

## EQUILIBRIUM, GROWTH AND REFORM

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In 2001 the Hungarian economy departed from the path of balanced growth. During the past six years the state budget deficit has grown to an unsustainable level, and also the deficit in the current accounts has become too high. Real wages have increased considerably faster than labour productivity. These difficulties and other macroeconomic troubles led the Hungarian Government to the introduction of an adjustment program in July 2006. The first part of the article analyses the current macroeconomic situation and the expected economic and social effects of the adjustment program. The commitment and determination of the government is shown by the fact that they are ready to accept the political “price” of the program, i.e. that the unavoidable measures will probably reduce the popularity of the election winning political powers.

The second part of the article discusses the relationships concerning measures requiring immediate execution and reforms aimed at long-lasting effects and in-depth institutional changes. These are indispensable to the sustainability of the effects of the adjustment. In connection with this, the paper reflects on the relationship between the budget deficit and the size of the state, on the proportions of state- and self-support, as well as on the speed and the gradual implementation of the reforms.

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### THE ADJUSTMENT PROGRAM<sup>1</sup>

In April 1995, shortly after the announcement of the so-called “Bokros-package”, I was interviewed by Duna Television. The reporter put the following question. “In general, how did you react to the policy-package?” I answered – “Look, I could make critical remarks, I can see shortcomings ... However, these are secondary. I would like to make it clear, and this is the most important thing, that I agree with the basic tenets of the recently announced government program; I find them necessary, appropriate and unavoidable. I must add right away that these measures will also come with a great deal of hardship and distress, causing suffering for many. I am completely aware of this, and I feel great empathy towards those who find themselves in these difficult circumstances. I do not regard the government program as some kind of good news, but rather as the beginning of an essential course of therapy, the carrying out of which is necessary for the good of the country.”

Now, 11 years later, I could repeat word for word what I said at that time. It is saddening that the same generation must experience for the second time an adjustment program accompanied by trauma and affliction. However, I can state again that I agree with the basic tenets of the program, and – for the good of the country – I consider their realisation necessary.

I am an independent researcher. I do not speak on behalf of the government or the coalition parties, instead I merely state, from my own point of view, how I read the program, what I believe led the government to develop the program and to initiate its implementation, what kind of effects are to be expected, and what type of problems will arise.

#### Macroeconomic relationships

Hungarian economic growth, after leaving the balanced path, returned to it following the stabilisation and adjustment program path launched in 1995. For some years, we successfully proceeded along the path of sustainable growth, but from 2000 onwards, we left it again. Even though in 2004 and 2005 there was a

<sup>1</sup> The English version of a two-piece article written for a wide readership and published in the Hungarian daily newspaper *Népszabadság* on 28 and 29 June 2006. This version corresponds to the published Hungarian text except for minor changes. A few explanatory footnotes have been added mainly in order to assist non-Hungarian readers. The author is grateful to László Tóth for the excellent translation and to Christopher Ryan for his superb help in editing the text.

small-scale correction, until the introduction of the new program growth was still taking place under gravely unbalanced conditions.

What do I mean by saying that we left the path of balanced growth? I shall begin my explanation reviewing two relationships. I must ask the reader to wade patiently through these dry – and seemingly quite abstract – sentences. In the light of these, perhaps the later argumentation will become clearer.

According to the first relationship, all new value produced in any given year, the GDP, is equal to the sum of consumption and investment minus the net resources flowing in from abroad, or plus the net resources flowing out to abroad. (The word “net” refers to the fact that we have to take into consideration the balance of imported and exported resources.) The sum of consumption and investment is the “aggregate demand”.

This is a type of relationship which in the language of mathematics is called “identity”. Thus, it is not some kind of good advice to the government, meaning “you would do well to abide by this rule”. The rule is bound to prevail, whether the government or anybody else wishes it to prevail or not. For instance, if for whatever reason the sum of the foreign net resources were equal to exactly zero, then we could only consume and invest as much as we produce. Aggregate supply (production) would set the limits of aggregate demand (consumption and investment), and aggregate demand would set the limits of aggregate supply.

There is another macroeconomic “identity-like” relationship. This one states that investment in a given year is equal to domestic saving in the same year, plus (minus) financing of foreign origin. Domestic saving is generated by the three big sectors of income owners: all households and all firms in the economy, and the government. The saving of all big sectors of income owners can be positive (this happens if not all their income is spent) or negative (if more than their income is spent, i.e. if they run a deficit). The basic relationship is bound to be fulfilled, even if part of the income owners (for instance the government) runs a deficit. In this case, the other income owners’ positive savings and/or foreign financing (the growth of debt) will balance it.

If the patient reader willing to learn a little macroeconomics has reached this point, then he or she can now better understand what we mean by *balanced* growth. The country’s growth is on a balanced path, if – now looking at its dynamics – the above relationships materialise according to the following characteristics:

- Production grows at a healthy rate.
- Aggregate demand averaged across several years does not grow faster than production. This – in the light of the previously discussed basic relationship – also means that even if foreign resources are drawn in, these will not grow faster than production.

- Within aggregate demand, consumption averaged across several years does not grow faster than investment. Rather, investment grows somewhat faster, allowing for a healthier rate of growth.
- Domestic saving does not lag behind the growth of investment. In other words, the proportion of foreign financing will not grow; the country will not fall into a state of accelerating indebtedness.

These relationships are not identities; their materialisation is not automatic. They are proven “rules of thumb”, which it is advisable to comply with, but which it is possible to violate. This is exactly what has happened in Hungary since 2000.

Aggregate demand has grown faster than production. Consumption per capita has grown faster than production per capita. Real wages have grown considerably faster than labour productivity. In the saving equation, the negative saving (state budget deficit) of the government has continually increased, and unfortunately, this has coincided with a dramatic rate of decline in the net savings of the household sector, with the steep run up of home, car and consumer loans etc... (The business sector is usually a net debtor, because that is the only way it can finance its projects, thus this does not have a negative influence on the final picture.) The inevitable consequence of this is that foreign financing has grown sharply, which has been primarily expressed by the growth of the deficit in the balance of payments on current accounts.

*The essential goal of the adjustment program of 2006 is to steer the Hungarian economy back towards the balanced path.* In order to accomplish this, it is necessary for economic policy to try to change the trends which lead in wrong directions. The program states that it intends to accomplish the following changes:

- It will stop the dangerous growth of the government’s budget deficit, and it will put in motion the opposite tendency, favouring the reduction of the deficit.
- It will slow down the disproportionately fast growth of household consumption. The much faster growth of average real wages compared to the performance of the economy, which has continued since 2000, will be replaced by a considerable, painfully felt temporary decline in real wages. For a certain period, real incomes will remain stationary, somewhere around the previous level or somewhat below it.
- Because of the influence of the changes described above, demand for foreign financing will decline (proportionately, as a percentage of production).

