much too long to follow the whole historical course of the reform process. Therefore we shall contrast two specific periods instead: the early 1950s, a period which saw the peak of bureaucratic centralization in most (although not in all) spheres, and came closest to our concept of a maximal state, and the present period which began in the mid-1980s and which we shall call the 'reformed state'.

Each observation will be presented in a concise and simplified form, and qualitative analysis will not be bolstered by statistics.¹⁶ Besides, many qualifications could be added to each item for the sake of precision, but limitations of space do not allow us to become immersed in details.¹⁷

Part of the change has taken the form of a definitive amendment of Hungarian law, and has resulted in the repeal of old legislation and in the introduction of new laws. Another and certainly no less important part has been the result, not of openly declared new rules, but simply of the relaxation in the enforcement of old laws and governmental directives. The state has not only shrunk, but has 'softened' as well, a fact which has opened new doors for private initiative and enterprise, and for voluntary, private contracts, often in the grey area between legality and illegality, in what is often called the second economy. These effects have been inseparably accompanied by such side-effects as the weakening of the respect for the law, and a laxity in the attitudes towards cheating and corruption. In our survey we shall endeavour to make clear which changes have occurred formally and which changes have come about informally through a 'softening' of state control, although we cannot always make a sharp distinction in every case.

4.1. Property and entrepreneurship

In a maximal state almost all people earning wages or salaries must be employed by the state. With a few exceptions there is only one route towards upward mobility in society, and that is by making a career within the bureaucratic hierarchy.

In Hungary cooperatives have existed, mainly in agriculture and in urban services, but they have not arisen out of a genuine, voluntary cooperative movement. In their functioning they have differed little from their state-owned counterparts: managers have always been appointed by the bureau-

¹⁶Data are available, but they describe the situation in minute detail, while here we shall deal with phenomena for which descriptive indicators cannot be measured by a simple process of summation.

¹⁷Interested readers can find a more elaborate survey of the Hungarian reform process in my (1986) paper, which offers some statistics and a long list of references for those who seek more detail and more quantitative data.

crazy de facto and they have had to follow mandatory plans. In addition, the number of private craftsmen has been almost negligible, and of these only a few have ever hired labor, typically one employee at most. Before the period of reform shadow-economy activities did occur, but only sporadically, since it was rather risky to pursue them.

The most visible, and in our view the most important change has been the evolution of a significant private sector. This sector operates in various forms, of which we shall only mention the most important:

- (i) *Small family businesses:* Here we find craftsmen, traders, owners of car repair shops, and the like. These are now licensed by the state authorities and allowed to hire a limited number of employees.
- (ii) *Small family farming:* In this sector we find that part of the family's working time is spent on the private farm, while one or more members of the family often work on an agricultural cooperative, or on a state farm or in other sectors of the economy.
- (iii) *Private 'business work partnerships':* These must be officially licensed, and they may run small or medium-sized businesses. The members are owners who have formed a partnership to which they also jointly contribute their labour.
- (iv) *Self-employed, freelance individuals; part-time workers or workers serving larger companies, but working at home:* A substantial proportion of these work in the 'second economy'.

It is impossible to estimate the total size of the formal and informal private sector, since much of it, by definition, is unrecorded. According to crude guesses, it generates one-fifth to one-quarter of total national output. At least three-quarters of all Hungarian families make some contribution to the second economy. Moreover the full significance of this factor lies not in actual production but, as was alluded to in our methodological discussion earlier, in the opportunity offered by the mere existence of a substantial private sector. Before the reform there was ultimately only a single employer, the state, hence there was no meaningful economic alternative to working in the state sector. Today, even if the great majority of individuals continue to be employed by the state, they have more freedom on account of the simple fact that the exit option exists. If they wish, they can start a private business or experiment with self employment, or become an employee of a private business. That is to say, in spite of the overwhelming presence of the state, its employment *monopoly* has been broken. The individual consequently, has become far more independent, and though subject to many restrictions he can still be his own master. The acquisition of this feeling marks a change of historical importance.

For those who are energetic and gifted, there are now two ways to move ahead in life, instead of only one. As before, they might always choose to

make a career in the bureaucratic hierarchy, but another course is now open; they might choose to become an entrepreneur. Many individuals prefer the second option because they like taking charge of their own affairs, and enjoy the independence and the opportunities for risk-taking on the market.¹⁸ In addition, they are often able to earn far more than those in the highest government positions, provided they are efficient, and encounter a bit of luck. It is exciting to see how genuine entrepreneurs have emerged again after a period of several decades in which this personal characteristic was almost completely suppressed. There are people, who in a truly Schumpeterian way, introduce innovations, create new products, open up new markets and establish new organizations.

But private activities are still severely impeded by a range of bureaucratic curbs: administrative licensing, capricious changes in taxation and handicaps in the access to land, buildings, materials, credit and foreign currency. There are upper limits to the number of people that can be employed: the number of permanent staff may not exceed nine (in commerce it may not exceed twelve), inclusive of family members. This can be circumvented, for example, by the hiring of more casual labour rather than permanent labour, but private businessmen feel, quite rightly, that there is no way for them to become 'big capitalists'. Moreover, and this is perhaps the most important constraint, small private business has been operating in an atmosphere of uncertainty and insecurity, without adequate guarantees of property rights and without protection against unpredictable bureaucratic intervention.

In a quick digression, let us look at the problem from the angle of moral and political philosophy.¹⁹ It is important to ensure that all the restrictions imposed by the state are not motivated by *consequentialist* considerations of ethics; not motivated for example, by keeping in mind the distributional pattern to be achieved or by keeping in mind the limits of tolerable inequality. What really matters is the permissibility or rather impermissibility of a certain *procedure*, namely the 'capitalistic relationship between a private businessman and a large number of employees', resulting in certain income *entitlements*. A rich, private businessman might, if he wishes, spend his income on luxury goods. But he is not permitted to build up a large private business, even if the entrepreneur and a large number of prospective employees are willing to enter into a voluntary labour contract. In our judgement, this constitutes a serious curtailment of individual freedom of choice in order to prohibit the evolution of procedures and institutions of a capitalist kind.

¹⁸On these two types of upward mobility and on entrepreneurship in the Hungarian village, see P. Juhász (1982) and I. Széleányi and R. Manchin (1986). See furthermore I.R. Gábor and T.D. Horváth (1987).

¹⁹See R. Nozick (1974, esp. chs. 7 and 8) and also A. Sen (1981) and A. Sen and B. Williams (1982).

To sum up, the reformed state is a curious and inconsistent blend of the traditional 'night-watchman' state – which protects the safety of public and private property – with a 'revolutionary organization' that limits property rights or in some cases goes so far as to appropriate private property.

4.2. Choice of profession, job and working hours

These issues have partly been covered in the preceding section on the state-owned and private sectors, but there are quite a few other issues which deserve further enquiry. The survey is presented here (and also in the latter sections 4.3 and 4.4) in a tabulated form.