After careful consideration of the state of the Hungarian economy I am convinced that the adjustment program is pointing in the *right direction* in terms of macroeconomics. My impression is that most macroeconomists who are able to

recognise the problems and are capable of objective consideration share my stance, and those who do not see it the same way right now, will come to the same conclusions sooner or later.

Personally, I consider this – the *direction* of the correction – to be the key issue. However, this still leaves open a great many other problems, which I would like to examine in the following sections.

### **The magnitude of the correction**

Let us try to reflect on the prospective aggregate macroeconomic consequences of the changes in the making. According to the Finance Minister, the government deficit will decline by 350 billion forints in 2006 and by 1000 billion forints in 2007 – in comparison to the deficit that would occur if the government did not initiate and did not carry through the adjustment program. The size of the program can be demonstrated if we compare it to the volume of production. The volume of the 2006 state budget correction is about 3.5% of the expected second half of the annual volume of the GDP. The volume of the 2007 adjustment is 4–4.5% of the expected GDP for the next year. There have been many stabilisation-adjustment programs executed in various countries of the world. Those who are familiar with them can attest that though this Hungarian version is not among the most drastic ones, it is still quite extensive and radical. Some domestic and foreign experts do not emphasise this adequately. Personally, I consider it important. The extent of the adjustment package, its aggregate volume, is the most important signal of the seriousness and resoluteness of the government's intention to set matters right, and this deserves adequate attention.

The adjustment program does not only contain specific, one-off actions (these prices or those tax rates will rise, such-and-such an organisation will be shut down); on the contrary it will initiate numerous rapidly or slowly developing macroeconomic processes. For instance, if some of the people employed by the state are laid off, and the salaries of other state employees are frozen, then this will affect wages in the business sector as well. This will then generate further effects; for instance, the income growth of households will slow down. This, in turn, also has an impact. It will influence total consumption and saving in the household sector, which will then affect production and so on. The primary consequences of the program will therefore have secondary and tertiary spillover effects. It is difficult to predict them: perhaps after a month or two we will sense them better, and after 12–18 months we will have a relatively clear picture.

There is much uncertainty involved in these types of forecast. To mention but one example – saving in the household sector. The standard reaction might be the

following: if income decreases, but the household wishes to maintain the level of its consumption, then it will reduce its financial savings. Surely, this will happen in many households. However, others might think differently. “Uncertainty has grown. Who knows what the future holds? Suppose I get laid off? It will be better if I save more. It will be better, say, to put off replacing my car, or buying a new home – I daren’t take out a loan.” This reaction, on the contrary, increases savings. No one can tell today which type of reaction will be more common or stronger. The magnitude of the problem is well illustrated by the fact that in 1998 household savings were more than 9% in terms of the GDP, but this figure fell to 0–1% in 2003–2004. The difference between the highest and the lowest points is roughly equal to the state budget deficit! I remind the reader of my earlier statement: that the savings of the household and business sectors, as well as those of the government (positive or negative) together determine how large the demand for foreign financing in the economy will be. Therefore, a great deal depends on the savings of households – and this is something that we cannot predict with certainty.

I only wanted to shed light on the difficulty of providing quantitative estimates for the expected macroeconomic effects of the adjustment program. Politicians and economic analysts who find the correction too extensive, and indeed those who do not find it extensive enough, should think twice before making any statements. Can any of them be certain of correctly sizing up the expected effects, in cases such as these where substantial errors are easily made? This is also a warning to all those who believe that the government and the majority in parliament only need to *want* something and work hard enough on its implementation, to be sure that it will materialise. There are things that are in fact in the hands of political decision makers. These can be *initiated* through a decree, a regulation, or a prohibition. However, the outcome will depend on many influencing factors, such as the indirect domestic effects, as well as independent events in world politics and the international economy. All of us, the politicians on the side of the government and in opposition, as well as the experts, commenting and easily offering advice in the light of the events, should think with due modesty of the limits of our knowledge and will.

The adjustment program consists of a large number of specific provisions. I will not attempt to judge whether the composition of the elements of the package is optimal or not. I observe with a shake of the head the bravery of those who do this – no doubt I would be more careful. I recognise some of the principles which underlie the combination of these elements. I would mention only a few of these, without intending to provide an exhaustive list. The elements to be included in the package should be sufficiently tangible, and because of this, clearly attainable. Besides, nothing should be included unless it is politically acceptable, albeit with grinding of the teeth, at least to the supporters of the government. The package

should not be loaded with too many measures that would arouse strong resistance. Not only politicians, but also researchers into the relationships between politics and the economy are well aware of how powerfully such considerations influence actual economic policy. I personally see nothing reprehensible in the fact that these considerations play an important role in the selection of the content of the adjustment package.

### **Revenue side, expenditure side**

When discussing the collection of measures intended to reduce the budgetary deficit the following criticism has repeatedly been made: The weight of the changes which will increase government revenues is too great in comparison with those that will reduce government expenditures. The latter should occupy a far more prominent place, because they are the ones that will assure long-term stability.

In my view, this is only a half-truth. Whatever prestigious literature might inspire this criticism, and whichever stereotype sourced from an international organisation is being reiterated by the critics – it will remain a half-truth.

We can approach the problem from the *time sequence* perspective. I am one of those who would be glad to see the total tax burden on society decline in relation to total output and to total income. On this point, I will expand in the second part of the present paper. However, I find it completely wrong to begin everything by reducing the revenues of the state, and to expect a subsequent decline in expenditure *as a result*. The production-stimulating effects of tax cuts will emerge only after some delay, and nobody can predict how extensive they will be. However, revenues will decline immediately, and this, with all certainty, will raise the budget deficit. Ronald Reagan chose this absurd sequence in the US – at the suggestion of incompetent advisors – and so did the incumbent president George W. Bush. The latter stuck with the tax cuts, while the war in Iraq led to higher expenditure and further strain on the budget. In both periods, the budgetary deficit grew tremendously. Coming back to the Hungarian case, policy-makers should not have listened to equally bad advice, to the unconditional proposals to slash taxes, each overbidding the last which characterised the run-up to the recent general elections. I approve of their current retraction from the premature tax cuts and I hope this embarrassing adjustment will at least ensure that such mistakes are never made again. Let us start by putting the balance of the budget in order. When we have reached a reassuring situation, then the proper sequence is as follows. First expenditure should fall. When this achievement is firmly in our hands, and only then, can we (and should we) cut taxes.

Let us turn to another aspect of the problem, to the *permanency* of the regulations which are intended to reduce the budgetary deficit. If two authorities or other state institutions are merged, and as a result money is saved, it is a fine thing – but who can guarantee that it will last? I have already lived through so many ministerial consolidations, reorganisations, and then separations, that I am incapable of being excited about them. Today people are laid off; tomorrow others are hired again. Here, therefore, we can reduce expenditures but we still cannot be certain that the effect will be permanent.

Alternatively, consider a situation with the opposite characteristics. Let us suppose that new legislation introduces a property tax, and that this tax will become a prime source of revenue for local governments. The tax system will be reorganised in such a way that local governments will have a strong stake in collecting the property tax. The apparatus for the collection of the new tax evolves, and a routine for its operations develops. After a while, the public grows accustomed to paying property tax; and this will become the natural order of life. Here, therefore, we have established a new source of revenue – however, the sustainability of this revenue is ensured by strong guarantees built into the institutions and the behavioural norms of society.

Thus, the deciding factor in this context is not whether the change occurs on the revenue or on the expenditure side, but how hard or easy it is to reverse. How far will the change build itself into the legal system, to what degree will its execution be coerced, and how deeply can it take root in people's mentality? In this regard, the composition of the adjustment package shows a mixed picture. There are quite a few items in it which can be reversed rather easily on both the revenue and the expenditure sides. This calls for caution. Those measures that were intended to be temporary from their inception should in fact be terminated as soon as they are no longer necessary. However, those that are to be maintained should be institutionalised ever more deeply and strongly; they must be "cemented" into the legal system and into people's minds.

### **The distribution of suffering**

I have already emphasised in the introductory sentences of my paper that the adjustment program will cause pain, material loss and growing uncertainty to many people. Fate will not bestow equal suffering on all. What can we expect in this regard? Just as with the distribution of income or wealth, we must also examine this distributional problem in many dimensions.

Here, above all, we are talking about the *distribution* of pleasure and sacrifice, costs and benefits *between generations*. When consumption "took off", contem-

porary generations enjoyed the accelerated growth of their standards of living. A few years have passed since then. The austerities now burden the generations of some years later. If we do not complete this arduous correction, the situation will be even worse tomorrow. Already, the rate at which debt increases has started to accelerate. The deterioration of the country's creditworthiness and trustworthiness concerning repayment is tangibly shown by the increase in interest payments on outstanding loans. The further the country slides into debt, and the more it is threatened by financial crisis, the higher the yields must be in order to attract investors and to persuade them to finance our budget deficit. The interest burden weighs heavier on the state budget, and this also increases the deficit, so financial investment in Hungary is becoming even less attractive. One unfavourable phenomenon strengthens the other, and a debt spiral develops. The debt, growing ever faster, is inherited by future generations. The adjustment, among other things, is also necessitated by the demand for an equitable distribution of pleasure and suffering among the generations.

Let us consider the present, the distribution of the burdens borne by today's population. It would be irresponsible to promise that the adjustment program assures the equitable distribution of burdens. To achieve this, we would need not only a just state, but also an omniscient and omnipotent one. Such a state does not exist. We can be sure in advance that the distribution of suffering will be riddled with painful injustice. I would already feel reassured if the governing powers of the country would admit this – that is to say the limits of their own influence – and would also add that they are doing everything in their power to *alleviate injustices*. Now, I will highlight three elements, three characteristic parts of the adjustment program, in order to demonstrate how the intention to alleviate injustice can be felt:

- In my judgement, to artificially slow down the rise in energy prices was not simply detrimental economically; it was not even fair. The well-off household, which heats a large residence where the lights are switched on in many rooms and several kinds of electric appliances provide the owners with comfort and entertainment, receives a significantly larger amount of subsidy than the poor family living in a cramped home, utilising only a few electric appliances. That poor household, which uses only a small amount of energy, subsidises the rich by many thousands of forints via the channels of the state budget. All measures in the program that reduce the financial subsidies for any product or service will make the distribution of burdens more just. If possible, all costs should be paid by those who consume the given product or service. Those in need should be helped not by the artificial reduction of prices, but by targeted subsidies. The best instrument for this is financial support, because it respects their sover-

eignty as consumers. The instruments of targeted price compensation should be resorted to, at best, only as auxiliary mechanisms.

- In the composition of the adjustment package, the intention is clearly to focus on taxes with the widest possible basis. Everyone consumes, therefore everyone who is purchasing legally pays VAT. Taxes are levied not only on wage earnings and revenues from enterprise profits, but also on capital gains. Various special taxes are calibrated so as to affect certain targeted groups. The ensemble of all these changes does not constitute a consistent tax reform: some of them seem to be somewhat improvised, occasional and temporary regulations – but at least the honourable aspiration, according to which everyone should bear their share of the burdens, is perceptible.
- The main method of wriggling out of shared sacrifices is the crafty exploitation of legal loopholes: tax evasion, if possible without openly breaking the rules. Under the scope of the correction, the government is trying to confront free-ride behaviour. The closing of the back door of “enterprise-by-necessity”<sup>2</sup> can be listed among these attempts: preventing people from dodging of tax and social insurance payments by camouflaging employment through contracts with outside enterprises. The taxing of the “cash reserve”<sup>3</sup> can be also classified in this category, since many try to hide here the revenue that they have already taken out of the enterprise. Property tax indirectly places a tax burden on special actors in the economy who report relatively low incomes on their tax returns, which are often no more than the minimum wage, while they live in expensive luxury villas. The general and unconditional tax exemption of the minimum wage has unavoidably tempted wily people to gain eligibility to the free services provided by the state, whilst wriggling out of the obligation of paying taxes. All the aforementioned measures (and further elements of the program that could also be added here) have drawbacks. Maybe the measures should be made more effective and equitable. Here, I primarily want to stand up for the *intent*, and I wish to encourage the lawmakers not to yield to those who go on raising objections, and – instead of making constructive proposals – try to discredit the intention itself.

<sup>2</sup> “Enterprise-by-necessity” is the term used in Hungarian economic jargon for individuals who are in fact employees but render their services in the legal framework of an “enterprise” in order to achieve a tax position more favourable to both the employer and the employee.

<sup>3</sup> Again a term used in Hungarian business jargon for a well-known trick. There was a special tax shelter, which will become taxable from now on.

### Credibility and determination

One of the requirements to the success of this tremendously unsettling adjustment program is the *credibility* of those introducing and leading the implementation. The program is essentially a promise, and its realisation partly depends on whether those who play a role in the upcoming events believe in this promise or not. I have used an oft-repeated cliché once again; however, this does not alter the fact that it reflects a very significant and long-established truth.