The situation has not been perfectly uniform either in time or over the various segments of the economy. To obtain a sharper contrast, we have singled out the most extreme situations (which were by no means unimportant exceptions but were, rather, situations which have prevailed for some time in at least one major sector). We shall use the same selection in the subsequent tables.

Table 1 covers only the state-owned sector.

This table is self-explanatory, and we comment only on row 4. Here we must keep in mind the information provided in section 4.1 above, on the private sector and use it in conjunction with the information provided on the state-owned sector as described in table 1. In the maximal state individual options in connection with the classical choice between more work (in order to earn more) and more leisure, were severely restricted. Work, in the sense of a regular job, was mandated by law, and only precisely specified exceptions permitted for reasons of health, maternity, and the like. Those who did not conform were labelled as 'parasites' and were liable for prosecution. An employee could be compelled to work overtime, but if overtime was not required by his employer, he could not find (and in fact was not allowed to find) other ways to earn more. This situation has changed dramatically in the reformed state. On the one hand individuals are now permitted not to have a regular job. While the old law obliging people to work remains in force, it is not consistently applied and violations are largely ignored. On the other hand individuals can now choose to work far more than the prescribed legal minimum of 40 hours, and they often hold second or even third jobs. They do a variety of odd jobs, working partly in the first economy and partly in the second economy. According to some estimates, at least half the adult population works for more than 60 hours a week, not counting household work, and a smaller fraction of the population works even more, 80 or 100 hours a week. As a result, many Hungarians are physically exhausted from overwork. But as far as the freedom of the

Table I
Choice of profession, job and working hours.

| Choice problem | Maximal state: Early fifties | | Reformed state: Mid-eighties | |
|--|--|---|---|---|
| | State control (at the peak of bureaucratic centralization) | Remaining scope for individual choice | Individual freedom (at the peak of decentralization) | Remaining bureaucratic constraints |
| (1) Choice of secondary and higher education | Strong bureaucratic influence on the choice regarding where to apply for admission. Number of applicants greatly exceeds capacity of educational institutions. Severe selection, priorities according to political criteria. Where composition of demand for education and manpower diverge, applicants for higher education redirected according to requirements of production | Within the bureaucratic constraint, some (but not all) individuals able to influence decision concerning their education | Individual freedom in the choice regarding where to apply for admission | Excess demand for secondary and particularly for higher education remains. Many applicants not admitted. Bureaucratic assignment to certain professions in vocational training not infrequent. Composition of educational services not adjusted to demand |
| (2) Choice of first job after education | Mandatory posting | Some influence on posting | Free choice | None |

| | | | | |
|--------------------------------|---|--|---|--|
| (3) Change of job | Not permitted without consent of superiors. Severe penalties for 'arbitrary' quitting. Mandatory transfers if considered necessary by superiors. Mandatory use of 'labour exchanges' in arranging transfers from one job to the other | Employee able to initiate own transfer and in some cases to influence decision | No formal administrative restriction on changing jobs | Bureaucratic pressure against changing jobs can be applied in professions where the number of jobs is small |
| (4) Extension of working hours | Bureaucratic pressure on employee to work overtime if required by enterprise. Otherwise usually prohibited | Minor possibilities of seeking extension of working time for extra payment | More flexibility in overtime arrangements. 'Enterprise business work partnerships' (Hungarian abbreviation VGMK), a new institution, mainly providing opportunities to do extra work within the company at higher wages | Some bureaucratic constraint on 'regular' overtime. Many restrictions on the activities of VGMKs |
| (5) Employment abroad | None permitted | None | Possible | Work permit from Hungarian authorities, required. Mandatory repatriation of prescribed percentage of foreign earnings |

individual to choose between work and leisure is concerned, it has expanded enormously.²⁰

4.3. *Consumer choice*²¹

The changes are surveyed in table 2, which is not fully comprehensive, since it only covers the most representative sectors. Just a few comments on the table need to be made.

Rows 3 and 5: According to the guiding notions of socialist transformation, housing and medical care are basic needs which the state must satisfy. Every citizen is entitled to them, and thus rents are much below the market-clearing level and medical care free of charge. But the individual has no way of influencing the quantity of resources used in these sectors, since it is entirely up to the bureaucracy to decide on their allocation. In fact, special attention is not paid to these basic needs: rather, the priority goes to other sectors, that is mainly to those which the planners consider as having a direct impact on economic growth. Housing and health are persistently neglected, and their share of total national investment is far lower than in market economies. Centralization of resource allocation allows a suppression of consumer priorities.

The reform has brought about beneficial changes by enhancing the influence of consumer choice, but the changes have not been smooth or painless. After decades of neglect, the bulk of the burden of provision of housing has been passed back to the households. A citizen in need of housing is in deep trouble. There is not enough credit, and there is no well-developed system of small and medium-sized contractors prepared to build private homes quickly and reliably. Many households have been forced by shortages and by high prices to build their houses in a 'do-it-yourself' fashion, with help from family, friends and the second economy, at the expense of tremendous sacrifices in terms of money and time. Some households are simply unable to cope with this cumbersome process and become lost amidst the inadequate supply of public housing and the insupportable costs of private housing. Still, many individuals feel that the

²⁰A public opinion poll in 1986 asked this question to a sample of individuals: 'What do you do when your real income declines?' The answer of 42% of the respondents was, 'We cut expenses', while 41% replied, 'We extend our working hours and earn more'. The source of the data and also of some more data referred to in the later parts of the paper is a memorandum compiled by K.I. Farkas and J. Pataki (1987) summarizing some findings of the Mass Communication Research Center in Budapest. Their valuable help and the support of the Mass Communication Research Center is gratefully acknowledged.

²¹Limitations of space prevent examination of a very important aspect: the transmission mechanism between consumer choice and production response. For that purpose a close look at the operation of the price and taxation system, incentives to companies, etc. would be required. These could be topics for a separate paper.