Concerning credibility, we must discuss two “target groups”. In the business world, one group is usually called “the markets”. This is an ambiguous label, since we are not talking about the markets that take place in the market-hall, or about the markets for automobiles or CD-players, but about a much narrower slice of the economy. Let us first look at the demand side. The Hungarian government primarily obtains external financing by selling bonds, it can also directly contract for loans. In addition, the business sector also needs financial loans, and even the household sector needs them (for instance, for buying and building homes). On the supply side, among the creditors we mainly find banks, together with big insurance companies and pension funds which want their accumulated capital to yield returns. We also find other financial investors who want to invest their clients’ money remuneratively. The investment organisations employ well-trained experts who must carefully analyse the investment opportunities. This is quite a difficult profession, because one must simultaneously consider the yields and the risks of each investment. Will there be any problems with the repayment of the loan? This is where the issue of credibility arises. If a country is financially unstable, then the threat of crisis exists, and the risks of investment grow. An army of experts entrusted by investors watch carefully how the “country risk” is shaping. If there are problems, will they begin fixing the errors? If they promise adjustments, will they stick to their intentions? Is their promise credible?

Those who are puzzled by national finances (and especially those, who loathe and are averse to banks, stock markets, stocks and speculation) will shrug their shoulders and ask why it is so important to preen ourselves in front of the financiers. However, here we are not talking about an emotional relationship. We live in a small country that is open to the world economy. To us Hungarians it was Széchenyi, the great reformer of the 19th century, dubbed “the Greatest Hungarian” by his contemporaries, who first explained the importance of *credit*. It is the common interest of all citizens to obtain loans under improving conditions. Therefore, it is an important public matter that the experts of the international financial community, the foreign and domestic investors, i.e. the “markets”, should receive favourable impressions of the adjustment program now commencing in Hungary. The first reactions were not favourable, owing to several factors. Many have al-

ready analysed the problem. Certainly, even the first response matters, but at this point, it would be too early to discuss what the *lasting* reaction of the markets will be. Judgement will be based on actions and not on the evidence of the first words. Will the announced measures materialise? Will the initially declared consistent firmness soften up as we go along? Is the government only determined now, or will they also remain so later? What will the 2007 budget look like? How will the government react to those secondary and tertiary effects, including some that may well be unfavourable, but which could not be predicted? Will they retreat? Or, will they continue forward on the road they have taken? We are not talking about a two or three hour examination here. This special test will last for months or years. The really far-sighted analysts are aware of this, and they will be ready to revise their initial and improvised reactions, if their observations prove to be promising and reassuring. Already, addressing my fellow countrymen, I have been able to make the point that those who are discrediting the program with their sulking, their nit-picking, their scaremongering or their excessive demands, are doing a great disservice to the country.

The reaction of the “markets” – in this context – means the stances and the continuous decisions of a few hundred or thousand financial experts. The signals come on a different wavelength from the millions of Hungarian citizens. They also talk and think about the program, and pass judgement on whether those who worked out and lead the implementation of the program of correction are to be trusted.

We are talking about an extremely complex problem. How has the program been communicated to the Hungarian population and to the international financial community? What was revealed before and after the elections about the country’s problems, about the tasks facing us? There has been much discussion of this in the press, as well as on television. In my article – even though I am aware of how important the method of disclosure is – I do not propose to discuss the questions regarding communication. I can only repeat what I said earlier, when discussing the reaction of the “market”: actions are more important than words. Temporarily, speech (as well as silence) can have a great effect, by harmfully influencing the climate of public opinion and by inflaming people’s passions. Sooner or later, however, the much stronger influence of experience will break through.

In the published text of the government program, Prime Minister Ferenc Gyurcsány writes the following in the introduction which he has signed. “In the past five-six years we imposed increasingly heavy, less bearable burdens on the state. The justifiable social and modernisation objectives have not gone hand in hand with the responsible behaviour that should have characterised the government’s fiscal policy. Irrespective of the fact that the departure from the balanced

path of sustainable growth had begun in 2000–2001,<sup>4</sup> there is no doubt that the greater responsibility lies with the government of 2002–2006.”

No Hungarian prime minister has ever gone so far in proclaiming self-criticism for the mistakes in economic policy of the past period.

Serious dilemmas have weighed heavily on the prime minister and his colleagues recently, especially in the election year. They must have known about the economic state of the country and about the impending dangers. Should they have launched the adjustment right away, with all the upheaval that it was bound to cause? Or, should they have postponed it, but announced in advance what they intended to do after the elections? Repeated promises were made, saying that in economic policy, in the shaping of the budgetary revenues and expenditures, there would be no “election year”. Only half of this pledge was kept. This after all leads to the inescapable question of what was more important from the perspective of the *country's interest*. Should the incumbent government stay at the helm, and not hand over power to an opposition that is advocating irresponsible policies – so that the economy could recover as fast as possible, and the country's citizens could receive more extensive and more honest information about the difficulties? Could a more fortunate compromise have been found among the three – then conflicting – objectives, between achieving political victory, overhauling the economy and observing the requirements of honest communication? It is easy to say afterwards that these or those measures, which now must be withdrawn, were completely unnecessary populist actions, because the election could have been won anyway, without these measures. It is easy to be wise after the event. It is not possible to determine, by an *ex post* analysis, the extent of the risk perceived subjectively *ex ante*. Beforehand, decision-makers could have thought that victory in the elections might depend precisely on those decimal percentages that are the result of the popular “electoral” fiscal policy.

I am a researcher, whose professional obligation is to feel in his mind and to express in his writing the uncertainties involved in his statements, and who is inclined to revise his conclusions time and time again, often in a self-torturing manner. This is not a flaw, but rather a virtue in my profession. Among other things, this is the reason why I have held myself aloof from being a professional politician, because I have an inclination to this kind of approach. I do not wish to apply to the political decision makers the same type of benchmark as is set for researchers. I am aware of the serious problems with the evaluation of the previous period, and I have already formulated certain *questions* above that will remain unan-

<sup>4</sup> The parliamentary cycle ended in mid-2002. Before that date, the parties presently in opposition were in power, and following that date the present ruling coalition took over the government.

swered in this paper. I do not feel the impulse to play the judge on ethical matters, forming an opinion on the difficult political and moral dilemmas of political and economic expediency or on the answers given to them.

Not as judges, but as observers we can see that, at this point, not only his opponents but also neutral and objective analysts, and even his enthusiastic supporters, will take the undertaking of commitments by Ferenc Gyurcsány and his government with stronger reservations than before. Naturally, the government's credibility will depend on their "communication" abilities, and could strengthen in case of the appearance of a better explanation of their plans, this, however, is only a secondary question. The really important issue is what will happen in practice. The *resoluteness* of the prime minister and his team of colleagues is already manifest. It took considerable political courage for them to announce an unpopular program only months before the local government elections. It will take courage to proceed with a program that demands sacrifices from all strata and groups of society, thus evoking indignant, angry, disappointed and hostile reactions everywhere. Sooner or later, of course, more and more will begin to understand that the *political price* which the political leadership is willing to pay now, by the introduction of the adjustment program, is in fact an important measure of how committed they are to the execution of the program.

The commitment to adjustment does not mean that every letter set down in these days must be insisted upon. There is a need for flexibility, as success sometimes also demands compromises. It would be wise to avoid stating, for instance, that the currently announced package is now enough for the correction, and that there will certainly be no need for more. What if the need emerges for further painful measures? What if the initial calculations prove to be erroneous? What if external conditions deteriorate? Reassurances that might contain untenable promises should not be launched again. The country's population, the financial community and – in the end – history will not measure commitment according to whether all the 50 or 100 provisions, determined at the beginning of the program, were in fact introduced or not. Full and powerful credibility can only be achieved by the *outcome*. If, and only if, the government is proven to be committed, the country will return to the balanced path and proceed along it. As we get closer to this, with the passing of months or perhaps even one or two years, trust will increase.

### ON THE TRANSFORMATION OF SOCIETY

In this section I would like to contribute to the development of an "agenda" for the discourse regarding the reform. What should we discuss? What are the essential topics?

It is not my aim to propagate my own suggestions; nor does the limited amount of space in this journal allow for systematic explanation and reasoning. However, I do not want to avoid taking a stance, and because of this, I will shortly indicate my opinion about the issues under debate.

### **The mystical healing power of reform**

In the commentaries on the government's adjustment program, one often finds references to reform. Those who principally agree with the correction, benignly remark: "This is only the beginning of a process that will really be completed by the reform." Those wishing to criticise the program sharply will use the same expression in the opposite way. "What is presented to us now is not worth much. We need real reform: only that can solve the problems."

Whatever the intended direction of the remark, the allusions are rather mysterious. The typical conversation that occurs between the television reporter and the expert being interviewed gives the impression that they both know exactly what should be reformed and how. For instance, obviously there is a need for "the reform of the large distributive systems". If this reform were to be implemented, everything would be solved; among other things, the balance of the budget would be restored. The only trouble is that the politicians keep putting the reform off: they are scared of it, they are not willing to embark on it. "What's going on, why don't you get started?" – echoes the question aimed at the politicians.

This caricature-like description would not only be typical of more or less superficial conversations. Well-trained economists and economic policy makers also converse in a similar language. Moreover, even prestigious international organisations express the same point of view in the form of criticism, advice, and time and again in the form of categorical expectations. Some of our domestic experts parrot opinions heard in the financial organisations of Washington or in some office or other in Brussels.

I have the impression that I am swimming against a strong current when I risk the following statement: Every part of the aforementioned train of thought is erroneous.

What is this "reform" which is being talked about as if it were some kind of unequivocally and clearly defined postulate? There is no consensus, either in our country or world-wide, about what directions the changes should take in the current situation. While, for instance in Budapest the liberal minded consider the decentralisation of the financing of the healthcare system as the cornerstone of the reform, in the US certain liberal economists are urging a reform in exactly the opposite direction: the establishment of a national healthcare service. The reformers

themselves disagree with each other about the necessary directions of changes, and the difference stems primarily from the ideology and political philosophy they follow. In addition, different visions of reform are suggested by people who want to protect the interests of different social groups or classes. Maybe some fresh intellectual experience influences the reformer; he or she has a pet idea – for some it is the health care account that appears as the panacea for all our problems, for others it is deferred tuition fees in higher education.

One of the main reasons for anxiety and delay is the ambiguity surrounding the direction of change. When two authorities meet, they agree that yes indeed, the reform is required! However, we cannot be sure that they mean the same thing by “reform”.

If radical changes take place, it is by no means certain that they will contribute to the treatment of the current macroeconomic troubles; among other things, to the solution of our budgetary problems. Maybe they would, maybe not. There could be a reform, for instance in the pension or in the education systems, which would temporarily or permanently demand not less but more state resources.

One of the points on the agenda of the reform debate should be precisely the question of whether we should place the reform plans primarily at the service of extinguishing the burning macroeconomic problems, or whether the reforms have the right to an independent life of their own. I myself, for instance, recommended many years ago that in the health care services “cost-sharing” or “co-payment”, i.e. a deductible sum paid by the patient, should prevail to a certain extent. I made this suggestion at a time when the budget was not seriously in trouble. The proposal was based on the well-known economic observation that demand will rise rapidly if the user receives the goods or service for free. Co-payment, even if it involves only small sums, will somewhat limit the demand. I would maintain this proposal even if the budget happened to be running a major surplus.

So, if the contribution to fiscal correction is only one of several requirements to be considered, we need to clarify what those great objectives and values are – the promotion of growth, competitiveness, efficiency, the extension of choice by the citizen, the strengthening of society’s sense of security, the more consistent enforcement of equity and justice – that are to be served by the reforms.

In this section I will first consider the *substance* of the reforms, the direction of the changes. After that, I would like to make some comments about “how to do it”, i.e. about the *implementation* of the reforms.

### The size of the state

Two completely separate questions are often mixed up in debate – what is the size of the state and what is the extent of the budgetary deficit. The truth is that deficits can arise in small-, medium-, and large-sized states as well. In the US, the size of the state is relatively small in comparison to most Western European countries. Yet, American fiscal policy has time and time again shifted towards a serious deficit, while in this regard the state budget is in a stable condition in many European countries.

The correction of the state budget is an urgent task. Firm steps must be taken to effect it, and within a year or two the deficit should be reduced to an acceptable level. We cannot make this dependent on the speed with which the state is reformed.

Should the state be smaller? We should *not* begin the clarification by posing this question. The first question that we must answer is what services society expects the state to provide.

There are some truly important responsibilities, which even in our days belong exclusively to the state. These include running the military, issuing the notes and coins of the legal currency, enforcing punishments imposed by the courts (for instance, imprisonment). For the moment, I could not even provide further examples. Many other responsibilities that have been traditionally considered as monopolies of the state are partly provided by non-state organisations, to be more precise by business (for profit) enterprises, or by civil society (non-profit organisations, NGOs).

Think of *public security*. The number of people employed by the state police is no more than the number of those working for security companies, as well as for the security services directly operated by business enterprises. There are about as many “private policemen” as public policemen. Relatively few people take part in volunteer security services in Hungary; in some other countries their numbers are significant.

Another example is the *administration of justice*. Of course, this is still primarily the responsibility of the state. However, it would be desirable, and would lift part of the burden borne by the state juridical system if the role of the ethical committees overseeing the integrity of each profession or organisation, as well as the arbitration tribunals commissioned by the parties engaged in legal disputes, were to become more significant. In other words, the non-state administration of justice would expand. (This is not to be confused with taking the law into one’s own hands!)