Table 2
Consumer choice: Goods and services.

| | Maximal state: Early fifties | Reformed state: Mid-eighties |
|---|---|--|
| State control and shortages due to bureaucratic centralization) | In certain periods basic foodstuffs rationed (coupons). Chronic, intensive shortages; whole groups of commodities almost completely lacking. Some foodstuffs directly distributed to workers within state-owned enterprises. Special, better supplied, stores for the privileged groups | Individual freedom (at the peak of decentralization) |
| Good or service | Remaining scope for individual choice | Remaining bureaucratic constraints and shortage phenomena |
| (1) Food | Purchases for money subject to constraints listed on the left. Sporadic black markets | Shortage phenomena persist, although much less intensive: partial shortages in the range available, late deliveries, insufficient allocation for some localities, etc. Special stores selling for convertible currency |
| (2) Other consumer goods | As 1 | As in 1 |
| | No coupons. Chronic intensive shortages. Special stores (as in 1) | Great improvement in supply. Abolition of all official rationing. Abolition of stores for privileged, with some exceptions |
| | As 1 | Great improvement in supply |

Table 2 (continued)
Consumer choice: Goods and services

| | Maximal state: Early fifties | Reformed state: Mid-eighties | |
|-----------------|--|---|---|
| Good or service | State control and shortages (at the peak of bureaucratic centralization) | Individual freedom (at the peak of decentralization) | Remaining bureaucratic constraints and shortage phenomena |
| (3) Housing | <p><i>Urban housing:</i> Apartment housing nationalized. State-owned apartments allotted by authorities. Intensive shortage waiting lists for years. Frequent forced sharing of apartments. Forced evacuations and relocations by administrative order. Subletting severely restricted. Narrow limits within which houses or condominium apartments may be privately owned</p> | <p><i>Urban and rural housing:</i> Rapid expansion of private housing; majority of new-buildings private. Small proportion of state-owned housing privatized. Illicit, but tacitly tolerated trading of state-owned housing tenancies. Widespread subletting, providing substantial rent income to individuals in cities and in resorts</p> | <p><i>Urban housing:</i> Greater part of urban housing still state-owned: intensive shortage, very long waiting time, poor adjustment of the composition of supply to demand.</p> <p><i>Urban and rural housing:</i> Severe limits on home ownership: or what kind and how much housing may be owned by an individual.</p> <p>Excess demand for mortgages, tight credit rationing.</p> <p>Recurrent shortages of building materials and capacity for private building</p> |
| | <p>Remaining scope for individual choice</p> <p><i>Urban housing:</i> Some minor possibilities for selling or buying privately-owned family houses or condominium apartments. Exchanges of state-owned apartments between tenants allowed on a voluntary basis, but official permit required. Some scope for obtaining a subtenancy.</p> <p><i>Rural housing:</i> mainly private; housing can be sold and bought, subject to administrative restrictions</p> | | |

| | | | | |
|---------------------------------|--|--|--|--|
| (4) Transport and communication | <p>All transport services supplied by state-owned enterprises. Private cars allowed only to a small number of privileged. Administrative allocation of telephone lines to homes. Extremely long waiting lists for telephones</p> | <p>Subject to constraints listed on left, means of transportation chosen by individuals. No special permit for long-distance domestic travel required (as in some other socialist countries)</p> | <p>Rapid growth in number of private cars, free market for second-hand cars. Queue-jumping for a telephone line allowed if the individual buys a telephone bond</p> | <p>Chronic excess demand for new private cars sold by a monopoly state-owned company, long waiting lists. Privileged individuals can jump the queue. Waiting lists for telephones lengthening, administrative allocation continues</p> |
| (5) Medical service | <p>National health service; medical care free of charge. No freedom of choice – mandatory assignment of doctor and place of treatment (hospital, etc.). Intensive excess demand for medical services, overcrowded hospitals and surgeries, long waiting lists. Private practice by doctors, prohibited with few exceptions. Special hospitals for privileged</p> | <p>In some cases a chance to influence which doctor individuals are assigned to and to choose the place of treatment. Some exceptions to the general prohibition of private medical practice</p> | <p>Curious 'dual-allocation' system in health service. Nominally still free of charge, but many patients tip doctors ('gratitude money') in the hope of better treatment, a practice which is illegal, but tolerated, and has strong influence on the choice of doctor and place of treatment. Private practice greatly extended</p> | <p>Formal mandatory assignment of doctor and place of treatment still prevails. Free choice not legal, and so risky and inconvenient. Excess demand for medical service remains or has even increased. Special hospitals for privileged continue</p> |

Table 2 (continued)

| | Maximal state: Early fifties | Reformed state: Mid-eighties | Remaining bureaucratic constraints and shortage phenomena |
|--|--|---|--|
| Good or service | State control and shortages (at the peak of bureaucratic centralization) | Individual freedom (at the peak of decentralization) | Some excess demand for public day nurseries and kindergartens remains, accompanied by retention of administrative allocation |
| (6) Child care | Increasing proportion of women work due to low wages and social pressures. Institutional child care: public day nurseries and kindergartens. Excess demand for and administrative allocation of institutional child care | Extension of maternity leave, accompanied by modest financial support. Rising proportion of mothers stay at home with children, also encouraged by availability of part-time work or home-work. Some private child care: private kindergartens, babysitters, etc. | |
| (7) Recreation and travel to foreign countries | Places in public holiday accommodation assigned by trade-union officials. Travel to foreign countries for family visits and tourism very rare, allowed only to the privileged. Usually in organized groups without family. Tourism to Western countries almost nil | Holidays could be spent at homes of relatives or friends Many families own holiday homes or chalets. Commercial holiday facilities (hotels, campsites, rooms in private homes) available. Very large number travel individually or with family to foreign countries, East and West, for family visits and tourism | Administrative allocation in much public holiday accommodation (Trade Union, company guest houses) remains, but several other possibilities available. Administrative permission required to travel abroad, including consent of the employer (except travel to a few socialist countries). Frequency of private tourist trips restricted. (See under purchase of hard currency in section 4.4.) |

situation has improved, because they at least have a clear conception as to how to tackle their accommodation requirements.

In the health service there is a somewhat perverse combination of bureaucratic rationing and veiled commercialization. The mere fact that medical care is free of charge to every citizen does not make patients satisfied, since the quality of service is frequently substandard. Besides there is substantial disaffection amongst the doctors and the medical staff. Louder and louder public complaints have pushed the planners to allocate more resources to the health sector. The widespread occurrence of 'gratitude money' is a peculiar signal of many people's willingness to spend more of their own money on their health directly, hoping to get better care and attention. However an appropriate institutional and economic framework for satisfying the citizens' demand for medical care has yet to be found.

Attention should be drawn to row 7 of table 2 and also to row 5 in table 1, that is to the right to travel to and to work in foreign countries. The number of private Hungarian tourists travelling to non-socialist countries is increasing from year to year. From 22,000 in 1958 it has increased to 655,000 in 1985²² (out of a population of 10.6 million). The number of tourists travelling to socialist countries is several times greater. In spite of remaining restrictions, this is a tremendously important change, and after decades of severe isolation, most Hungarians now enjoy the freedom to explore the world.

4.4. Household saving and investment

Under the pre-reform system the decision on how much to spend and how much to save out of their income was left to households, subject to certain restrictions.

Almost annually, low-yield government 'bonds' were issued and citizens were compelled to buy them by aggressive political campaigns. This practice has now been abolished. (We shall return to the problem of other, more 'commercial' bonds.)

Involuntary saving appears when consumer goods and services that are demanded are not supplied in sufficient volume and so a proportion of household income intended for spending cannot be spent. There is controversy among students of consumer macro-markets in socialist economies over the extent to which shortage-induced saving exists, given that involuntary saving it is difficult to measure. In any case, wherever it has occurred it has clearly amounted to a restriction of individual freedom. Under the reformed state, spending possibilities have certainly expanded very much, if not in the first, then in the second economy. Hence shortage-induced saving, if it ever existed at all, has certainly ceased to be prevalent.