Overseeing business life, diplomacy, disaster recovery, environmental protection – we could go on listing spheres in which state and non-state organisations

share the duties and the responsibilities of regulation, governance, administration, monitoring and inspection. As the role of non-state organisations expands, the size of the state's operations is reduced – in comparison to private operations. If we look at a longer period, this tendency will cause the size of the state to shrink in relative terms, and this will be measurable for instance in the reduction of the total expenditures of the state, calculated as a percentage of the GDP.

This tendency has already emerged with great strength. The process can be slowed down if we retain monopoly rights for the state, but it can also be accelerated if we give more freedom to private enterprise and civil initiatives.

The “reform of the state” does not only demand consideration of what kind of reorganisation should be carried out *inside* the state apparatus. Of course, this is also important. However, it is perhaps more important to clarify *which* necessary tasks, needed for regulation, governance, administration and inspection, *should be handed over* to the non-state sphere.

I myself would advocate the acceleration of the extension of the non-state sphere's role concerning the performance of public service tasks, but without trying to create a “minimal state” at a blow simply by enacting a few drastic measures. It is to be feared that any excessively radical therapy aimed at reforming the state would create a vacuum in regulation and control.

### **The extent of state redistribution**

The modern welfare state not only regulates, governs, administers and monitors, but also provides for the country's population. It achieves this in two ways. On one hand, it acts *directly* through the organisations it owns, providing as it were a service “*in kind*”. Patients are treated in state hospitals and clinics, students are educated at state schools and universities, and homeless people are accommodated in state shelters. On the other hand, the state redistributes primary income in money terms. It takes income from citizens as taxes, social security contributions, or other mandatory payments, and after that, it provides them with income in the form of pensions, sickness and unemployment benefits, etc. These two main types of state support (in kind and in cash) are intertwined in many ways.

Besides state support, the *self-support* of individuals and families manifests itself in hundreds of ways. State support and self-support could replace each other to a certain degree. There are also areas, where one could *choose* between the two. Children can be sent to a state kindergarten, or parents can pay for a more expensive private kindergarten, or even keep them at home all day long. The aged parent might live in a state-financed home for the elderly, or look after herself, or be

looked after by her children at home, or she may be placed in a private home providing higher standards of care at the expense of the family.

With regard to the reform of the state, the most difficult thing to decide is how far state support and how far self-support should extend. Those who try to avoid this issue are merely waffling in vain.

The frequently mentioned “reform of large distributive systems” might make some small contribution to the alleviation of fiscal problems, if they try to organise their operations to become more efficient. However, we should not expect too much from this. The real question concerns *the relative proportions of state support and self-support!*

Let us consider the issue of old-age income. (I use this term deliberately, as I do not wish to limit the issue to pensions alone.) I do not want to speak about those who are already pensioners, or are close to retirement. Let us look at young people starting out on a career, who will only retire (if they ever retire) from the workforce forty or fifty years from now. What should their old-age income portfolio look like? How much of it should consist of a state pension flowing through the state budget, which can be considered in a sense as “state support”, because both contributions and disbursements are based on state legislation? We can contrast this with “self-support”, in whatever form it occurs. This could include several components: allowances paid by private pension funds, running through bank deposits accumulated during active life, or using up other investments, selling off properties or goods bought during active years. I will not enter into details here, on purpose. I will not discuss how the state pension system should operate, nor will I go into particulars about what the composition of the instruments serving as the financial source of private care should look like. I would prefer to draw attention to the most important demarcation, to the establishment of the relative proportions of state and self-care.

My further points apply not only to old-age income and within that, to pensions, but also to the other branches of care-taking. Redistribution by the state, relative to total income, will decline only if self-care takes its place to an increasing extent. *This* is the principal question, on which anyone who wishes to think seriously about the size of the state must take a stance.

I can summarise my position in three points:

- I do not approve of either of the extreme solutions. I would reject the monopoly of state paternalism, as well as a situation where each citizen could only rely exclusively on his or her own efforts. I believe in mixed systems, which rest on several pillars. The various organisations and mechanisms of state care and self-care should operate by complementing each other.

- The political philosophy that I identify with does not stand for far-reaching egalitarian distribution, for the artificial and forceful equalisation of income and wealth. I am egalitarian – *up to a certain extent*. Basic health services, education, old-age care and other welfare must be provided for everyone – but beyond this, everyone must be allowed to obtain more for themselves through their own efforts, and from their own resources.
- Those benefits already given by state redistribution should not be curtailed in absolute terms.<sup>5</sup> However, as the economy grows in the future, the surplus income flowing through the channels of state care should increase by a lower rate and the self-care part at a higher rate in comparison to the growth rate of production.

Now, we can return to the size of the state and to the difficulties of the state budget. A significant fiscal cutback could materialise in the near future, if and only if the political decision reduces the absolute volume of state care in comparison to the levels already attained. Consequently, less state money would be spent on pensions, healthcare, education, care for children and the elderly, welfare payments, etc. than before. This is, of course, possible in economic or financial terms; however, there are powerful arguments against it. In the case of numerous expenditures, constitutional scruples arise, because these would involve the withdrawal of legal commitments. More importantly, ethical principles and political considerations also go against it. Stepping back compared to the status quo would cause a mighty – and understandable – uproar.

Realistically, political decision has hardly any leeway in the short run, which does not provide any real possibility of altering the current proportions of state care and self-care. However, there is room for manoeuvre in shaping the dynamics of future proportions.

One must use common sense and consider this train of thought, with its ethical, political, legal and economic implications. And if we do so, then we will be more careful with such vague statements as the claim that “the reform of the large distributive systems” offers the solution to the country’s fiscal and macroeconomic disequilibrium problems.

<sup>5</sup> I have omitted the following sentence from the original text published in Hungarian: “No one should be deprived of his or her “established rights”. An article by Tamás Bauer (*Népszabadság*, 18 July 2006) commenting on my article drew my attention to this problem. Beside other considerations, the concept has complex and profound constitutional implications. Therefore, I would like to leave it out from the present line of argument.

### **The state and economic growth**

There is quite a strong consensus that one of the most important factors affecting the country's prosperity is sustainable and powerful growth. However, the issue of the role of the state in the promotion of growth is yet unresolved. To tell the truth, serious debate has not even developed about this subject.

In the Western discourse about the question, one of the schools of thought emphasises the active planning and initiating role of the state. In the Anglo-Saxon literature, this aspiration has been labelled (with a not particularly suitable expression) "Industrial Policy". The followers of this school were mainly inspired by the great achievements that were accomplished by the Japanese during the 50s and the 60s, in which the government's industrial ministry played an important role. My impression is that many people working in the EU in Brussels are sympathetic to this idea.

Another intellectual school of thought considers technical progress as the key issue for growth. During the last few decades, there has been a break-through because of the appearance of the computer and the internet, the digitalisation of information and a radical revolution in communications. The leading country in these developments was and is still unequivocally and indisputably the USA. Examining the historically significant technological changes more closely, we can declare that they have *not* taken place under the central control of the state. This is a typical example of a process guided by the "invisible hand" in a decentralised manner. There is no central plan or vision determined by someone in advance, which would only have to be carried out. Small ventures launched in garages and tiny offices grow into giant corporations. Clever ideas are born and the ones foredoomed to failure die under competition, and it is not centrally appointed juries or committees that decide which proposals are desirable.

The USA, for decades now – in terms of the average long-term growth rate – has been ahead of Europe. This sustained advantage has been explained by all kinds of factors. I find that the most convincing explanation is the one which primarily emphasises the more unrestricted opportunities for venture and initiation, as these make it possible to hold the leading role in the field of the uniquely rapid growth of technology.

It should neither be the state nor a committee appointed by it that determines if something is really promising. Who could have told ten years before the appearance of Google that here indeed was a venture that should be supported; that it would be an enormous success? Hundreds of companies experimented with something; ninety went bankrupt, six or eight achieved some success, and one or two created a revolutionary breakthrough. No country's government should be so conceited as to regard itself as the one holder of knowledge about what direction the

economy ought to be directed in, and where resources should be concentrated. Stalin thought that he knew. The first Soviet five-year plans established the sectors that were to be concentrated on. (“First comes heavy industry, and within that the machine industry.”) During the same period, people in the West had begun to experiment with the first televisions – without state control, on their own initiative. No one imagined that in one or two decades there would be a television set in every household. At that time, only mathematicians carrying out “basic research” were thinking about the binary system of numbers and about the theory of finite automata, and they could not have imagined that within decades a whole information technology revolution would be based on these discoveries.

All this does not mean that it makes no difference how the state acts. It does make a difference. I would start with a negative statement that logically follows from the aforementioned. The state should have no voice in areas in which it does not have and cannot have enough competence. Leave the economy to the entrepreneurs, as well as to the scientists and to the applied researchers, to the decentralised flow of technological development, so that it heads in whatever direction its inner forces carry it. Do the country the favour of *not blocking* the path of this flow. Do not build barriers with bureaucratic restrictions. According to a comparative investigation, in the Republic of Ireland it takes 12 days, in Hong Kong 11 days, in the US only 4 days for someone to launch a new enterprise. In Hungary, it takes an entrepreneur 65 days to gather all the necessary permits.

Of course, besides tearing down the bureaucratic barriers, the state should take an *actively helping* role. Without trying to make up an exhaustive list, I will only highlight a few tasks for the state to perform:

- It should create the legal security necessary for successful ventures. It would be good, if the work of the judiciary could accelerate and become more efficient, and by doing so the reputation of private contracts would strengthen.
- It would not be proper to place education under the guardianship of the state; it is not practical to make its development completely dependable on state financing. The scope of self-care should be extended in this sphere also. Even this way, enough responsibilities would remain with the state: not least, it would help to pave the way for those starting out with fewer chances. The state could also play a role in promoting areas of learning in which Hungary is dangerously backward, for instance the command of foreign languages and computer-applications.
- There are lines of development requiring huge investments, in need of the active involvement and financial contribution of the state. These include, for instance, the construction of subway lines and motorways. This – in terms of the

entire economy – does not serve to replace private initiatives; it rather provides the infrastructure for economic development.

- If I were writing this paper at another historical point in time, I would have stopped with the above review of the enumeration of the state's responsibilities concerning growth. Today, however, I cannot overlook the extraordinary fact that the European Union is ready to contribute with enormous sums to the economic development of the new member countries, and it ties the transfer of these resources to specific conditions. This makes the active and efficient involvement of the government indispensable in the selection of development projects. Besides this, the Hungarian government is obliged to contribute to the development with its own financial resources. If we want to take advantage of this unique opportunity, then we will need a much higher level of state involvement in this sphere than the level that I, like a significant number of economists dealing with growth, would normally consider as ideal. I hope that those who decide on the utilisation of the EU resources in Hungary will select projects and programs without professional bias, and that their eyes will be kept open to every healthy grass-roots initiative. This manna falling from the sky must be taken advantage of – but I would like to hope that the apparatus organised for this purpose will not hold its strong position permanently and irremovably.<sup>6</sup> Long-term future growth – and this is proved by a century of economic development – depends on the opportunities created for innovators, initiators and entrepreneurs.

This debate, which I only wanted to outline, has not even begun in Hungary. It is my impression (though I could be wrong) that the government is more inclined to favour the first type of approach: long term central planning by the state. Perhaps the machinery of Brussels is also pushing the new member states in this direction. These notions do not convince me. It would be worth thinking about them further.

### **Bottom up or top down?**

Although I have by no means exhausted this vast topic – *in what direction* these reforms should lead, I must turn now to my second topic – *how* the reform should take place.

<sup>6</sup> The manna metaphor is often used in economic literature for unconditional support. Here I find it important to supplement the original article published in Hungarian highlighting that financial support from the EU Cohesion Fund is provided *on conditions*.

If I read the previous sentence with a rigorous eye, it seems that the phrasing is not too fortunate. The “should take place” expression, with its directive modality, reflects the deeply rooted view that the upcoming actions of the reform *must be specified in advance*.

The transformation of society is a natural, elemental process. It takes place mainly through evolution. Initiatives are born, “at the bottom”, primarily within the circles of the population, companies or other organisations. The viable ones will spread slowly or perhaps at high speed, the initiatives that are incapable of surviving will wither away and disappear.

The reformist politician, the opinion leader and the scientist must primarily watch out for viable initiatives to appear. In case such an initiative does appear it should be taken up, helped by the state, encouraged and criticised, and its flaws should be curtailed. I will mention two examples, from two very diverse parts of the world. During the 70s, in some of the cities of China (not in metropolises, but in cities smaller than Beijing and Shanghai), a strange and unheard-of formation appeared, which was called the “town or village enterprise”. It was half owned by the town or village, and half (at least obliquely) by a private entrepreneur. Dominant Western economic theory and legal practice demand the clean separation of state and business. In these bizarre enterprises, it was often the mayor who became the director; the town or the village helped by investing money in the enterprise, and the town’s budget, the director, the executives, and maybe the other hidden owners shared the profits. What is this? Is it an intricate form of corruption? This much is certain: the population of every town, as well as the leaders of the enterprise, all had a stake in the profits. The “sector of the town and village enterprises” began to grow at tremendous speed, and became one of the main propelling forces behind the historically unparalleled, rapid Chinese growth. No one had planned this “ownership reform” in advance. It was initiated at the bottom, but the political leaders recognised the possibilities inherent in it and took it up. However, now time has begun to pass by them, their role has been declining and perhaps in the future they will disappear.