²²Source: Central Statistical Office (1966, 1986b).

Once saving has been decided upon, the question arises as to what form the savings should be held in. Before the reform, the number of choices was very small. Most savings were kept in cash or savings accounts at the bank which typically yielded a low nominal (and in most cases a zero or negative real) rate of interest. Only a narrowly limited set of value-retaining real assets was available. The tight restrictions on purchasing real estate have already been mentioned. There were also administrative restrictions on holding precious metals and trade in art objects was small. The reform has increased the number of options. Banks offer a wider range of savings accounts, although the real interest rates remain low or even negative. Citizens can buy various life insurance, endowment and save-as-you-earn policies, to supplement the insurance and pensions provided by the state. Companies, co-operatives and local authorities now issue bonds with impressive returns, backed by a state guarantee, and these are proving very popular. The opportunities to buy real estate, though still very restricted, have widened, and the markets for other value-retaining assets have expanded.

In spite of these achievements serious restrictions remain.

Private business is in great need of outside financing and the state banking sector is tight-fisted with the credit it will provide. Many individuals would gladly lend to private business. Others would be ready to invest in private business and become silent partners in private enterprise.²³ These kinds of private financial and capital markets, of course, require appropriate institutions, legal regulations and a machinery for the enforcement of legal contracts. But these do not exist. On the contrary, such arrangements are illegal. Nevertheless, to some extent they are entered into, in the guise of personal loans and as acts of friendship (which are not illegal), and accordingly they are based solely on individual confidence, which makes them rather risky and prevents their expansion. Here, then, is a case in which the state, otherwise certainly more than a 'minimal' state, does not fulfil some of the necessary duties of even a minimal state, duties which require it to protect property and to enforce private contracts.

The proposal to allow state-owned enterprises to issue, in some way, common stocks making them in effect companies in mixed ownership, has been raised in discussion several times, but has not been accepted so far.

The Hungarian currency is not convertible. An individual Hungarian cannot purchase foreign currency freely, particularly not convertible currency. There are a few narrow channels for obtaining hard currency legally (for example a modest travel allowance which may be applied for every third

²³In the public opinion polls in 1983 quoted repeatedly, the following question was put to the sample: 'Assume that you inherited unexpectedly Ft 100,000 (around 1.5 year's average wage). You have two options: to place it into the usual savings account or to become a partner in a small private business. The second option is risky. Which one would you choose?' 48% opted for the first and 47% for the second. *Source*: K.I. Farkas and J. Pataki (1987).

year). Otherwise, there are fairly extensive illegal markets in various shades of black and grey, but operating in them is inconvenient and risky. This presents no small problem. Availability of foreign currency is a condition of full-fledged individual freedom, since it is required for the development of all kinds of human and cultural contacts with foreign countries.

This rounds up our brief comparison of individual economic freedom in Hungary before and since the reform. To sum up, the survey demonstrates what has been said in the introduction. The reform process has increased individual economic freedom substantially. At the same time, the present state of affairs does not satisfy those who regard liberty as a fundamental value.

5. Growth and welfare versus freedom

What is the relationship between individual freedom and welfare? (Limitations of space do not permit the considerations of the relationship between freedom and other fundamental values.) Welfare is, of course, strongly associated with the growth of production and consumption.

There are two widespread views. Socialist ideology assumes a negative relationship between growth and material welfare on the one hand, and freedom on the other. While not denying the moral value inherent in individual liberty, it requires that it should be subordinate to the public interest. Once the new socialist order has been established, the public interest amounts to a steady growth in production and productivity that fuels a growth in consumption. Individual liberties that impede growth must be sacrificed for public interest.

There are many arguments designed to demonstrate the existence of a trade-off. The most important is the need for a high rate of investment, since this is regarded as the main engine of fast growth. A high investment rate, the argument runs, cannot be assured if investment is mainly or exclusively financed out of individual, voluntary savings. Moreover, fine-tuning of supply to consumer demand is costly, requiring too frequent modifications of production, too wide a variety of goods, too large a level of stocks, and so on. Bureaucratic centralization and chronic shortages, therefore, save these costs of fine adjustment.²⁴ Perfect freedom of labour causes too high a rate of mobility which undermines discipline and the smoothness of production and causes a loss of skills and of acquired experience. The list of arguments could be extended.

²⁴P. Wiles, a distinguished analyst of socialist economies who was certainly not an exponent of the ideology of the socialist countries, wrote a paper entitled 'Growth versus Choice' (1956). His main line of thought was this: Socialist economies jettison the right of the individual to choose between 'more hair brush less nail brush' or vice versa, but are able to enforce a high investment rate, and hence a high growth rate, which provides ultimately more brushes of both kind.

The opposite view, taken by the disciples of market socialism, points to a strong positive relationship between individual freedom and growth. Free choice, free enterprise, the profit motive and competition on the market are among the strongest stimuli to efficient effort.

Unfortunately, the Hungarian experiment has not provided us with conclusive evidence. It has not provided us with unambiguous support either for the 'complementary' or the 'trade-off' point-of-view. Part of the reason is, no doubt, due to the fact that the reform itself has been inconsistent so far, lingering half-way along the road to individual freedom. While the discipline formerly enforced by the bureaucracy has slackened and the state has grown 'softer', a natural consequence has been that various methods of forced growth achieved mainly with the help of extremely high investment rate and large involuntary savings rate are no longer available. At the same time the tough discipline of competition has not prevailed yet and so the motivation linked to free choice is not yet strong enough in all spheres of the economy.

At this point one can follow two alternative trains of thought. The first one, that of the constructive reformer, is to work out a programme for the elimination of the inconsistencies and for the strengthening of the bonds between free choice and efficiency. Such an exercise might no doubt be fruitful, but nevertheless another line of thought will be followed which hinges on a prediction. The prediction is that the Hungarian situation will not remain exceptional. If not in exactly the same way, something comparable, probably an inconsistent 'half-way' reform, can be expected to evolve in all other socialist countries which begin a reform process of decentralization and liberalization while maintaining their existing political structure. The prediction is supported by the preliminary experiences in China and Poland.

Let us now explicitly confront a choice problem: If we have to choose between the historical reality of the 'maximal' state and the other historical reality of a semi-reformed 'less-than-maximal' state, what should we prefer?²⁵

Let us be more specific, and look at the German Democratic Republic, whose leadership has distanced itself from any Yugoslav, Hungarian or Chinese-style reform. It is a country in which the non-reformed institutional framework has been preserved intact and has managed its affairs in an intelligent and effective way. To justify itself, the Hungarian reform must bear comparison with the GDR. To this end, to facilitate comparison table 3 presents the conventional figures for the growth rates of production and consumption of GDR and Hungary. At first sight the figures for the GDR are more favourable.

Before appraising them, however, a few words of qualification.