I bring my other example from the area of the American healthcare system. The so-called “HMO organisation” goes way back in time; its first precursors appeared in the middle of the 19<sup>th</sup> century. This special formation combines in itself the operations of insurance (financing) and provision (service). (The HMO is not the same as what many in Hungary advocate – insurance and service should remain separate, but the private sector should separately begin to take part in both.) The HMO structure began to spread widely from the 70s, and as early as 1973 legislation was enacted to regulate its activities. The HMO network embraces a significant part of the healthcare system; nevertheless, the HMO has not become an all-encompassing form, monopolising insurance and provision. At first, many

complaints were voiced against HMOs. Criticism frequently appeared in the media, attempts were made to improve their activities. The complaints have not yet completely disappeared and new problems have emerged. But one thing is certain: the HMOs did not evolve as a result of a centralised reform plan, or state decrees.

Those wishing to transform a society must keep a look-out for the places where viable new forms are born. Should their development promise results, the primary duty of the state would be to clear the bureaucratic barriers out of their paths. It should create legal and institutional frameworks which support the operations of good initiatives. Generally, the establishment of suitable state supervision is also required.

There is no need to work out a uniform, definitive solution “carved in stone”, which can be universally utilised in all parts of the country, and to which all citizens of the country must be subordinated. The English expression “trial and error” is appropriate here: one must try again and again, mistakes must be tolerated and considered as natural occurrences. The mistakes should be corrected and trials ought to re-commence.

Of course, we should not deny that certain changes could initiate from the top. This could succeed too, but the centralised will should not hold the monopoly of initiatives. The “trial and error” approach should be applied to centralised reforming activities too: even in the case of a centralised initiative it makes sense to experiment, to observe the implementation, and to correct the initial measures.

### **The speed of reforms**

The adjustment program guiding the economy back to the path of balanced growth is *really urgent*. There should be no procrastination over the first steps. The government was right to pass concrete resolutions and to set out to implement them from the very start. Considering the speed of correction, the units of measurement are weeks or months.

The reforms, deeply transforming society, are also urgent – but in this case, the scale is different. Perhaps a year, and in the case of some processes it could even be a period of several years. Work on the preparation and the implementation of the reforms should be carried out *patiently, without haste*.

There is a need for great discretion during the *preparation phase*. I confess that at times the impatience that echoes from statements about the reforms fills me with anxiety. I would exemplify this problem with the issue of *college tuition*. I would like to start by saying that I oppose the principle that higher education should be uniformly free of charge. In an effective system I would expect a combination of all of the following: tuition fees from a part of the student body, exemp-

tion from tuition fees tied to strict conditions for the other part, scholarships awarded according to various criteria, and student loans. It is quite possible that the recently announced government plans point in this direction, and in this case I would support them. I am not commenting on the *content* of the tuition reform here, but rather on *the method of announcement*. First, the idea of “deferred tuition payment” was floated, then this was taken off the agenda and another construct was hastily announced, with the rider that a parliamentary bill proposing it had already been prepared. What is the good of the government first conveying the impression of improvisation, and then making everyone face a fait accompli over the issue? How much more sensible it would have been to start with the publication of a thorough and balanced study presenting to the interested parties and to the public the widely differing experiences of foreign countries, listing the main alternatives, and objectively explaining their advantages and disadvantages. After all this, the study would have continued with the government’s own proposal, supplemented by the reasons that led to the choice of this particular alternative. After the publication of the study and the government proposal, an opportunity should have been created for public debate over the alternatives. In this way, we would have a parliamentary bill based on much surer foundations and in the end a better tuition statute, which would receive greater support from both the parties interested and the general public.

It is sensible to set a deadline for the workgroup which has to assemble the materials of the preparation phase. However, one must be careful about setting deadlines for the completion of each deeper transforming process. I am horrified to hear people saying that this government “must complete *the* health care reform” within the current parliamentary cycle. I highlighted the definite article “the”. The reader who has reached this point in my paper will understand the irony of this. What kind of reform are we talking about here? What can justify the idea that the end of the parliamentary cycle should be the deadline for the completion of the great transformation? I will be satisfied with the current government if, during the four years of its term in office, conscientious preparatory work for the reform is carried out, and on the basis of this *some significant steps* towards the transformation are taken. Each step might turn out to be either successful, or not successful. If it is unsuccessful, it must be corrected – perhaps even in the fourth year of the cycle. The transformation processes on the agenda should not be treated as a campaign with a deadline.

I consider the distorted combination of a macroeconomic adjustment program and the issue of the deep transforming reform of society to be especially detrimental. Often domestic and foreign experts, think-tanks, and even spokesmen for international organisations give the impression that they would like to squeeze the reforms out of the Hungarian government. “Get started on the reforms right now,

because otherwise we will not believe that you seriously want to straighten out the macroeconomic troubles and the lack of balance!” I am not surprised about the impatience, because since 1998, serious reforms have taken place in only a few domains, and the process of deeper societal transformation has slowed down alarmingly. Still, I have to emphasise that this kind of pressure only leads to ideological confusion and to irresponsible blathering. The reforms should not be carried out “under pressure”; on the contrary, they should be accomplished with a sincere inner inspiration, in a field which has been well explored in calm and patient debates.

The steamroller is not the most appropriate tool to ensure deep penetration into the fabric of society and the achievement of profound transformation, at least not in a democracy. If in China the communist rulers of the country decide that there is a need for reforms, these will be carried out literally through fire and water. In a democracy this is much more difficult. The rules and the limitations of the constitutional state slow down the process. Freedom of speech, freedom of press and freedom to organise, which allow for loud protest, render the efforts of strong-willed reformers more difficult. Strong resistance may not only slow down the reform, but actually block the changes.

Despite these disadvantages, I have no hesitation in choosing our democracy over the Chinese reform-dictatorship. It is reassuring that the same choice of values informs the government and the political forces behind it. Being aware of this, the new reform era is now commencing within the scope of opportunities constrained by democracy.

There is no point in aiming for complete consensus over the issue of any particular partial reform. It is sensible to set far more modest political criteria. Even if it means making concessions, resistance, manifested in angry and passionate outbursts, must be avoided. It is vital to ensure that at least an influential part of the public and of the stakeholders who are directly affected by the changes in question will actively line up in support of the reform. Of course, it is essential that the majority in parliament should unhesitatingly support the legislation for the execution of the reform.

These are realistic goals. There is a good chance that over the next few years the country will make successful progress along the paths of reform, and significantly faster than before.