First there might be a bias in the measurement of growth to the

²⁵This seems to be a fair comparison. It is fair to compare either alternative utopias, or alternative historical realities. It is not permissible to compare an historically *real* Stalinism with the Utopia of an *ideal* 'market socialism'.

Table 3
Average annual growth rates in GDR and Hungary
(percent).^a

| | German Democratic Republic | Hungary |
|-----------------------------|-------------------------------|---------|
| <i>National income</i> | | |
| (1) 1956-68 | 7.4 | 5.7 |
| (2) 1969-86 | 4.7 | 3.4 |
| <i>Personal consumption</i> | | |
| (3) 1954-59 | 7.3 | 3.9 |
| (4) 1961-74 | 3.9 | 4.7 |
| (5) 1974-80 | 4.0 | 2.7 |
| (6) 1980-83 | 0.5 | 0.2 |

^a'National income' is a net output concept within the framework of the 'Material Product System' (MPS), the accounting system used in socialist countries. 'Personal Consumption' consists of all consumer goods (excluded dwellings) purchased by households, received in kind as payment for work, or produced on own account on personal plots. The arbitrariness in choosing the periods for comparison is explained by the lack of commensurable data for the whole period. The data are not available for each year, the definition of personal consumption and the choice of base year for deflating current prices was altered repeatedly by the statistical agencies. These difficulties notwithstanding, the calculation of average annual growth rates is commensurable across the two countries for each period listed in the table. On the whole it seems to be obvious that the increase of personal consumption has been faster on the average in the GDR than in Hungary for the last 30 years.

Sources: Row 1: Central Statistical Office (CSO), (1971), p. 77.
Row 2: CSO (1971), p. 77, (1975), p. 73, (1986a), p. 64, (1986b), p. 374.
Row 3: United Nations (UN) (1968), pp. 236, 293.
Row 4: UN (1977), pp. 465, 579.
Row 5: UN (1982), pp. 435, UN (1983), pp. 576, 726.
Row 6: CSO, (1986a), p. 306.

disadvantage of Hungary.²⁶ Second, we must also take into account the fact that the GDR has a special relationship with the Federal Republic of Germany, which certainly contributes to its impressive economic results. No

²⁶Hungarian experts on price statistics are convinced that Hungarian price indices are more accurate than those in most other socialist countries including the GDR and reflect the process of inflation better. If that is so, it will mean there is a bias in the comparison, to the disadvantage of Hungary insofar as we are concerned with real growth.

other socialist country enjoys similar backing, and this factor certainly explains part of the difference.

It is difficult to arrive at a numerical estimate for the correct difference between the growth rates of the GDR and Hungary. To present the choice problem in a sharper form, let us assume that there is a positive difference in the growth rates of production and consumption in the GDR's favour. The other side of the coin, however, is that individual liberties are substantially greater in Hungary than they are in the GDR. In spite of a rather high consumption per capita rate, individual economic freedom in the GDR is strongly restricted by various shortage phenomena.²⁷ There are no thorough comparative studies, but observers would agree, that the Hungarian consumer has more opportunities to choose from, mostly on account of the additional supply resulting from the informal private sector and on account of more generous consumer good imports. As for bureaucratic constraints on individual freedom, the difference in favour of Hungary is even more tangible. Comparing the two-dimensional performance vectors for each of the two countries (including a composite indicator of growth and material welfare in the first dimension, and a composite indicator of individual economic freedom in the second dimension), neither vector *dominates* the other. Put another way, we face a fundamental value judgement: a choice between greater individual liberty coupled with slower growth of production on the one hand, and greater material welfare coupled with restrictions on individual liberty on the other.

It clearly follows from the statement in the introduction that if under a given socio-political and institutional framework there would be a negative relationship, or a trade-off between the expansion of liberty and growth, then I would, with some qualifications, opt for the increase of liberty. That is to say, in case the only choice is between a well-managed, disciplined, tough, highly centralized GDR and a more liberal – and, yes, more anarchic – Hungary, I would prefer the Hungarian situation.

This evaluation does not imply a blanket approval of all that has happened in Hungary since the beginning of reform. But this is not the place to present my critical analysis, which might be found in my other studies. Here, my statement means only that despite all the mismanagement, the great tragedies, the thousands of mistakes, inconsistencies and repeated

²⁷See Bryson (1984) about GDR consumption. Collier (1986) presents an extremely interesting study about the effect of forced substitution. He raised the following question: 'What would be the most an average East German family would be willing to pay for the "bourgeois" right to attain its notional demand at existing prices? This sum as a percentage of original total expenditures is defined to be the gap between the effective and notional purchasing power of the GDR Mark' (p. 24). Based on careful econometric analysis, Collier's estimate for the gap is 13%. Since the actual number depends on the 'fineness' of accounting for forced substitution, a more disaggregated analysis would probably lead to an even larger gap. Translated into the conceptual framework of this paper: that is the surcharge the citizen would be willing to pay for the increase of individual freedom in consumer choice.

reverses, the Hungarian road comes closer to my system of ethical values than the GDR road does.

The second qualification is that the above choice is not based on a lexicographical ordering, which unconditionally places liberty above all other values. I do not regard liberty as a yes-no problem. I am not prepared to sacrifice liberty in general; some restrictions on some of its dimensions would be accepted if such a sacrifice were indispensable to a significant improvement in material wellbeing. But I would disapprove of giving up too much for too little, since I attribute a very high value to individual freedom. There is not, of course, any *a priori* quantitative criterion, of what is 'too much' or 'too little'. The ethical dilemma can, unfortunately, only be decided case by case.

Without intending to blur the sharp moral problem, one can go on to ask if such a sacrifice is really needed, at least in the present Hungarian situation. One can be sure that Hungary is not on the efficiency frontier concerning the achievement of primary goals like welfare, justice and freedom. There are many potential measures of a further reform which could improve efficiency and material wellbeing without being accompanied by any further restriction of individual liberty. In fact, there are many potential changes which could improve efficiency and material wellbeing precisely by increasing individual freedom, that is by abolishing restrictions on competition and entrepreneurship.

6. Values in public opinion

Commenting on the positive description of changes, I have talked explicitly about my own value judgement, but this has little importance. What really matters is the value judgement made by the Hungarian population.

A widely accepted stereotype put forward is that there are two, antagonistic attitudes: that is to say that the bureaucracy opposes the extension of individual liberty, but the rest of the people demand it. The real situation is not quite so simple.

A bureaucracy is not a homogenous, monolithic social group. Many members are ambivalent in this respect. Most of them do not want to surrender their personal power, but they do not mind seeing the power of other individuals eroding. As citizens, they enjoy many of the liberties recently acquired: more freedom to choose in the education of their children, to select their own doctor if they were ill, to travel, to obtain consumer goods with less difficulty, and so on. Moreover, it is worth keeping in mind that many members of the bureaucracy, some in quite high positions, have lost their blind faith in the prevailing institutions and have become more open to new ideas.

As for the Hungarians in the street, they form a still less homogenous

population. E. Hankiss and his colleagues at the Institute of Sociology of the Hungarian Academy of Sciences conducted a remarkable survey in which they asked a large sample of individuals about their values and lifestyle. One set of questions was identical to the questions put by researchers in the United States and other Western countries to a similar sample. The subjects were asked to rank a set of 18 primary values, and the findings, relevant from our point of view are summarized in table 4. Americans attach a much higher value to freedom than Hungarians. Among Americans freedom follows immediately after peace and family security. Hungarians regard the same two values of peace and family security as first and second, but then these values are followed by five other values before we encounter freedom.²⁸ Only 25% of Hungarians rank freedom among the first four values.

What can be the explanation for this striking difference in preference, for the relatively low value attached to freedom by the Hungarians?

Have Hungarians become accustomed to a situation in which others must decide for them and all that remains for them to do is to obey? There is the parable in Dostoyevsky's *Brothers Karamazov* about the Grand Inquisitor

Table 4
Ranking of primary values in Hungary and in the U.S.A.^a

| Primary value | U.S.A. 1968 | Hungary 1978 | Hungary 1982 |
|-----------------|-------------|---------------|---------------|
| Peace | 3.30 (1) | 2.54 (1) | 3.88 (1) |
| Family security | 3.81 (2) | 4.09 (2) | 5.30 (2) |
| Freedom | 5.53 (3) | 8.45 (9) | 8.80 (8) |
| Equity | 8.51 (7) | 9.53 (12) | 9.07 (10) |
| Salvation | 8.75 (8) | 17.70 (18) | 15.47 (18) |

^aThe evaluation is based on a representative random sample drawn nationally. For the sake of brevity we do not present the ranking of all of the 18 values, only of a few selected examples. In each entry the first number is the mean of the ranks given by the whole sample. The second number in parentheses is the rank in the ordering over the whole set of 18 primary values according to the average ranks given by the sample of individuals.

Sources: For the first column Rokeach (1979), for the second column Hankiss et al. (1982). The data for the third column were supplied directly by Hankiss and his collaborators.

²⁸As for the distribution of rankings, freedom's value is higher among the younger generation than among the older generation, higher among the self-employed people or entrepreneurs than among state employees.

who explains that people are scared of freedom and want to be directed by the supreme authority.²⁹ Paternalism gives a reassuring feeling of security and protection.

Or perhaps the well-known psychological effect of 'sour grapes' is at work: if one does not have enough liberty, for the sake of one's peace of mind, one adjusts one's aspirations to one's possibilities, and 'devaluates' freedom.³⁰

Or can it result from a bias in education, and in the mass media? For decades the value of liberty has not been placed in the foreground of moral education. Characteristically, the crucial argument in favour of a legitimization of the market, decentralization or other reform measures was efficiency – the prospect of greater material welfare for greater, more intensive labour. Liberty as a value per se has hardly even been mentioned in the argument.

Table 4 does not show a clear trend, over a time period of 5 years, in the value attributed to freedom. Perhaps the trend has changed since the last survey in 1982 and will change further in the future. Maybe this is indeed the case in which, to use economic terminology, supply creates its own demand, at least in the long term. Hungarians receive more individual freedom, they become more accustomed to it and – after a time lag – demand more and more of it.

The survey had raised the question in a rather abstract way, by asking for a hypothetical ranking of general, primary values. Most Hungarians probably rate specific, well-defined individual liberties highly, while not being aware of the fact that these are part and parcel of a more general primary good, namely, individual freedom.

This explanation is indirectly supported by another study; a public opinion poll which was conducted on a small sample of blue collar workers and students in 1987.³¹ This time no ranking of abstract ethical values was asked for, but a series of concrete, specific questions were raised to find out how much an individual is willing to pay for more freedom of choice. The answers show a rather high regard for this value. It turned out that about one-half of the respondents were willing to pay a significantly higher price for the following liberties: (1) choosing freely the primary school for the child, instead of the school assigned by the education bureaucracy, (2) choosing freely a doctor, instead of the doctor assigned by the health care bureaucracy and (3) choosing between a larger variety of TV programmes than the present two channels. The figures do not show large differences between the response of the two groups, except on the question concerning primary education. Here students attribute a significantly higher value to the freedom of choice, perhaps because they have a more immediate experience with the impact of the quality of primary education on later success in learning.

²⁹Dostoyevsky (1880, 1958, pp. 288–311).

³⁰On 'sour grapes', see J. Elster (1982).

³¹Source: K.I. Farkas and J. Pataki (1987).

Our earlier proposition, namely that Hungarians value well-defined individual liberties highly, can be supported by another approach. There is clearly no excess supply of liberties; all new opportunities are immediately exploited, demonstrating that there has been a concealed demand for the right of free choice. Following the pattern of the theory of revealed preference, one could speak about a 'revealed ethical system of values'. Neither the intellectual advocates of reform nor its pragmatic implementers say much about individual freedom, but the movement of the institutional system in the particular direction surveyed in section 4 *reveals* a relative shift of moral values in favour of individual freedom.³²

7. Toward a 'medium state'?

What are the prospects? Almost half a century ago, F. Hayek³³ suggested that centralization, or even slight cuts in individual freedom would place the society on a slippery downward slope to complete etatization. He did not say so directly, but the reader is inclined to draw the ultimate conclusion: that this is a one-way street. Once the society has arrived at a critical point of centralization, at whose existence Hayek has clearly hinted, there might be no return. Looking back today on his analysis, full of remarkable insights confirmed by later experience, 'the one-way street' aspect of it at least is seen to have been disproved. The road between anarchy and complete state control, or more precisely between the minimal and maximal state is clearly two-way, and a wide variety of movements can be observed: slow progress in one direction which stops at a certain point, alternating, back-and-forth movements that are almost cyclical, and so on. The 'maximal state', as has clearly been demonstrated in the reforming countries, is not irreversible or final.

Many students of the socialist economies, myself included, expect that probably a blend of state control and individual freedom will evolve somewhere midway between the maximal and the minimal state. We might call it the *medium state*.

One cannot associate with this concept any notions of 'optimality'. Let us start with some normative ideas. In discussions of the role of the state among political scientists, economists and philosophers, three functions are mentioned: (1) Active governmental macro-policy is needed for stabilization, full employment and balanced economic relations with the outside world. (2) Governmental activities are required to combat adverse externalities and

³²This observation does not imply that the shift in moral values has caused the institutional changes. This paper does not undertake a causal explanatory analysis of the changes in socialist countries. It only examines what values are *served* by the institutional changes. The approach leaves open the question of whether or not these values have really operated as motives.

³³F. Hayek (1944, 1976).

ensure the appropriate supply of public goods. (3) Governmental redistribution of income is called for on the grounds of social justice and in order to support the poor and weak. Let us use the term '*justifiable medium state*' for a state in which governmental activities are restricted to those which serve at least one of these three functions to a substantial extent. As a citizen I sympathize with the idea of establishing such a state, a fact which clearly follows from the system of values indicated earlier. I regard not only liberty, but also welfare (and along with it growth in physical output, efficiency and productivity) and social justice as fundamental values. Irrespective of these personal value judgements, I am fully aware that the normative idea of a '*justifiable medium state*' is highly controversial; the fulfillment of the three functions just mentioned may cause great damage to one or other of the primary values. I want to be cautious in choosing the right epithet: I am talking about the '*justifiable*' activities of the state and not suggesting that a state of that kind is patently justified. The epithet merely conveys the fact that one might put reasonable arguments in favour of such a state, and that these arguments cannot be rejected out of hand.

In any case, one should not expect the end result of the reform process in socialist countries to be a '*justifiable medium state*' or the realization of any well thought-out blueprint embodying the three reasonable functions mentioned earlier. It will certainly not be an embodiment of a rigorous normative theory but will be an arbitrary, ad hoc medium state, arising out of improvisations, myopic political struggles, pressures and counter-pressures, innovation and inertia, and compromises between a yearning for the expansion of liberty and a temptation for its restriction. On the one hand such a state will retain governmental activities not needed for the performance of the three justifiable functions. On the other, some of the three functions may remain partly or completely unperformed, just as they have been up to now. For example, the state may not be sufficiently active in pursuing a reasonable stabilization policy (Function 1), or in protecting the natural environment (Function 2) or in supporting the needy through its social policy (Function 3), and so on.

Can such an arbitrarily evolved medium state solidify itself, and can there emerge an equilibrium between conflicting pressures for and against more state control, for and against more individual liberty?³⁴

Powerful forces operate in socialist economies, which attempt to revert to the maximal state and to deprive the individual of free choice in many economic spheres. Many bureaucrats who have lost power want to regain it. Besides, there are also internal consistency requirements for administrative control. When a great deal, but not all, of economic activity is regulated in a bureaucratic manner, loopholes begin to appear. It is only natural that

³⁴On this 'reform equilibrium' see T. Bauer's papers (1987a, b).

efforts are made to close these loopholes with more central regulations, laws and orders. Finally, traditional ideology and ethics have an important influence, because they appear to legitimize trends towards re-etatization, calling for an end to a whole range of undesirables, including anarchy, selfish individualism, profiteering, unearned income based on property instead of work, and the immoral affluence of a few fortunate people while the rest of society cannot share anything like the same level of welfare.

Yet there are opposing trends towards the medium (or perhaps the less-than-medium) state. The present dividing line between the legal rights of the individual and the actions bureaucratically prohibited or discouraged, is not a 'natural border'. Pressure is applied not for 'freedom' in general, but for specific extensions of individual liberties in the various dimensions of life.

The forces that seek to enhance individual economic freedom are not homogeneous. They consist of different categories differentiated by their general political philosophies and visions of a good state. Among them are liberal-minded bureaucrats willing to relax the stringency of control, and enlightened planners able to perceive the limitations of the old-fashioned command-economy and preferring to concentrate on the determination of a few main variables and relationships, while seeking to keep these indicators tightly under control. Many reformers are enthusiastic about a Scandinavian style of welfare state, which they hope will be more just and more egalitarian than the present one. Then there are those who would like to go beyond a medium state, and closer to the minimal state, but are glad for the time being to see movement away from the maximal state, towards more individual freedom, however small that movement might be.

Here a brief digression is needed. Some Western observers view the Eastern European reformers as 'Thatcherites' in disguise. To explain what a gross misconception this is, let us use the scheme of fig. 1 again. In fig. 2 there are three arrows. *A* represents conservatives in the West, while *B* and *C* represent two groups of reformers in the East. What they have in common is that all their arrows point downwards, in other words they all want to roll back the activity of the state and increase individual freedom, a fact which explains why there is much in common in the argument and rhetoric they use. Nevertheless, the differences between the groups are extremely important. What is too much of state activity, and too little of freedom, for Group *A*, is a desirable level of state activity and an acceptable level of individual freedom for the mainstream of Eastern reformers. One finds more intellectual and ethical kinship between Groups *A* and *C*, that is between some of the Western conservatives and some of the Eastern 'extreme liberals' but perhaps even the people in Group *C* would have strong reservations about dismantling all the institutions created by the maximal and/or the medium state.

The dichotomy between Group *B* and *C* is a crude oversimplification. Even the previous, more qualified classification of the various currents

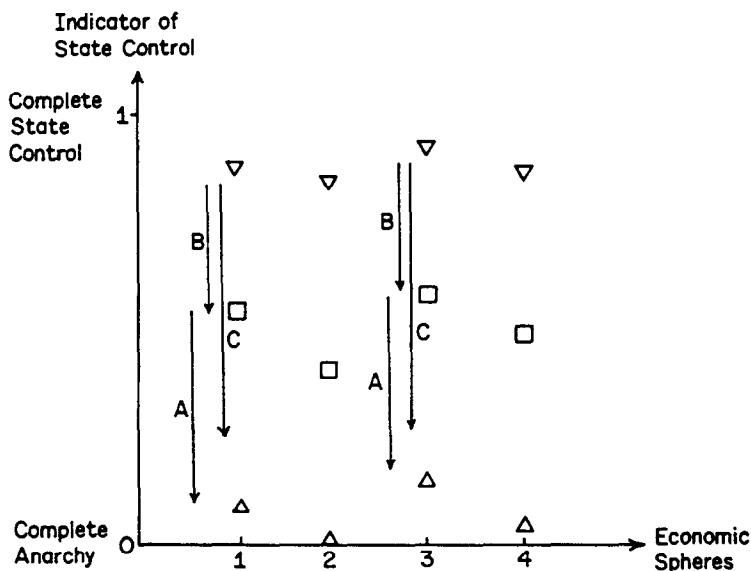


Fig. 2. Changes desired by Western conservatives and Eastern reformers. *Legend:* ▽ maximal state, □ medium state, △ minimal state. A: movements desired by Western conservatives, B: movements desired by Eastern 'mainstream' reformers, C: movements desired by Eastern extreme liberal reformers.

among reformers is somewhat simplistic. It would be better to say that the camp of reformers includes a range of widely differing views, commitments, latent programmes and perspectives. Once a medium state is firmly in place this coalition might very well fall apart. Some groups would then want to move upwards again in certain respects, and some other groups would wish to move downwards in other respects. Controversies could become quite sharp over the precise line to be drawn in the collation of state power with individual rights. The cement holding the 'coalition' together is precisely the ever acute danger of reversal; the fear that things may take a turn for the worse. Ultimately, this cohesion may contribute to a stabilization of a 'medium' state in which the opposing political and social forces, the ideologies and the systems of ethical values are delicately balanced.

The evolution of such a 'medium state equilibrium' and its endurance is not a firm prediction. It is only one of the avenues which history might take. Complete or partial movements back to the maximal state, granted in many dimensions of life, cannot be excluded from the forecasts.

The outcome of all these trends will depend, as always in history, on the actual constellation of relative strengths of the various groups, and on many other unpredictable factors. What is certain is that all those who take an active part in the events now face an extraordinary intellectual and moral challenge and must bear great responsibility for future generations.

References

- Antal, L., L. Bokros, I. Csillag, L. Lengyel and G. Matolcsy, 1987, Fordulat és reform (Turn and reform), *Közgazdasági Szemle* 34, 642–663.
- Bauer, T., 1987a, Reforming or perfecting the economic mechanism, *European Economic Review* 31, 132–138.
- Bauer, T., 1987b, A gazdasági mechanizmus továbbfejlesztése vagy reformja? (Reforming or perfecting the economic mechanism), *Közgazdasági Szemle* 34, 527–546.
- Berlin, I., 1969, Two concepts of liberty, in: I. Berlin, *Four essays on liberty* (Oxford University Press, Oxford) 118–172.
- Bibó, I., 1935, 1986, Kényszer, jog, szabadság (Coercion, law, freedom), in: *Válogatott tanulmányok (Selected Papers) Vol. 1* (Magvető, Budapest) 7–147.
- Bihari, M., 1986, Reform és demokrácia (Reform and democracy), *Társadalomkutatás*, 104–108.
- Bruszt, L., 1987, A több szólamu politikai rendszer felé (Toward the polyphonic political system), *Valóság* 30, 87–95.
- Bryson, P.J., 1984, The consumer under socialist planning, The East German case (Praeger, New York).
- Central Statistical Office, 1966, *Idegenforgalmi adattár 1958–1965* (Reference book of tourism 1958–1965) (CSO, Budapest).
- Central Statistical Office, 1971, *Statisztikai Évkönyv 1970* (Statistical Yearbook 1970) (CSO, Budapest).
- Central Statistical Office, 1975, *Statisztikai Évkönyv 1974* (Statistical Yearbook 1974) (CSO, Budapest).
- Central Statistical Office, 1986a, *Nemzetközi Statisztikai Évkönyv 1985* (International Statistical Yearbook 1985) (CSO, Budapest).
- Central Statistical Office, 1986b, *Statisztikai Évkönyv 1985* (Statistical Yearbook 1985) (CSO, Budapest).
- Collier, I.L., 1986, Effective purchasing power in a quantity constrained economy: An estimate for the German Democratic Republic, *Review of Economic Studies* 54, 24–32.
- Dostoyevsky, F., 1880, 1958. *The brothers Karamazov* (Penguin, Harmondsworth).
- Elster, J., 1982, Sour grapes – Utilization and the genesis of wants, in: A. Sen and B. Williams, eds., *Utilitarianism and beyond* (Cambridge University Press, Cambridge) 219–238.
- Farkas, K.I. and J. Pataki, 1987, *Feljegyzés az 1980–86. évi gazdasági közvéleménykutatásokról* (Memorandum on economic public opinion researches in 1980–86). Unpublished manuscript (Mass Communication Research Center, Budapest).
- Fehér, A., Heller, A. and Márkus, G., 1983, *Dictatorship over needs* (Blackwell, Oxford).
- Fricz, T., 1987, Az individualizáció esélyei (Chances of individualism), *Valóság* 30, 77–86.
- Gábor, R.I. and T.D. Horváth, 1987, Bukás és visszavonulás a magánkisiparban (Failure and retreat in the private small-scale industry), *Közgazdasági Szemle* 34, 404–419.
- Gombár, C., 1984, *Egy állampolgár gondolatai* (A citizen's thoughts), (Kossuth, Budapest).
- Gordon, S., 1980, *Welfare, justice and freedom* (Columbia University Press, New York).
- Hankiss, E., 1986, The black box: Interaction and conflict of social paradigm in contemporary societies, Mimeo. (Institute of Sociology, Budapest).
- Hankiss, E., R. Manchin, L. Füstös and A. Szakolczai, 1982, *Kényszerpalyán? A magyar társadalom értékrendszerének alakulása 1930 és 1980 között* (Are we on a forced path? The value system of the Hungarian society between 1930 and 1980), (Institute of Sociology, Budapest).
- Hayek, F.A., 1944, 1976, *The road to serfdom* (University of Chicago Press, Chicago, IL).
- Horvat, B., 1982, *The political economy of socialism* (Sharpe, Armonk, NY).
- Juhász, P., 1982, Agrárpiaç, kisüzem, nagyüzem (Agrarian market, small-scale enterprise, large-scale enterprise), *Medvetánc* 2, 117–139.
- Kiss, J., 1986, *Vannak-e emberi jogaink?* (Do we have human rights?), (Független Kiadó, Budapest).
- Kolm, S.-C., 1987, *Liberty-based public economics: its foundations, principle, method, application and structural results*, Mimeo. (CERAS, Paris).
- Kornai, J., 1980, *Economics of shortage* (North-Holland, Amsterdam).

- Kornai, J., 1986, The Hungarian reform process: Visions, hopes and reality, *Journal of Economic Literature* 24, 1687–1737.
- Lindbeck, A., 1988, Individual freedom and welfare state policy, *European Economic Review* 32, 295.
- Locke, J., 1690, 1967, *Two treatises of government* (Cambridge University Press, New York).
- MacCallum, G.G., 1967, Negative and positive freedom, *Philosophical Review*, 76.
- Madách, I., 1861, 1953, *The tragedy of man* (Pannonia, Sidney).
- Nozick, R., 1974, *Anarchy, state and utopia* (Basic Books, New York).
- Oppenheim, F.E., 1961, *Dimensions of freedom* (St. Martins Press, New York; Macmillan, London).
- Rawls, J., 1971, *A theory of justice* (Harvard University Press, Cambridge, MA).
- Rokeach, M., 1979, *Understanding of human values* (Free Press, New York).
- Sen, A., 1985, Well-being, agency and freedom: The Dewey Lectures 1984, *Journal of Philosophy* 82, 169–221.
- Sen, A., 1988, Freedom of choice: Concept and content, *European Economic Review*, this issue.
- Sen, A. and Williams, B., 1982, Introduction: Utilitarianism and beyond, in: A. Sen and B. Williams, eds., *Utilitarianism and beyond* (Cambridge University Press, Cambridge) 1–22.
- Szelényi, I. and R. Manchin, 1987, *Interrupted embourgeoisement*, Mimeo. (Graduate School, City University of New York, New York).
- United Nations, 1968, *Yearbook of National Accounts Statistics 1967* (UN, New York).
- United Nations, 1977, *Yearbook of National Accounts Statistics 1975* (UN, New York).
- United Nations, 1982, *Yearbook of National Accounts Statistics 1980* (UN, New York).
- United Nations, 1983, *Yearbook of National Accounts Statistics 1982* (UN, New York).
- Wiles, P., 1956, Growth versus choice, *Economic Journal* 66, 244–255.